Chapter 1

Land value capture through planning and taxation

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The extent to which government should seek to capture increases in land values, and the mechanisms that can best achieve this aim, have received increasing attention in recent years. The issue is given further salience because the UK government is part of a broad consensus that 'agrees that there is scope for central and local Government to claim a greater proportion of land value increases [arising from planning permission].'[1] Although land value capture can relate to all land uses, residential housing development is a key driver of land values and necessarily a major focus of attempts to capture value.

Through the introduction of section 106 agreements in the 1990s a particular form of land value capture (LVC) has become established as a key mechanism for providing affordable housing, and has been subject to some recent reforms. The community infrastructure levy (CIL) has been rolled out by most English local authorities since they were empowered to do so in 2010, and has been subject to a government review. These mechanisms are generally regarded as having been more successful than previous attempts at capturing increases in land values arising from planning permission, but the evidence suggests that much value remains uncaptured by the state. Consequently, there has been a good deal of discussion about how these existing mechanisms might be reformed, and whether they should be supplemented or replaced by others.

The operation of section 106 was discussed in last year's *Review* as part of Contemporary Issues Chapter 2. Since then, important additional evidence has emerged. This includes the latest edition of the government-sponsored survey on planning obligations, now extended to include the operation of CIL, and the House of Commons Select Committee inquiry on Land Value Capture. Further reviews of past attempts at LVC and the operation of LVC in Germany and the Netherlands have been published by the Scottish Land Commission. Government policy and its operation in England have also evolved with the publication of a revised National Planning Policy Framework in July 2018 (and accompanying guidance) and the outcome of a court case.

This chapter, which focuses on England,[2] seeks to provide an up-to-date overview and assessment of the operation of land value capture mechanisms, and to examine their possible development. We first examine the origins of LVC and establish the lessons that can be learned from its past use. We then examine the recent evidence on the operation of section 106 and CIL, and provide an overall assessment of LVC mechanisms. Finally, we discuss the future direction of land value capture.

The origins of land value capture

In the late nineteenth and early twentieth century the issue of land and its value was associated with Liberal (and early Labour) politics and underpinned by Georgist economics.[3] It focussed on the increase in value of undeveloped land (the 'unearned increment') that landowners enjoyed when it increased as a consequence of the efforts of workers and businesses. Some contemporary commentators also highlighted 'the direct expenditure of the ratepayers' money in sanitation and other improvement'[4] in creating the unearned increment – the factor that tends to be emphasised today. The policy prescription was a land value tax, or more precisely an annual tax on the value of land which, it was anticipated, would both recoup some of the unearned increment for the benefit of the community, and encourage landowners to seek returns by developing land. Although a land development tax was introduced before the First World War, it raised little revenue and was abolished in 1920. Whilst the theoretical case for land value taxation has always enjoyed wide support among economists (otherwise of very different views), it is only recently that it has returned to the policy agenda.

The politics of land subsequently shifted to the value created by the planning system. The key (and enduring) aspect of the Town and Country Planning Act 1947 was the nationalisation of development rights. This implied, first, that prospective developers need not be compensated for the refusal of development (although initially provision was made for compensation), and second, that uplift in land value arising from planning permission belonged to the state. Whilst the first of these implications enjoyed political consensus, the second did not. This logic was reflected in the 100 per cent development tax contained within the legislation. It survived only until 1952 when the new Conservative government abolished it. A pattern of attempts to tax development gains by Labour

governments and their reversal by Conservative ones followed, e.g. the Betterment Levy (1967-70) and Development Land Tax (1976-85). It is striking how little revenue these taxes raised. In 2018 prices, land value capture taxes raised £234 million in 1952, £482 million in 1969/70 and £237 million in 1983/84.[5]

All assessments of these attempts at capturing land value highlight the lack of political consensus as being a key reason for their limited life. However, a study published by the Scottish Land Commission highlighted other factors that contributed to their failure.[6] These included insufficient incentives for landowners to bring forward land for development; the lack of resourcing provided to agencies responsible for implementation (both administrative and, in the case of local authorities, to develop their own land banks); tensions between national agencies and local government, and the associated lack of sensitivity to local circumstances of a national scheme. Other factors were the relationship between a scheme and the economic/ property cycle, where a scheme developed during a property boom might be implemented during a downturn; and a perceived lack of fairness, exhibited for example when thresholds for development scale were set too low, so bringing in relatively trivial developments and sometimes causing hardship.

Section 106

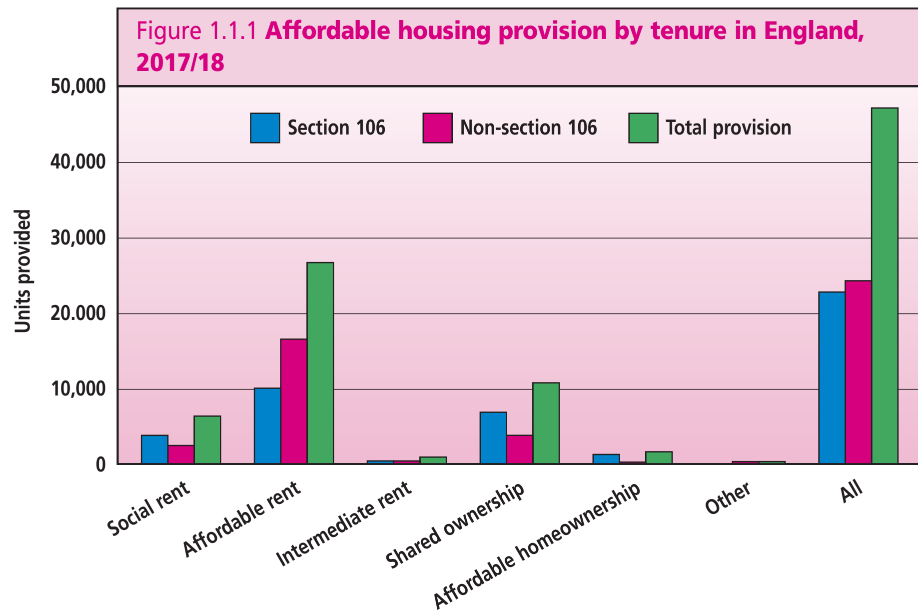
The modern form of land value capture emerged from planning agreements between local planning authorities (LPAs) and developers in the 1980s. These were formalised in England in section 106 of the Town and Country Planning Act 1990 (and related guidance), which provided for developers to contribute towards meeting the cost of off-site infrastructure costs arising from the development. Formally, a 'planning obligation' under the Act must meet three tests of being '(a) necessary to make the development acceptable in planning terms, (b) directly related to the development; and (c) fairly and reasonably related in scale and kind to the development.'[7]

Planning obligations are different in several ways from the previous development taxes. Operationally, they are legally not a tax at all. Whilst taxes can be site specific, the fact that the level of section 106 payment is negotiated breaches standard definitions of tax. Economists would identify them as being charges to address externalities (or spill-over costs) arising from a development, and government has cautioned against using them 'for tax-like purposes [i.e.] purposes not directly necessary for development to proceed.'[8] This leaves their use for the provision of affordable housing appearing to be anomalous, as it would take a convoluted argument to suggest that the need for affordable housing is 'directly related' to a development (in the way that a new road junction or a local school might be). This led one commentator to describe planning obligations as having become 'a hybrid kind of tax, partly a charge for infrastructure and partly a tax on development value.'[9] What is clear, however, is that the scope for meeting the cost of the planning obligation arises from the increase in the value of land arising from planning permission, and it is therefore unambiguously a form of land value capture.

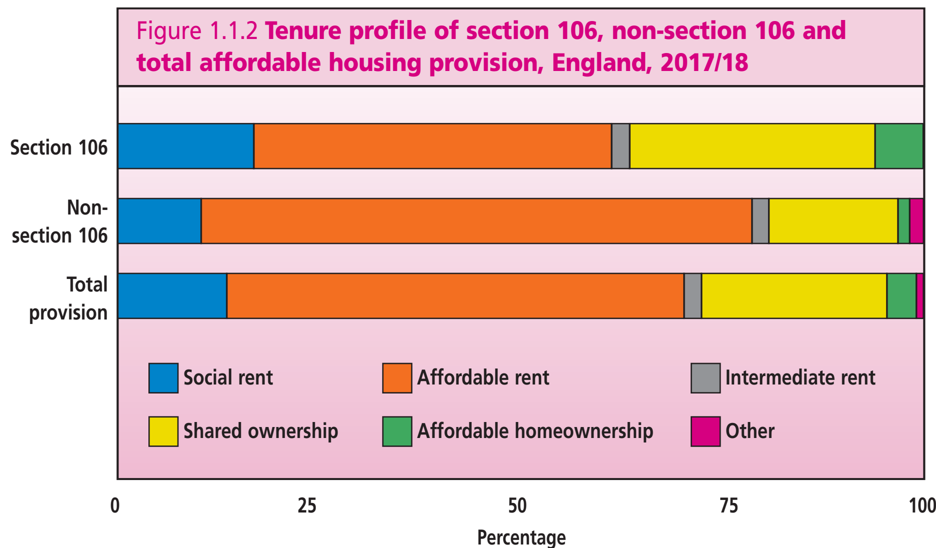
Table 1.1.1 **Section 106 affordable housing and total affordable housing provision, England, 2004-18**

Year	Section 106	All affordable provision	Section 106 as % of total
2004/05	**18,175**	**37,470**	**49**
2005/06	**23,869**	**45,983**	**52**
2006/07	**25,838**	**44,299**	**58**
2007/08	**27,273**	**53,176**	**51**
2008/09	**32,286**	**55,722**	**58**
2009/10	**29,065**	**58,288**	**50**
2010/11	**28,972**	**61,089**	**47**
2011/12	**16,963**	**58,327**	**29**
2012/13	**15,645**	**43,118**	**36**
2013/14	**16,193**	**43,027**	**38**
2014/15*		**66,698**	
2015/16	**12,911**	**32,626**	**40**
2016/17	**18,518**	**42,223**	**44**
2017/18	**22,929**	**47,355**	**48**

Sources: Section 106 2004/05-2013/14, Jones et al (2018); section 106 2015/16-2017/18, and All affordable provision 2004/05-2017/18, ONS Live Table 1000.
Notes: *2014/15 data not available; 2017/18 data are provisional.



Source: ONS Live Table 1000.



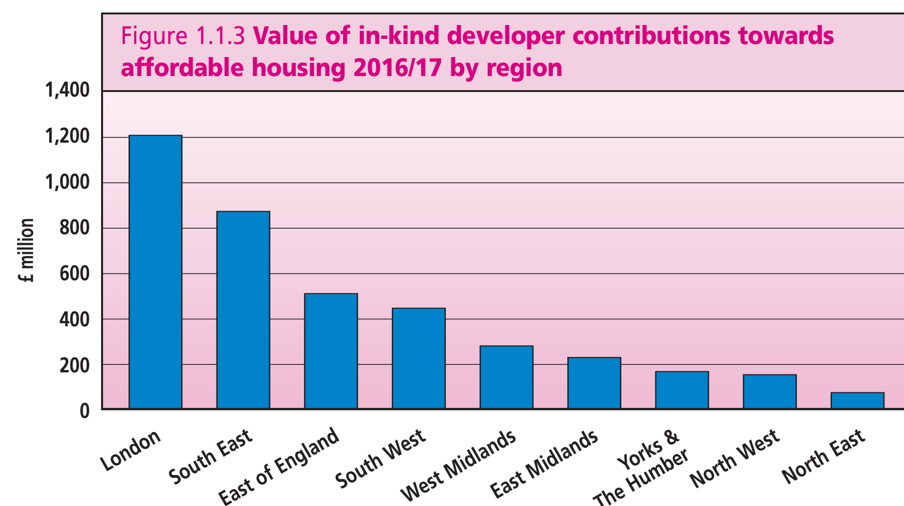
Source: Calculated from ONS Live Table 1000.

By the turn of the century, around one-fifth of affordable housing was being supported by section 106 agreement, but its role then rose significantly in the years up to the Global Financial Crisis (GFC). Its contribution increased from 18,175 units in 2004/05 to 32,286 in the peak year of 2008/09. This represented almost half of all affordable housing provided in 2004/05 and almost 60 per cent in 2008/09. As a result of the recession its absolute and relative importance declined to 15,645 units in 2013/14, 37 per cent of the total, and reached bottom in 2015/16, when just under 13,000 units were provided. However, the proportion recovered to 40 per cent as by this stage fewer affordable units were being provided overall. Total units provided by section 106 have now reached almost 23,000 – similar to 2005/06 both in absolute terms and as a proportion of total affordable provision, i.e. around half. These figures confirm another feature of affordable housing provided through developer contributions: it is pro-cyclical, whereas grant-funded affordable housing is often counter-cyclical, peaking at the worst of the GFC.[10]

Figures 1.1.1 and 1.1.2 show that the contribution of section 106 to provision of the sub-tenures that make up "affordable housing" in England differs from that provided without section 106 support. Some 62 per cent of section 106-supported housing was rented in 2017/18 whereas more than one-third was in forms of low cost homeownership. The balance is therefore tilted more towards ownership than to renting compared with non-section 106 provided housing, more than 80 per cent of which was rented. However, within the rental sub-tenures, more social rented housing was supported by section 106 than was not: 17 per cent of section 106-supported housing was for social rent, compared with 10.5 per cent of that not supported by section 106. Thus developer contributions played (and continue to play) a role in keeping new social rented provision alive when the emphasis of subsidy has been on Affordable Rent provision or homeownership.

Since section 106 is a form of land value capture, it should be expected to be most fruitful in parts of the country where house prices are high. Indeed, it is a rarely noted irony that the mechanism that contributes towards half of England's affordable housing provision becomes viable as a result of the problem that it is intended to solve. The chart demonstrates this clearly: more than half of the value

Figure 1.1.3 **Value of in-kind developer contributions towards affordable housing 2016/17 by region**



Source: Lord, A. *et al* (2018) *The Incidence, Value and Delivery of Planning Obligations and Community Infrastructure Levy in England 2016-17*, Table 3.7.

Table 1.1.2 **Number of affordable housing dwellings agreed by type of location**

Affordable housing contributions	2011/12		2016/17	
	No.	%	No.	%
Commuter belt	**2,240**	**7**	**12,464**	**25**
Established urban centre	**385**	**1**	**1,335**	**3**
London	**16,725**	**52**	**8,465**	**17**
Rural england	**6,856**	**21**	**15,096**	**30**
Rural towns	**1,451**	**5**	**6,488**	**13**
Urban England	**4,544**	**14**	**5,776**	**12**
Total	**32,201**	**100**	**49,624**	**100**

Source: Lord, *et al* (2018), Table 3.6.
Note: The two years may not be directly comparable as definitions of 'affordable' housing changed. The numbers of units agreed exceeds the numbers actually provided as not all sites are built out.

of in-kind developer contributions towards affordable housing are attributable to London and the South East. In contrast, the Northern regions account for only one-tenth of the total value of housing-related developer contributions in England. Whilst these figures do not take into account the relative populations or levels of housing need in the regions, they do highlight the way in which LVC's uneven geography underpins provision in the highest cost areas. A further effect, not apparent in the figures, is for section 106 to alter the mix of provision, for example by making social rented housing viable in high cost areas. In contrast the qualitative evidence collected in the MHCLG review suggests that developers operating outside London are often reluctant to provide affordable housing for fear that it might make a site unviable.

Nonetheless the most recent MHCLG survey (for 2016/17) suggests that there has been a change in the geography of provision since the last survey in 2011/12. Table 1.1.2 indicates that within an overall increase in the number of affordable houses agreed, the number in London fell very substantially in absolute and relative terms. In contrast there were large increases in commuter belts and rural England.

The authors of the MHCLG report note that there is not an even link between the value of land value generated (or captured) and the number of units of affordable housing provided because the cost of provision, the levels of rents and hence the depth of subsidy per unit vary greatly by region, site and sub-tenure (social, Affordable Rent, etc.). Nonetheless, the introduction of the community infrastructure levy (discussed below) must have crowded out on-site affordable housing to a degree in areas where it has been adopted.

In the last edition of the *Review* we highlighted concerns that developers were using viability tests to limit the amount of affordable housing that they provided through planning obligations. Since then, the government has revised the National Planning Policy Framework (NPPF) and accompanying guidance. The new NPPF envisages that viability will be tested at the plan-making stage by requiring developers to set out the levels of affordable housing they intend to provide. Further the accompanying Planning Practice Guidance establishes that developers will be assumed to have taken into account the affordable housing requirements set out in the local plan in the price that they pay for housing.

The guidance states, 'Under no circumstances will the price paid for the land be relevant justification for failing to accord with the relevant policies in the plan.'[11] This reinforces the Pankhurst Road Ltd judgment in April 2018, in which Mr Justice Holgate ruled that, 'I do not accept the appellant's position that the level of affordable housing provision is not relevant to the determining land value, as any notional willing land owner is required to have regard to the requirements of planning policy and obligations in their expectations of land value.'[12] This may help to reduce the temptation for developers to overpay for land since the affordable housing contribution is no longer the 'residual' in a viability calculation. However, it is likely that the waters will become muddied as market conditions change. The state has signalled that in normal market conditions over-bidding for land is not a reason for reducing affordable housing provision, but maintaining this position in a recession is another matter. Moreover, the reform also does not address the inequality in resources between local planning authorities and large developers, although the requirement to make viability assessments public marks a significant improvement in transparency.

Overall, section 106 is regarded as having been more successful than the explicit development taxes that preceded it. Affordable housing obligations are estimated to have been worth £4 billion in 2016/17, which is about £800 million more in real terms than in 2007/08 (the previous peak) and about £1.5 billion more than in 2011/12.[13] When all other developer obligations are added to this the total value rises to £6 billion (including CIL), which is almost identical to the 2007/08 total. In this sense its relative success is generally attributed to cross-party support, relative simplicity, the maintenance of a balance of incentives between landowner, developer and community, its site-specific flexibility, and visible benefits.

Nonetheless, two outstanding concerns remain. One is whether the balance of the benefits from land value increases arising from planning permission are shared fairly. It is difficult to provide figures with any certainty. The Select Committee report cites expert witnesses who suggested that the landowner is left with half the market value of the land (which not the same as its uplift).[14] Another witness suggested that landowners retain three-quarters of the uplift in land value arising from the granting of planning permission.[15] In a separate report, the Centre for Progressive Policy suggests that only 27 per cent (or £5 billion) of the total uplift in land values arising from land being granted planning permission was captured in 2016/17.[16] There are therefore grounds for believing that more of the increased value in land arising from planning permission could be captured by the state/community without deterring development.

Community infrastructure levy

The community infrastructure levy (CIL) represents an attempt to extend the scope of land value capture in terms of the developments expected to contribute and the use to which the resources generated are put. It is 'a locally-determined, fixed-rate development charge designed to help finance infrastructure needed to deliver infrastructure to support the development of the affected area.'[17] It differs from section 106 in two important respects. First, it is based on a standard charge (but see below) expressed in £ per metre rather than a site-specific negotiation. Second, it is used to finance infrastructure needs that are not directly related to the development.

CIL was intended to provide a simpler and more certain alternative to section 106, but the devil is in the detail. Charges (which are subject to statutory public consultation and independent examination) may vary *within* a local planning authority area, and *between* different kinds of development. Further complexity is added by systems of exemptions. Local authorities in England and Wales[18] have been able to introduce CIL since 2010, since when around two-thirds have done (or are doing) so. A review team which reported in 2016 noted that the uneven take-up (unsurprisingly) has a geographical pattern with many northern authorities finding that CIL was not worth introducing as it would not yield sufficient revenue and risked undermining development.[19] The review group also found that the range of exceptions and exemptions was problematic and CIL was unsuited to large complex developments, where, according to the chair of the group, it is 'almost impossible to apply the formulaic CIL approach.'[20]

CIL is estimated to have raised £945 million in 2016/17[21] and early-adopting local authorities found that it was raising 50 per cent less revenue than anticipated.[22]
In evidence to the House of Commons Select Committee, Transport for London and the Greater London Assembly found that the need to maintain 'strategic viability' of an area as a whole leads to 'a bias towards setting lower rates.'[23]
In other words it has an inbuilt and entirely predictable tendency to under-tax land value uplift arising from planning permission.

The review group recommended that CIL be replaced with a local infrastructure tariff (LIT) which would be set at a low rate, and a strategic infrastructure tariff (SIT) for combined authorities. The latter has some similarities with the Mayoral CIL established in London to contribute towards the costs of Crossrail 2, which was set at a low rate. It raised £500 million (£200 million over target), representing 15-20 per cent of the costs of the development.[24] The government has ruled out a LIT, but favours SIT for combined authorities.

Of longer-term relevance from a housing perspective is that 93 per cent of value of CIL is raised from residential developments (compared to 95 per cent for section 106).[25] Bearing in mind that affordable housing is not included on the schedule of permitted uses of CIL, it may well be that the robustness of affordable housing contributions in recent years is attributable to the poor design and more limited viability of CIL. If CIL is made more effective, or is replaced by mechanisms that are more effective, then affordable housing might suffer. There may be more scope for capturing the uplift in land value arising from planning permission, but it can be captured only once.

LVC and housing delivery

The debate on LVC has broadened in recent years, partly in response to the widely accepted need for a step change in housing supply which the current private sector development model is ill-equipped to deliver. Many commentators have highlighted the success of the post-war New Town Development Corporations which initially were able to acquire land at (close to) existing use value, to put in infrastructure and sell on some of the land to private developers. However, under the Land Compensation Act 1961, compensation under compulsory purchase orders (CPOs) is based on valuations that include so-called ‘hope value’, i.e. the value of land taking into account planning permission for its development. This greatly diminishes the scope for using CPOs as part of a LVC mechanism. The government introduced a ‘no scheme’ principle in the Neighbourhood Planning Act 2017 (which applies in England and Wales) which allows local authorities to value the subject of a CPO on the assumption that neither the intended scheme nor any other scheme will replace it, so lowering its value. Thus, ‘...it is to be assumed that there is no prospect of the same scheme, or any other project to meet the same or substantially the same need, being carried out in the exercise of a statutory function or by the exercise of compulsory purchase powers.’ [26] The impact of this measure will doubtless be tested in the courts, and there remain calls for further reform.

The question of compensation under CPOs is inherently problematic as it goes to the heart of the disputed territory of property rights. In the context of estate renewal, particularly in inner London, many leaseholders (for example former tenants who exercised the right to buy) contested local authority valuations on the basis that they would be unable to purchase a similar property in the area – breaching the ‘equivalence principle’. There are clear tests of public interest and proportionality under the European Convention on Human Rights (ECHR) which may allow CPOs to be made at existing use value. Whilst it is true that the UK was a signatory to the ECHR before the 1961 Act and that other signatories continue something akin to this practice, a definitive answer can only be found when it is tested legally. An additional anomaly experienced in the 1950s arose from landowners receiving quite different amounts depending on whether they sold their land on the open market to private interests or through CPO to the government. Much controversy can be expected if such disparities were to re-emerge within the present-day system.

The solution may lie in the economics of land value capture. If LVC mechanisms are effective then they can have the effect of reducing the open market value of land down towards the existing use value. This appears to be the lesson from Germany and the Netherlands where (to simplify greatly) the purchase of land by the state under site preparation schemes operates through the deduction of infrastructure costs from the value of the land.[27]

Limitations and conclusions

It is notable that current mechanisms to capture increases in land value focus on development and planning permission. Yet, historically, it is well understood that land values benefit from economic growth and public investment in infrastructure long after development has taken place. This means that huge amounts of land value remain uncaptured whilst government focuses on capturing value from activities that it wishes to encourage, notably housebuilding.

The land value capture debate will remain partial until it refocuses on the mechanisms for taxing current land and property values rather than focus entirely on planning gain. The current taxes on housing are widely accepted to be inefficient (in the case of stamp duty land tax and its equivalents employed by the devolved administrations) and inequitable (in the case of the council tax).[28] Land value taxation is often dismissed as being impractical logistically and politically impossible. It has been revisited in a recent report for the Scottish Land Commission.[29] Yet there is a huge gap between a full recurrent tax on current land values and what we have now – a council tax system that is designed to be regressive between individuals and regions and is riddled with anomalies arising from its being based on property values that are more than a quarter of a century out of date (in England and Scotland).[30] Whilst 'in principle' and even pragmatic reform proposals abound, much greater consideration is required to devise ways to build consensus and implement fundamental reforms. The time horizons for reforms of this nature are necessarily long, but can be built up from a small base. Is it time to resuscitate the mansion tax?

Notes and references

1 MHCLG (2018) *Government Response to the Housing, Communities and Local Government Select Committee inquiry on land value capture*, SM 9734. London: MHCLG.

2 Wales operates both section 106 and CIL. Scotland operates a similar system to section 106 known as section 75, but the Scottish Government does not publish statistics on affordable housing provided through it. Provision is made for an infrastructure levy in the current Planning Bill. Such mechanisms are not well developed in Northern Ireland. See Jones, C. *et al* (2018) (note 6 below).

3 Henry George (1839-97), American political scientist; author of *Poverty and Progress* (1879).

4 Hobhouse, L.T. (1911) *Liberalism*. Oxford: Oxford University Press, p.53.

5 Recalculated using Bank of England inflation calculator from Rowley, S. & Crook, T. (2016) 'The incidence and value of planning obligations', in Crook, T., Henneberry, J. and Whitehead, C. (eds.) *Providing Infrastructure and Affordable Housing*. Chichester: Wiley Blackwell.

6 Jones, C., Morgan, J. and Stephens, M. (2018) *An assessment of historic attempts to capture land value uplift in the UK*. Inverness: Scottish Land Commission.

7 See National Planning Policy Framework (NPPF) 2018, para. 56 (www.gov.uk/government/collections/revised-national-planning-policy-framework).

8 ODPM, 2004, quoted in Crook, T. (2016) 'Planning Obligations in England: de facto Taxation of Development Value', in Crook *et al* (eds.) 2016), *op.cit.*, p.87.

9 Crook (2016), *ibid.*, p. 64.

10 However, section 106 helped developers during the GFC, as they could dispose of units which they could not sell on the open market to housing associations (albeit at discounted prices) as a means of discharging section 106 obligations. This eased their cash flow problems.

11 Quoted in House of Commons Housing, Communities and Local Government Committee (2018) *Land Value Capture*. Tenth Report of Session 2017-19, HC 766, para. 54.

12 *Ibid.*, para.56.

13 Lord, A. et al (2018) *The Incidence, Value and Delivery of Planning Obligations and Community Infrastructure Levy in England 2016-17*. London: MHCLG, Table 3.3.

14 House of Commons Select Committee, *op.cit.*, para. 28.

15 *Ibid.*, para.27.

16 Aubrey, T. (2018) *Gathering the windfall. How changing land law can unlock England's housing supply potential*, Working Paper 03/2018. London: Centre for Progressive Policy.

17 House of Commons Select Committee, *op.cit.*, para. 68.

18 There is currently no CIL in Scotland, but the current Planning Bill contains provision for one.

19 Peace, L. *et al* (2016) *A New Approach to Developer Contributions: A Report by the CIL Review Team*. London: MHCLG.

20 Quoted in House of Commons Select Committee, *op.cit.*, para.73

21 Lord, *et al* (2018), *op.cit.*, Table 3.3.

22 House of Commons Select Committee, *op.cit.*, para. 72.

23 *Ibid.*, para. 72.

24 House of Commons Select Committee, *op.cit.*, para. 75.

25 Lord, *et al* (2018), *op.cit.*

26 Evlin, D. (2018) *CPOs and Compensation: The no scheme principle and s.6A of the LCA 1961*. London: Landmark Chambers.

27 See Crook, T. (2018) *Local authority land acquisition in Germany and the Netherlands: are there lessons for Scotland?* Inverness: Scottish Land Commission.

28 For example Mirrlees, J., *et al* (2011) *Tax by Design*. Oxford: Oxford University Press, chapter 16.

29 Hughes, C. *et al* (2018) *Investigation of Potential Land Value Tax Policy Options for Scotland*. Inverness: Scottish Land Commission.

30 It is regressive between individuals as a result of the 'band multipliers' which mean that it levies a smaller proportion of property value as value rises. It is thus unambiguously regressive against its base. The same feature causes the tax to be regressive between local authorities through the allocation of central government grant. Reforms in Wales and Scotland made the system marginally less regressive.