A Taxing Question

the contribution of economic instruments to planning objectives

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A Report for the Town and Country Planning Association

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The Town and Country Planning Association
17 Carlton Housing Terrace
London SW1Y 5AS
UK

Tel: 0207-930 8903
Fax: 0207-930 3280
E-Mail: tcpa@tcpa.org.uk
Website: www.tcpa.org.uk

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contents

foreword

The economics of development has been a central theme of the Town and Country Planning Association since its foundation a century ago. The popular image of the Garden City is of the plans and designs of Barry Parker and Raymond Unwin, arts and crafts houses set within generous (and now gloriously mature) landscaping.

We forget that Letchworth Garden City and Welwyn Garden City were entirely private developments. Financial backers were risking their capital in the hope that these bold ventures would attract pioneers to live and establish factories and shops in the Hertfordshire countryside. The uplift in land values as the development gained momentum would provide both the financiers and the community with a return.

Ebenezer Howard recognised that those who owned or bought land at agricultural use value stood to make a substantial windfall as development proceeded. Once landowners had received a fair return, his view, and that of many other social reformers of the time, was that the betterment should benefit the people. He conceived a system of rate-rent, whereby an element of the local taxes paid by leaseholders would contribute towards a community chest, funding all manner of social benefits, including pensions for the elderly.

The major new towns programme after the last war was based on this thinking. However, instead of the private sector, it was government that led the process, red-lining land and then purchasing by agreement or compulsorily at existing use value. The public purse has benefited (and still does benefit) enormously as a consequence.

Attempts to capture the uplift in land values of development generally has had a chequered past. The 1947 Town and Country Planning Act contained clauses on compensation and betterment. The Community Land Act in the 1970s tried again. On each occasion, a change of government brought repeal of the legislation to neuter the provisions – this report catalogues the history.

The task a century on, therefore, is still to seek a way which does not discourage landowners from selling, by enabling them to receive a fair return above existing use value, and which captures for the community that uplift in values that the communities themselves have created. The present context is also about recycling appropriate brownfield land back into active use and the fiscal incentives that may be needed to achieve this. The Urban Task Force Final Report, published a year ago, confirmed this approach.

It is against this background that the Association was commissioned by the Joseph Rowntree Foundation (JRF) to undertake this study. We are very grateful to Dr Bob Evans and Richard Bate for leading the research and producing this report. I would also like to thank all who attended the four seminar sessions and all those who contributed to the thinking.

This is an issue which has not gone away; indeed it must not go away. The present system is inequitable: for a few individuals to make massive windfalls while the public purse struggles to pay for the essentials cannot be right. This report suggests a way forward and it deserves serious consideration.

Graeme Bell
TCPA Director
June 2000

acknowledgments

We are greatly indebted to the delegates to our four seminars held in the Autumn of 1999, who generously gave their time and who furnished the expertise and knowledge which underpins this report. The insights and experience which they contributed were invaluable to us in the preparation of the report, and we are grateful for all their help and assistance.

We would also wish to thank Stephen King, Rick Minter, David Lock, Tim Jenkins and Richard Best, who read early drafts of the report. Their comments and suggestions were of crucial importance to us in developing our arguments and conclusions.

Bob Evans
Richard Bate

executive summary

1 This paper reports on a study undertaken in the Autumn of 1999 and Spring of 2000 which aimed to examine and evaluate a range of policy mechanisms that could be applied in support of land use or environmental planning objectives. The study was undertaken by the Town and Country Planning Association and was funded by the Joseph Rowntree Foundation.

2 The study was stimulated by several factors:
■ the Government's declared intention to encourage 60% of new dwellings onto brownfield sites;
■ the recommendations of the Government's Urban Task Force;
■ the Government's interest in using economic instruments to aid planning policy;
■ the widening concern over the environmental effects of development; and
■ the resurgence of interest in recovering land value gains to the public purse.

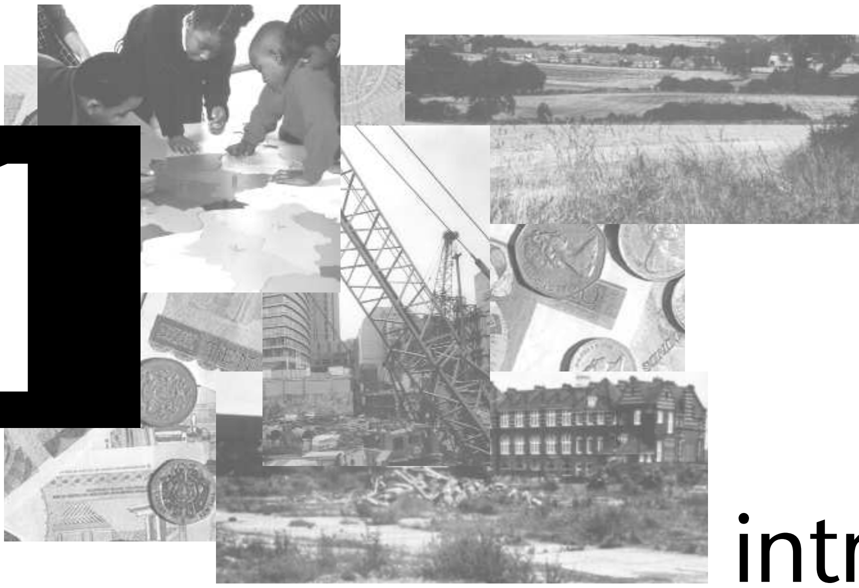
3 The aims of the study were to consider and make recommendations on policy mechanisms which seek to:
■ shift the balance of housing development from greenfield to brownfield sites;
■ ensure that developers pay for the social, economic, environmental and infrastructural costs of proposed housing development; and
■ recover to the community the increases in the value of land created through the award of planning consent for housing.

4 The report examines a range of policy mechanisms under each of the above categories, assessing the policy proposal against a range of policy evaluation issues. The report argues that proposals for economic instruments should ideally:
■ work alongside other policy instruments, and should be clearly complementary to the land use planning system;
■ accommodate or respond to the differing needs and circumstances of localities and regions;
■ have a high degree of predictability, to ensure that development is not unduly delayed;
■ not result in an increase in house prices;
■ not worsen regional inequalities, and preferably reduce them, whilst ensuring that a degree of local control is retained;
■ be easy to understand and simple to implement: extending existing policy mechanisms should be seen as preferable to establishing new ones;
■ be hard to evade and cost effective;
■ be able to command a level of political support, reflecting a broad range of public opinion, which will ensure stability in the medium term;
■ not have the effect of choking off the overall quantity of development, nor encouraging a significant shift of investment away from housing to non-housing development; and
■ form a coherent package, with clear policy objectives.

5 The report makes recommendations for the adoption of economic instruments in support of the planning system which will both send out the right 'signals' to the market and raise the finance for urban regeneration.

Recommendations

1 Value added tax should be raised to a rate of 17.5% on all new house construction on greenfield sites.
2 New social housing and housing built by registered charities should remain zero rated for VAT everywhere.
3 A package of development incentives should be created, including tax breaks encouraging investment in new development, building repair and conversions on brownfield sites, focused particularly on limited areas needing regeneration, such as the Urban Task Force's proposed 'Urban Priority Areas'.
4 A principle of 'expenditure equivalence' should be established to permit additional government investment in 'Urban Priority Areas' at a level broadly equivalent to the tax revenues from Recommendation 1 above.
5 The 'planning obligations' system should be restructured as 'development obligations', with a plan-led framework and a clear emphasis upon dealing with the local impacts of development.
6 The Government seriously examine the case for establishing a system of land value taxation in the UK in the longer term.



1 introduction

Background

1.1 During the last few years there has been increasing discussion of the role that economic instruments might play in furthering land use and planning objectives. This paper reports on a study undertaken in the Autumn of 1999 and Spring of 2000 which aimed to examine and evaluate a range of policy mechanisms which could be applied in support of land use or environmental planning objectives. The study was undertaken for the Town and Country Planning Association, and was funded by the Joseph Rowntree Foundation.

The study was stimulated by several factors:

- the Government's declared intention to encourage 60% of new dwellings onto brownfield sites;
- the recommendations of the Government's Urban Task Force;
- the Government's interest in using economic instruments to aid planning policy;
- the widening concern over the environmental effects of development; and
- the resurgence of interest in recovering land value gains to the public purse.

1.2 There is an on-going debate over the need to find land to accommodate dwellings for the projected 3.8 million additional households in the period 1996-2021 in England. Although there has been considerable conflict over the accuracy of these figures and the consequent number of dwellings required, there is general acceptance that a substantial number of new houses and flats will need to built during the next two decades. Recognising both the potential opposition to the large-scale development of greenfield sites, as well as the need to adopt the principles of sustainability with respect to the non-renewable resource of land, the Government has a declared national target of 60% of all new dwellings to be built on brownfield sites. Whilst the land use regulation instruments of the planning system can be effective in restricting greenfield development, they have been less successful in encouraging development in areas which have historically been less attractive to the market. Economic instruments such as taxes on vacant land or various financial incentives have been proposed to encourage brownfield development, whilst a greenfield tax has been suggested as a possible mechanism for discouraging new development on greenfield sites.

1.3 The second factor was the publication of the Urban Task Force Report *Towards an Urban Renaissance* in the summer of 1999. The Task Force was established by the Government and briefed to 'identify causes of urban decline in England and recommend practical solutions to bring people back into our cities, towns and urban neighbourhoods'. The Final Report made several recommendations regarding the use of economic instruments, including environmental impact fees, changing the rate of value added tax (VAT) and taxing vacant land. In addition, the Task Force commissioned a major background study by KPMG which examined fiscal incentives for urban housing (Urban Task Force, 1999b).

1.4 The third factor is the Government's declared interest in the use of economic instruments to support planning policies. The Government White Paper *Planning for the Communities of the Future* in February 1998 noted the wide interest expressed in economic instruments, such as greenfield taxation or the reform of the policy on planning obligations, to support higher land recycling targets, and commented:

> 'It is time to consider whether any of these options could be sensibly developed to help us achieve our policy objectives. As a first step we want to open up debate with those most concerned – in local authorities, the building industry, with landowners and others – in order to see whether sensible measures could be brought forward which would help us achieve sustainable development objectives in a way that was fair to those concerned and did not stifle necessary development.' (DETR, 1998, p.85).

1.5 Fourthly, environmental considerations have begun to assume increasing importance within planning decision-making, and this has led to calls for the environmental costs of development to be assessed and charged to the developer. Although there is a history of charging developers for the infrastructural costs necessary to service developments – roads, community facilities and even school places – recent years have seen an increased interest in concepts such as 'environmental capital'. This approach argues that all development has an environmental impact – for example in terms of traffic generation and associated fossil fuel consumption and CO_2 production – and, as such, the costs should be chargeable to the developer, perhaps through a negotiated planning obligation or an environmental impact fee.

1.6 Finally, during the last decade, there has been a gradual resurgence of interest in what might be termed 'the development value question'. There remains a widespread view that the large gains made by landowners in some parts of the country as a consequence of securing planning consent should be returned to the community or the public purse in some way. The current arrangements for capital gains tax and the planning obligations system do in some measure serve this purpose. However, it is clear that neither of these mechanisms is entirely satisfactory, and that the development value question is inextricably linked to many of the previous factors.

The Expert Seminars

1.7 There has been little attempt to synthesise the common themes involved in these topics in order to formulate approaches which might assist policy development in support of planning objectives. This is despite the substantial range of literature and published research on each of them. In view of this, the principal objective of this study was to re-think and re-evaluate research evidence and policy prescriptions relating to economic instruments and their use in support of planning objectives, in order to formulate policy proposals.

1.8 During the Autumn of 1999 four day-long expert seminars were held. Around 20 contributors chosen because of their expertise, were invited to each of the seminars. Participants were drawn from the development industry, the professions, pressure groups, housing associations, government departments and agencies, local government and universities. Every seminar had a focused topic with a briefing paper circulated beforehand. The seminar discussions were 'on-the-record', with a verbatim account of each seminar recorded: the proceedings of the seminars may be viewed on the TCPA web site (www.tcpa.org.uk). The purpose of these expert seminars was twofold. First, it was an opportunity to gather together an extremely experienced and well-informed group of people with a view to securing their views upon this group of policy initiatives and mechanisms. Secondly, given that most organisations connected with the development process were represented at the seminars, the seminars provided insights into their views on the desirability and acceptability of the various policy mechanisms.

The seminar discussions were extremely productive, providing a wealth of information and significant insights into the complexities of the development process. Moreover, it was notable that although there were differences of opinion on many of the issues discussed, there were many more areas of common ground. This was extremely encouraging, indicating that there is a window of opportunity for policy initiatives in this area.

The Project Brief

1.9 The seminar discussions were centred around two key themes:

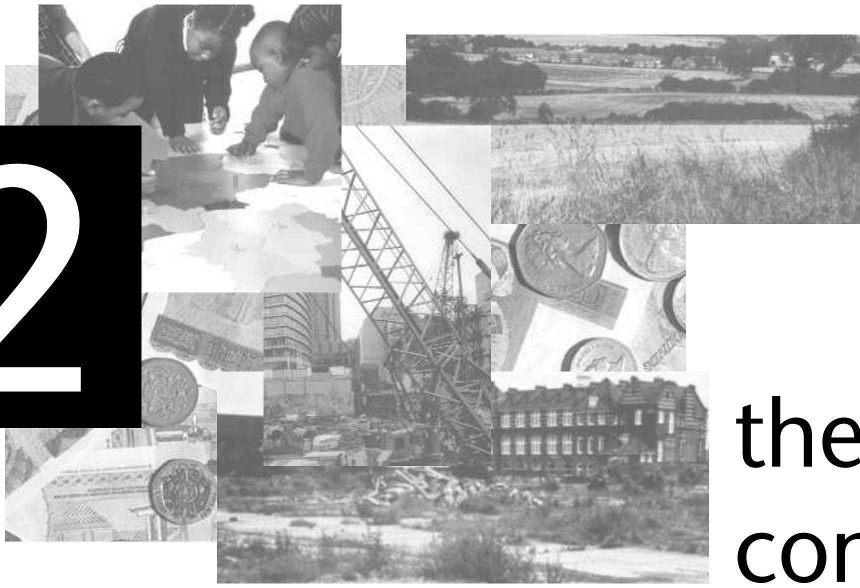
- first, the evaluation of the fiscal measures and wider taxation options which might be effective in securing the development of brownfield rather than greenfield sites; and
- second, an exploration of the options for reflecting the full environmental costs of new development through the use of economic instruments.

As the seminar discussions progressed, however, it quickly became apparent that the question of development value recoupment is inextricably intertwined with these two themes, and thus should be treated as a third theme.

1.10 In view of this, the principal purpose of the project and this report may be summarised as follows:

> To consider and make recommendations on policy mechanisms which seek to:
> - shift the balance of housing development from greenfield to brownfield sites;
> - ensure that developers pay for the social, economic, environmental and infrastructural costs of proposed housing development; and
> - recover to the community the increases in the value of land created through the award of planning consent for housing.

1.11 Although much of what is contained in this report is of relevance to all development, it should be noted that our focus here is upon housing development. This is partly because of the currently high profile of the housing debate and the associated policy instruments, and partly because of the dominance of this land use in development proposals. Also, given the slightly different legislative context for Scotland, it should be emphasised that we are concerned here principally with England and Wales, although, as will be seen later, some of the report's recommendations have wider applicability.



2 the policy context

2.1 We are acutely aware that we are considering an area of policy which has been, and will perhaps continue to be, intensely controversial. Equally, we are very conscious of the need to develop the policy instruments which will assist in achieving the kind of urban renaissance that Lord Rogers and his team quite rightly seek. In our seminar discussions we were particularly concerned to establish the ground rules for assessing and evaluating the various proposed policy instruments under review, and in this section of the report we outline the issues that we have taken into account.

In addition, we comment briefly upon:

- the Urban Task Force Report (and the associated KPMG report), since this was one stimulus for this study, and the recommendations contained here may in part be seen as a response to their report;
- raising finance for urban regeneration;
- the process of hypothecation;
- the categories of 'greenfield' and 'brownfield' land which bear upon later debates; and
- the question of land value taxation (LVT), which was also referred to in the Urban Task Force Report, explaining our position on this.

Issues in Policy Evaluation

2.2 Issues we took into account when evaluating policy proposals may be summarised as follows. Proposals for economic instruments should ideally:

- work alongside other policy instruments, and should be clearly complementary to the land use planning system;
- accommodate or respond to the differing needs and circumstances of localities and regions;
- have a high degree of predictability, to ensure that development is not unduly delayed;
- not result in an increase in house prices;
- not worsen regional inequalities, and preferably reduce them, whilst ensuring that a degree of local control is retained;
- be easy to understand and simple to implement – extending existing policy mechanisms should be seen as preferable to establishing new ones;
- be hard to evade and cost effective;
- be able to command a level of political support, reflecting a broad range of public opinion, which will ensure stability in the medium term;
- not have the effect of choking off the overall quantity of development, nor encouraging a significant shift of investment away from housing to non-housing development; and
- form a coherent package, with clear policy objectives.

We touch upon each of these issues in our presentation of the merits of each policy, although we have opted for a review in discussion style rather than a systematic entry against each heading in turn. It should be acknowledged at the outset that there is no ideal solution which scores highly on all counts. In particular, there is little retention of local control in most of the policy instruments designed either to assist brownfield development in place of greenfield development or to recover land value increases.

The Urban Task Force Report

2.3 The immediate impetus for this study was the publication in the summer of 1999 of the Urban Task Force Final Report *Towards an Urban Renaissance*, which recommended the adoption of economic instruments, working with planning policy in support of urban renewal. In the Executive Summary there are a number of policy recommendations which relate directly to the concerns of this report. Specifically the Task Force seeks to:

- replace the negotiation of 'planning gain' for smaller urban development schemes with a standardised system of impact fees; and
- harmonise VAT rates at a zero rate in respect of new building and refurbishments – if harmonisation can only be achieved at a 5% rate, then a significant part of the proceeds should be re-invested into urban regeneration.

In addition, within the main report, the Urban Task Force makes further recommendations and indicates that several other areas of policy are worthy of further examination. Recommendations and proposals within the report include:

- a recommendation to revise national guidance on the use of planning agreements;
- a suggestion that there should be further research into a greenfield tax;
- a suggestion that it may be time for a re-consideration of site value rating (SVR) as a system of commercial property taxation; and
- a recommendation for a scheme for taxing vacant land.

2.4 We consider all of these recommendations and suggestions, with the exception of site value rating, in more detail below. In addition, the Urban Task Force made other recommendations relating to economic instruments which, although clearly related to the three central concerns of our report, identified above, are not considered in any detail here, principally because they have already been discussed in the report commissioned from KPMG by the Task Force and because they are less closely tied to planning policies. These recommendations are:

- introduce a new financial instrument for attracting institutional investment into the residential private rented sector;
- introduce a package of fiscal measures, providing incentives for developers, small landlords, owner-occupiers and tenants to contribute to the regeneration of urban sites and buildings that would not otherwise be developed; and
- allow local authorities to retain a proportion of additional revenue generated from council tax and business rates as a result of regeneration in designated Urban Priority Areas – the retained resources should be recycled into the management and maintenance of the area.

2.5 The authors of the KPMG report concluded that fiscal measures have the potential to influence the key players in urban housing development and that targeted incentives such as corporation tax deferment for housebuilders and developers, or the removal of stamp duty on brownfield homes, might result in an additional 100,000-300,000 brownfield dwellings by 2021, at an average cost per dwelling of around £8,000-£25,000. However, the report also recognises that whilst fiscal measures have an important role to play in shifting the balance of housing development from greenfield to brownfield land, their impact in isolation is likely to be limited; and that they would need to form part of a carefully targeted package of policy measures focused on particular urban areas. Raising the finance to provide economic incentives which support regeneration in this way – whether direct aid or tax breaks – is a key topic for our report.

Raising Finance for Urban Regeneration

2.6 The report of the Urban Task Force is clear that planning policies alone cannot achieve urban regeneration and that financial incentives are generally more effective than financial penalties in trying to achieve more investment. Our approach to economic instruments has therefore been to pay particular attention to the means by which economic instruments supporting planning policies can also raise money which can be redistributed to assist urban regeneration.

One alternative we considered was that the Chancellor should be persuaded that urban renewal was of such national importance that it should be much more heavily funded out of existing revenue. This would have set urban policy in competition with health services and education, for example, for resources from the Exchequer. That we considered naïve and unlikely to be effective. We reached the same verdict in respect of the option of inviting the Chancellor to raise basic, widespread taxes, such as income tax and national insurance. The Chancellor has made clear he is seeking to reduce these, and in any event 'green' taxation should aim to avoid penalising employment.

2.7 Instead of either of these approaches, we preferred to focus on economic instruments to raise money that could be applied either to grant aid or to compensate the Exchequer for income foregone in tax breaks. We set ourselves the task of evaluating mechanisms which could be linked to the planning and development process. In particular, we were keen to explore instruments which adjusted their impact according to whether or not planning permission was granted and development took place.

The mechanisms we investigate impose costs on the development process. It is central to understanding their comparative merits to appreciate who will bear those costs. We can say with confidence that, almost without exception, the mechanisms will not raise house prices. The price of houses is set by the second-hand market (which accounts for nine out of ten houses on the market at any one time), so the development process cannot set market prices. If increased costs created by an economic instrument cannot be passed on in other ways (for example to users of all houses, new and old, or be borne by developers through slightly reduced profits, or – above all – taken out of the price of the land which the landowners are paid), then, rather than house prices being raised above levels which purchasers in the market will accept, development will simply not go ahead.

2.8 A key issue in reviewing economic instruments is therefore the amount of land value which they could capture in different circumstances and the knock-on effects from this. We review this in our Conclusions, but we note here five points which are common to all the scenarios for raising revenue and which influence the whole debate.

First and most obviously, land value can only be used once: if some is taken as part of an economic instrument to encourage a shift of development from greenfield sites to brownfield sites, for example, there will be less available for negotiating local benefits through planning agreements.

Second, value-related taxes are much less regressive in their impact on areas in need of investment than are flat rate taxes. Flat rate taxes will be much more easily borne in economically buoyant areas with high land values, whilst necessary development will tend to be impeded in weaker market areas. Economic instruments which are profit-related or value-related also work with the market cycle: higher charges are more bearable and produce greater revenue at times of market boom, whilst conversely lower charges are payable at weaker periods.

Third, any tax or charge will impose an additional burden and can therefore be expected to choke off marginally economic development. Our aim has been to ensure that the impact of economic instruments is not so great as to choke off significant amounts of development. There is no merit in killing off the goose which lays the golden egg. The point of the exercise is to ensure that the overall benefits of the process significantly outweigh the disbenefits.

Fourth, care must be taken to handle the introduction of a new economic instrument through a transition phase, the nature of which would need to be adjusted for each instrument.

Fifth, in the event of a new tax being introduced which affected land values, a proportion of landowners could be expected to withhold land from the market in anticipation of the tax being withdrawn by a future government. This might undermine the development process and affect the overall supply of necessary housing development. We therefore consider cross-party commitment to a permanent tax as highly desirable, even if this means that introducing the tax takes a period of time – just the experience with the abolition of mortgage interest tax relief, which was considered politically unthinkable when first promoted seriously by the Joseph Rowntree Foundation but has recently (April 2000) finally faded away with political consensus. Contributors to our seminars from the development industry reminded us that many landowners have tried to anticipate future government action in this sector and cover themselves against its risks so far as possible: 'freezer clauses' are therefore becoming more popular in land option agreements (see Box 1, below).

Box 1: Freezer Clauses

These clauses in land option agreements specify that if a tax is applied or increased, such as capital gains tax or a new tax such as a greenfield tax, the land owner may either 'freeze' the tax at a percentage slightly above current rates, or may withdraw from the option for a specified period or possibly for ever. In such cases the land may not come forward for development for the foreseeable future.

2.9 Against this, it is important to note that Compulsory Purchase Order (CPO) provisions remain on the statute book and, given the appropriate policy environment, could be utilised to ensure that land required for development was brought forward. The Urban Task Force recognises the need to consider CPOs if necessary, and several of our seminar contributors emphasised this point. In particular, representatives from the development industry indicated that public/private partnerships based upon land assembly through compulsory purchase would be one possible way to ensure that desirable development went ahead. Conversely, we were reminded by local authority representatives that, owing to the decline in the use of CPO powers, there is little knowledge and experience of the process remaining in local authorities, and this will need direct investment if CPOs are to be used again in any significant manner. These needs and difficulties illustrate the timeliness of the Government's current review of CPO powers.

Hypothecation

2.10 There is an ongoing debate within and outside government on how far the process of revenue raising and expenditure should be linked. There are competing priorities which include 'seeing what one's money is being used for', 'giving flexibility for money to be used where it is most needed' and 'funding essential services that don't win votes'. There are also arguments about how durable such linkage is: road fund tax is now largely 'another tax' which must be paid by vehicles using the road rather than a source of revenue for building new roads as originally intended. Similarly there is a possibility that a known income stream from greenfield development to fund urban renewal might lead to the gradual cutting of other sources of urban renewal funding over time. There is also a worry that if the linkage is unbreakable this can mean that a decline in revenue causes a decline in funding for (perhaps) vital services. Furthermore, it was made clear to us at one of our seminars that the Treasury's instinct is not to 'hypothecate' revenues. There may well be a case for some more spending on one thing, and there may well be a case for a tax on another thing, but these decisions are generally taken separately. One of their concerns is that fields of expenditure which generate little revenue, like health and education, tend to miss out on the advantages of hypothecation.

2.11 On this basis, one of our starting points – that we should look for economic instruments which can raise money for urban regeneration – is necessarily caught up in this debate. We see this as an opportunity rather than an impediment. Aside from expenditure, revenue-raising is far from being value free, and Governments are well used to applying the price mechanism to reward desirable behaviour. Differential rates of duty on less polluting fuels (and, now, vehicles) illustrate this. In the environmental jargon, the 'polluter pays'. Furthermore, the Chancellor continues to evaluate a raft of tax proposals aimed at taxing environmental 'bads' and rewarding environmental 'goods', linking revenue-raising with wider social policy objectives. For example, the tax on construction aggregates extraction announced in the March 2000 Budget is aimed at: penalising the 'bad' of digging of holes in the countryside which have adverse local environmental effects; encouraging recycling of building materials (which are not taxed); and producing a revenue stream. The proposals go one step further in claiming to be revenue-neutral in that National Insurance will be reduced commensurably, providing a stimulus to the 'good' of employment. The principle can be taken a step further, with tax revenue recycled to a specific related purpose – true hypothecation. For example, the Government has accepted the case for the partial hypothecation of the landfill tax through Entrust, which provides a big incentive for funding local environmental improvements out of waste disposal revenues. The question we have addressed is: how far down this line towards linkage is it necessary to take revenue-raising mechanisms tied to planning policy?

Contributors at our seminars regularly returned to this subject. In our view, if there is a strong argument to be made in favour of taxing to change behaviour (as in the case of tobacco smoking or car driving), there is an equally powerful case which holds that revenues derived from such taxation should be invested in support of associated policy goals. We consider that a linkage between revenue-raising and expenditure will be needed, but that a looser association, well short of direct hypothecation, would be sufficient. This could amount to little more than the Chancellor announcing the two arms of the package in the same Budget statement. This would retain flexibility in the application of future revenues, more related to need than to funds raised in the short term. Depending on where the money came from, it could also be presented in varying degrees as a 'green' tax.

Greenfield and Brownfield Land

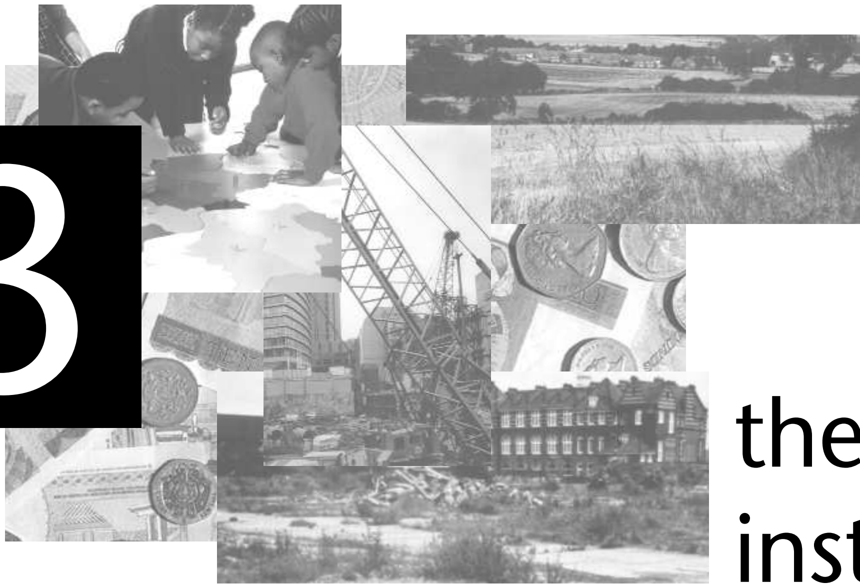
2.12 The distinction between places which have not previously been developed ('greenfield' sites) and those which have been ('brownfield' sites) is widely utilised in the whole policy debate considered here. However, the separation is not without its problems. There is an implicit assumption within much of the debate that 'greenfield' development is undesirable, and conversely that 'brownfield' development should be encouraged. Whilst we would generally support the notion that land is a non-renewable resource, and thus any proposal to develop previously undeveloped land should be rigorously assessed against planning and sustainability criteria, it would be inappropriate to argue that 'greenfield' development is necessarily 'bad'. An element of greenfield development may offer the most sustainable solution for accommodating development in urban areas and within the built environment as a whole. Conversely, it is not clear that developing all 'brownfield' development is desirable. Land may be needed for urban parks or nature reserves, for example.

Convenient though the concept is, we recognise that careful attention will need to be paid to finding legal definitions of 'greenfield' and 'brownfield' land. The recently published revised PPG3: *Housing* (DETR, 2000) provides a definition of 'previously developed land', although it remains to be seen how 'watertight' this will prove to be. A recent paper (Alker *et al.*, 2000) reviews some of the problems involved here, and whilst it is not within the scope of this study to contribute to this debate, we do need to recognise the possible difficulties which could emerge with respect to any economic instruments which depend on such definitions – the clearest example being a greenfield tax.

Land Value Taxation

2.13 The Urban Task Force Report specifically refers to site value rating as a possible mechanism for operating a system of land value taxation. Advocates of LVT, such as the Henry George Foundation, argue that LVT works in other countries; that it can replace taxes upon enterprise; that it is very difficult to evade; that it can incentivise development where required; that it can ensure the optimal use of land; and that it can replace unpopular property taxes such as the uniform business rate (Vickers, 1999a, 1999b).

Within the scope of this short study, we are unable to assess LVT in the necessary detail or evaluate its wider context, and like the Task Force, we have to accept that proposals for LVT will have to be considered elsewhere. However, the case for LVT is a strong one which requires serious examination, and this has led us to the view that the policy conclusions resulting from this study should not be an obstacle to the adoption of LVT at some time in the future.



3 the policy instruments

3.1 In this section of the report we examine the principal policy mechanisms in turn. Some of these are existing instruments, and others have been actively promoted as possible mechanisms during recent years. We have not attempted a comprehensive review of all possible mechanisms. That would not be reasonable within such a short study and, as we have indicated above, some initiatives have been extensively evaluated elsewhere. However, we discuss all the measures that were considered at our seminars. We have grouped the instruments into three categories, reflecting our three project aims outlined above:

- policy instruments designed to shift the balance of housing development from greenfield to brownfield sites;
- policy instruments designed to ensure that developers pay for the social, economic, environmental and infrastructural costs of proposed housing development; and
- policies instruments designed to recover to the community the increases in land value created through the award of planning consent for housing.

Policy Instruments Designed to Shift the Balance of Housing Development from Greenfield to Brownfield Sites

A Greenfield Tax

3.2 Raising a tax on housing development taking place on greenfield sites but not on brownfield sites could be a direct means of shifting the emphasis of development to the latter. The tax would not be related to the environmental cost of new development, although its existence would reinforce the principle that greenfield development carries an environmental cost. The Urban Task Force considered the issue but called for more research into greenfield tax options and their impacts.

We distinguish two parts to the process. First, the tax could act as a direct disincentive to greenfield development. Its effect would lie somewhere between an irritant and a strong deterrent, depending on the level of taxation and where the charge fell (principally on the developer or on land value). The second part of the concept involves using the money raised to assist the development of brownfield sites. Supporters such as the Civic Trust (Civic Trust, 1998) see hypothecation as an integral part of the mechanism if it were to be adopted. This is generally considered the more valuable feature, with the tax on greenfield development simply being the way the money is raised. The mechanism might even be renamed a ‘land recycling levy’. A genuine increase in brownfield land recycling could result from hypothecation of the money for that purpose. The two elements offer a neat connection between greenfield and brownfield development which give an inherent appeal to this mechanism in principle. A greenfield tax would be an economic instrument which operated in close association with planning policy.

3.3 The additional funds for brownfield land recycling would enable more development to take place on those sites. There might be some marginal decline in the consequent rate of greenfield site development, although there would be a counterbalance through the extra brownfield development. What is less clear is the direct effect of the tax on greenfield development, or even what the objective should be. The view of the housebuilder and development industry contributors to our seminars was that any greenfield tax would be reflected in a reduced land price. If the tax was set at too high a level, development would not take place, or landowners would withhold their land from the market. There was general agreement that a greenfield tax would not increase house prices. The main impact of the tax would be on landowners, which could affect the quantity of land brought to the market. The speed of development should not be affected by the tax.

There are two different views on the intended impact of the tax on the scale of greenfield site development. One is that it should cause greenfield development rates to be reduced. This is likely to happen to some extent as economically marginal sites are withdrawn in the face of an additional development cost. It is also possible that some landowners will hold back land for a while in the hope of the tax being withdrawn in future. However, there are other, arguably better, means than a tax for deciding where development should or should not take place, particularly the planning system.

3.4 The alternative view is that the tax should raise money without causing land to be withheld from development on any significant scale, so that profits obtainable would still be sufficient to encourage land-owners to sell. The expectation in this view is that the land value is generally large enough to absorb the cost of the new tax. We heard research evidence from Michael Crook that this was indeed a realistic proposition (RICS, 1998b). In this scenario, the tax would be a revenue-raising activity (and a political gesture) more than a policy measure. Furthermore, by being taken mainly out of the land value generated by the development process, it would in effect be a betterment tax.

The tax could be effective at raising money since the Government expects that nationally around 40% of housing development should be on greenfield sites. A flat rate tax per hectare within each region might well be an appropriate basis for raising the tax, although any arrangement would have its winners and losers. (A flat rate tax would discourage greenfield development most in areas with the weakest housing markets, whereas a value-based tax would be inefficient because of the wrangling over what could or could not be included in the calculations.)

3.5 There are other issues on a broader political front:

- With virtually full hypothecation of funds to brownfield land recycling, which is the only basis on which it is being advocated, the tax would not be seen simply as adding to Treasury coffers.
- As a new tax it would require legislation rather than the adjustment of an existing mechanism, but conversely it could be tailored to its objectives from the outset.
- The regional geography of need for finance to assist brownfield development is different from the regional geography of revenue-raising potential from new greenfield development, so the tax would have to be administered nationally, not regionally or locally, to have the intended redistributive effect.

3.6 The main points of the case against a greenfield tax are as follows (although these are also likely to apply to other economic instruments which raise money from development on greenfield sites):

- It would penalise all greenfield housing development, even that fraction which is widely accepted as necessary to meet housing requirements.
- The tax itself offers no incentive to developers to divert their activities to brownfield sites (as that would depend on receipt of tax monies), so it will not capture the hearts and minds of the building industry.
- A perverse incentive would be set up to encourage greenfield land release as a fund-raising device for brownfield land recycling, so the message behind the mechanism will not be politically simple; also the revenue would need to be spent in areas other than where it was raised, to avoid the possibility of planning decisions being compromised for economic gain.

3.7 Another important issue is the basis upon which such a tax might be levied. If it were to be based upon land value (as advocated by the Civic Trust) there would have to be some process of land valuation which would be likely to replicate the delays, administrative costs and complexities experienced in the previous attempts to tax development value. Furthermore, as was discussed earlier, although the new PPG3 offers a possible definition of 'previously developed land', there may be some problems, at least for a while, in establishing liability for the tax in the case of more marginal developments.

Adjustments to Value Added Tax

3.8 At present, new build is zero-rated for VAT (and the conversion of commercial buildings for housing also attracts no VAT), whilst conversion or refurbishment of existing homes, and general repairs and maintenance, carry full VAT at 17.5%. The Urban Task Force took up this issue. They evaluated a variety of options for adjusting VAT to make it more sympathetic to development on brownfield sites, and recommended that VAT rates should be harmonised between new build, conversions and refurbishments. The Task Force preferred zero-rating as the ideal basis for harmonisation, but considered that harmonisation at 5% was a more practical proposition. In the latter case, it recommended that a significant part of the proceeds should be reinvested in urban regeneration. Harmonisation at 5% has also been a long-standing proposal from the Empty Homes Agency as a means of encouraging empty dwellings back into use. We note too that EU finance ministers have agreed that member states should have the discretion to raise VAT at lower-than-standard rates on 'labour intensive services', which might well include repair and maintenance of buildings. The Civic Trust and others are pressing the Treasury to accommodate this adjustment, reinforcing the case for a downward adjustment of VAT on this item.

3.9 We were told by government officials that the apparent anomaly in the current regime was recognised by the Government. However, we were advised that there is absolutely no prospect whatsoever of equalisation of VAT at a zero rate, partly because of the revenue costs, which would be enormous, but also because it would be illegal under European Commission law. As for the possibility of equalisation at 5%, there were barriers to doing that under EC law. Nevertheless, we understand that since the Urban Task Force reported, France has reduced taxation on building repair works, suggesting that the barriers can be overcome.

There is a further VAT anomaly in the case of listed buildings, where repair carries full VAT but alterations are generally zero-rated – thereby encouraging change to the built heritage rather than its maintenance. This has been a campaigning issue for the historic buildings interests for many years. Spurred now by both the Urban Task Force and the decision of France to cut the VAT burden, the historic buildings interests are seeking VAT harmonisation on all repairs and alterations to listed buildings at 5%. Supporters of this kind of change include the National Trust, the Churches Main Committee, the Society for the Protection of Ancient Buildings and the Civic Trust.

3.10 Reducing the rate of VAT on the conversion and refurbishment of existing houses would self-evidently increase the amount of the activity. Harmonisation between new build and conversion/refurbishment would level the playing field. Both these measures found wide support from those attending our seminars, and implicitly, therefore, support for the Urban Task Force's approach. There was considerable support for the Government pressing ahead with VAT harmonisation at around 5%, even though it was not a critical contributor to the objective of urban renewal on brownfield sites. This would certainly be a worthwhile step in the right direction, although further adjustments would be needed to raise substantial sums of money for urban regeneration rather than introduce an approximately tax-neutral change.

3.11 A further group of options we considered involved charging VAT on new build housing. This would move intervention away from the Urban Task Force's primary focus on creating incentives for using brownfield sites and into more wide-ranging revenue-raising to fund the incentives. This would be for more than the direct disincentive to greenfield land development. We understand, for example, that this arrangement is successful in the USA, where, against a background of tax on new build, the refurbishment of buildings can be set against personal or business tax. This method has considerable attractions in the UK, as it would be easy to introduce (as an extension to an already well-used system) and easy to administer.

VAT is clearly a tax imposed on the top of the cost of goods or services, but in the case of new build housing that cost would *not* be borne by the purchaser of the house: VAT on new build will not raise house prices by the amount of the tax. Like other charges incurred in the development process, it will largely be taken out of land values. There is flexibility in principle to select a rate of VAT to ensure that an intended quantity of land value is recovered. Unlike a land tax (for example betterment), the tax is made on the sale price of the dwelling (i.e. the structure in addition to the land it sits on). If this was to be taken at the current standard rate of 17.5%, it would clearly represent more than 17.5% of the land value – much more in areas with weak markets where the structure accounts for a higher fraction of the total cost. A major tax on new building would create a significant source of revenue. The tax would be applied only to the first sale of dwellings, like motor vehicles. It would be unavoidable – title would not pass (or be accepted by the Land Registry) until the VAT had been paid – and easy to collect.

3.12 There is a need for care in the transition period for introducing this particular tax, which, the Task Force rightly noted, would need to be sufficiently long to ensure that its impact was felt largely in land values rather than added to the costs of developers or purchasers. If housebuilders have acquired land at full development value and the tax is introduced before they have been able to build and sell housing on it, they will be faced with having to absorb the VAT, which would be financially very painful. It is therefore important that housebuilders are given a reasonable time to 'build out' their current land holdings before the tax is applied. A cut-off period would be required, so that beyond that period housebuilders would be deemed to be speculating in land by owning it for longer periods and therefore not entitled to avoid the tax.

3.13 One way to apply the tax would be to charge VAT only on new build on greenfield sites – in effect a greenfield tax with an element of disincentive to greenfield site development. KPMG thought this an effective and practical measure, but likely to be politically unacceptable. We are not so convinced of its political downfall. This proposal would bring the UK into line with a number of other European countries which already raise VAT on new houses. (For example, the rate levied on new build in France is 20.6%, in Austria 20%, in Finland 22% and in Sweden 25%.) It could be introduced in the way outlined in the previous paragraph to limit the impact in the transition phase. We also understand that the DETR is investigating the matter seriously, although contrary to press speculation no first step was included in the Chancellor's March 2000 Budget.

3.14 We have been advised that it would be possible to exempt charities and social housing providers from the payment of VAT on new housing, and that it would be possible to permit the reclamation of VAT in designated circumstances, for example brownfield sites or within defined geographical areas where new housing development should be encouraged (for example within the Task Force's 'Urban Priority Areas').

Vacant Land Tax

3.15 The Urban Task Force estimates that there is approximately 5,300 hectares of developable vacant land for housing in England, which could provide around

150,000 units. Vacant land is exempt from business rates in Britain, and there is therefore no charge for keeping it undeveloped. (In countries where there is no specific tax on vacant land, but where a land value tax applies, vacant land is subject to taxation in the same way as any other land.) The rating mechanism would be one which would allow a vacant land tax (VLT) to be collected through an existing mechanism. The Urban Task Force Report suggests that a scheme for a vacant land tax be prepared principally because this is seen as increasing the incentive to develop. The report makes clear that there should be mechanisms in place to ensure that owners whose land is vacant because of market or site conditions should not be penalised.

3.16 Our seminar contributors were doubtful that a vacant land tax would have the desired effect. The general view was that incentives rather than taxes should be the preferred policy approach. Moreover, recent research from the University of Aberdeen outlined by Norman Hutchinson at our seminars casts doubt upon the effectiveness of VLT as a mechanism for bringing land onto market. Most vacant land is in areas of low land demand and such a tax would tend to discriminate against owners who are trying to sell but cannot. Moreover, a VLT may well encourage 'undesirable' development such as temporary buildings or car parking by landowners seeking to evade the tax.

The view of our contributors was that dispersed land ownership is not usually as great a problem as the Task Force suggests. Moreover, increased use of already existing CPO powers could to some extent overcome the problem if the market and the local planning authority deem that development is desirable. As the Task Force has indicated, the long-term solution to the vacant land problem may lie in land value taxation. In the short term, some combination of compulsory purchase powers and fiscal incentives may serve to ensure that land is available for housing development as required.

Stamp Duty

3.17 Stamp duty is a property tax. It is paid normally at the top rate of 4% (raised from 3.5% in the March 2000 Budget) on the transaction cost when property is bought. It applies whether or nor the new owner intends to undertake development on the property, and is therefore somewhat removed from the development process compared with other schemes evaluated in this study. Nevertheless, where development is intended, the duty can be normally factored-in to the calculation of development costs, so the duty would be taken out of the land price rather than added to the price of the development. Also, by applying to all property transactions (i.e. including sales of pre-existing dwellings), increased stamp duty would depress house prices generally. The ability of property to bear the duty makes it an attractive source of revenue to the Exchequer.

Raising stamp duty would clearly be a practicable way of raising more revenue. In most cases, significant increases from the current rate could be absorbed before property transactions would be substantially choked off. The value of property would generally decline to reflect the duty. However, higher stamp duty rates would hit transactions which did not involve a development intention as much as those which did. Furthermore, there was hardly any discussion of or support for this option at our seminars. The RICS has conducted an economic analysis of the impact on the UK economy of increasing stamp duty on commercial property which concludes that increases in such duty will have a significant impact upon capital values, which in turn will result in greater volatility in property prices. Given the significance of property in the wider economy, the RICS report argues that an increase in duty could result in a more volatile and unstable macro-economy (RICS, 1999b).

3.18 The Urban Task Force, advised by a supporting report by KPMG, recommended one circumstance in which adjustments to stamp duty could provide a useful incentive to brownfield urban development. This was to remove or reduce stamp duty on property acquisitions in particular places where development is being encouraged. This differential benefit would clearly have some advantage and may therefore be worth implementing. The Chancellor announced in the March 2000 Budget that he would consult further on this proposal from the Task Force. In our view, there are likely to be better arrangements for raising revenue to assist the implementation of planning policy objectives. In areas most in need of development, land costs are likely to be low in any event, so the benefit of a lower duty would be small. In areas which did have a higher land value, reducing the duty on the property sale might simply encourage the landowner to charge commensurably more.

Taxes on Property Ownership and Use

3.19 The principal tax in the UK on the use of property is the rating system, including the uniform business rate. Council tax and the uniform business rate are collected locally. The money is spent by local authorities, although the uniform business rate is pooled nationally and redistributed to authorities most in need. The tax is on the business occupier rather than the property owner, an arrangement which attracted considerable criticism at our seminars because it offers no disincentive to land hoarding by some owners (who may seek unrealistically high prices if they do bring their land to the market). The DETR has circulated consultation proposals on the reform of the rating system, including the option of greater flexibility in the way rates are collected and used. There is therefore an opportunity to consider ways in which the system might better support planning objectives.

Nicholas Falk (of URBED) made a strong case to our seminars that the rating system should be reinvigorated to provide incentives for achieving urban renewal. Rates are a major feature in the economic landscape, raising about £13 billion annually. They therefore offer a significant opportunity to change behaviour, and adjustments to the way they work would be easier than starting from scratch by promoting new legislation. Rates, he argued, should provide the facility (as they have done historically) for local collaboration – principally between local businesses and the local authority – to raise funds to achieve benefits for their area (especially those contributing). Within designated areas, local authorities in partnership with businesses should be allowed to raise a supplementary rate where there is sufficient agreement on its merit for the intended specific purpose. The source of revenue should be primarily the property owner (as the long-term beneficiary of local improvements), rather than the occupier (although rents could well rise in response). Funds raised could be supplemented by other public funds. Apart from overseas examples, such as 'Business Improvement Districts' in the USA, there is local experience of this kind of initiative in various town centre partnership schemes, whilst the new 'Beacon' authorities will have powers to raise additional funds in certain circumstances.

3.20 The rating system could achieve local improvements which the planning system by itself could not possibly secure. This is particularly prominent in areas of urban decline: planning cannot rescue areas experiencing increasing vacancy in shops, lack of investment and environmental deterioration, although the rating system could be used to assist planned regeneration. These areas need an injection of money by people confident that improvement is possible and likely to offer a good return. A key attraction to trigger investment is likely to be the certainty of a rates holiday, of the kind offered in Enterprise Zones. This would be an alternative to a supplementary local rate targeted to projects of real value to local businesses.

The impact of the rating system at present is keenly felt on empty property, which attracts 50% of the normal rates on occupied buildings, but which nevertheless brings in £1.5 billion to local coffers. There are clearly cases where owners could readily afford to pay the full local rate on empty buildings, as they find it financially attractive to keep them empty in the hope of a higher price later. However, there are also clearly examples of owners in weaker market areas who cannot find an occupier (or a buyer) at a reasonable price and are victims rather than beneficiaries of the rating system. There is an ongoing debate on how best to resolve these difficulties.

3.21 The rating system faces a conundrum: on the one hand business is more likely to be promoted by reducing the rate burden than by increasing it; on the other hand local control over the raising and spending of supplementary rates could be an efficient means of improving a locality and its business prospects. There appears to us to be a *prima facie* case for the local government finance system to include the option of the approach outlined by Nicholas Falk. Any system of raising additional funds locally should clearly work in the interests of the local area, not subsidise unco-operative land owners or penalise impoverished ones (or indeed be redistributed to other areas). The sources and distribution of funds should be structured to encourage all parties to contribute to that local interest: landowners to bring forward land for development, local authorities to give planning permission for community developments, and rate-payers to see the local benefit from their money.

3.22 The rating system envisaged could sit comfortably alongside our own proposals both for redistribution of financial support to weaker areas in need of regeneration and for dealing with the impacts of development. We would not support increases in the uniform business rate as a means of raising more funds for redistribution to areas in need of urban regeneration, principally because they are an ongoing charge related to property use rather than a single charge consequent upon property development, and because rates are already a significant burden on business (which cannot be taken out of land value).

Beyond this, we are not in a position to make firm recommendations on the rating system, although any package would overlap with our main areas of interest. The greater use of Compulsory Purchase Orders, which the Government is currently investigating in a major review, does appear to offer a parallel way into the problem of land withheld from the market on occasions where this is causing significant local problems. Adopting this approach would allow reform of the rating system to be focused instead on more strategic aspects of local regeneration.

Zones

3.23 The concept of geographical policy zones is probably unavoidable if one wishes to encourage development in one place and discourage it in another. However, it has to be recognised that the general problem of area-based action, such as happened with Enterprise Zones, is that such designations may simply move already existing economic behaviour from one geographical location to another, in order to take advantage of preferential tax arrangements or trading opportunities. However, in the case of housing, it may be possible to designate priority areas where development activity is encouraged through incentives such as tax 'holidays', rather than through arrangements such as grants. The special circumstances of housing (unlike economic activities such as manufacturing) is that it is immobile. Once the dwelling has been constructed it cannot easily be moved. Initiatives designed to encourage house renovation such as the General Improvement Areas and Housing Action Areas of the 1960s and 1970s are examples of such initiatives, although it should be recalled that these did tend to encourage large-scale gentrification in inner urban areas.

In general, the zone approach was not widely discussed at our seminars. However, incentives (for example to encourage housing on brownfield sites) will need to have geographical boundaries in order to limit and predict costs, plus criteria for designation. In addition, any policy zone designation will need to be time-limited and subject to regular review since this will ensure development now, and conversely will provide an exit strategy for the funding commitment. The Task Force's proposed 'Urban Priority Areas' could provide a logical focus for policy action.

Policy Instruments Designed to Ensure that Developers Pay for the Social, Economic, Environmental and Infrastructural Costs of Proposed Housing Development

3.24 The policy instruments considered in this section are planning obligations, impact fees and environmental compensation. In contrast to policy instruments designed to shift the balance of housing development from greenfield to brownfield sites, the policy instruments considered here are intended to deal with the impacts of development at all times. The wider impacts of development are independent of the stage in the market cycle and ought to be borne in all cases; and, if not, the development ought not to proceed. It has to be accepted that efforts to use economic instruments to reflect these impacts will be disproportionately difficult to bear in weak markets and disproportionately easy to bear in strong markets.

Planning Obligations

3.25 The terms 'planning gain' and 'planning obligations' tend to be used interchangeably. However, strictly speaking, planning obligations are the legal instrument through which planning gain is secured. The current legal basis for the negotiation of planning obligations is the 1991 Planning and Compensation Act, which introduced planning obligations by amending Section 106 of the 1990 Town and Country Planning Act. Current government advice on planning obligations is set out in Circular 1/97 of January 1997.

In principle, planning obligations should be 'reasonable' and should relate directly to the proposed development. In practice, particularly in areas of high demand for development land, planning obligations may involve developers paying for services and facilities which are in some cases only tenuously related to the proposed development. Although not seen formally as such, planning obligations are often regarded as a mechanism for extracting 'betterment', especially in areas of high demand for development land. Receipts are retained locally and as such are highly valued by local authorities as a source of income and 'in-kind' provision which is largely outside central government control. Planning obligations are also often viewed as the British equivalent to the North American impact fee in that, although there are differences in approach, applicability and administration, both seek to secure contributions to local services and infrastructure. In general, planning gain is likely to be secured mainly in areas where there is high demand for development land.

3.26 In our seminar discussions the shortcomings of the planning obligations system were frequently cited. In particular, representatives of the development and housebuilding industry were critical of the delays caused by protracted negotiation and of the unpredictability of the final costs to the developer. This unpredictability may be exacerbated if, as has happened in some cases, the local authority returns to the developer for 'a second bite of the cherry' to reflect increases in land or property values occurring during the course of negotiations. In contrast, several contributors emphasised the importance of planning gain as a locally levied and controlled 'tax' which, as an individually negotiated agreement, can respond appropriately to local needs and conditions. Similarly, the Royal Institution of Chartered Surveyors has concluded that 'the present system [of planning obligations] although flawed, provides the most practical method of ensuring that developers pay for remedying the impact of their developments' (RICS, 1998a).

3.27 Planning obligations are formal negotiated agreements conducted between the two principal parties of developer and planning authority. In such two-party bargaining negotiations, it is unlikely that a true 'market price' will be struck because there is only one buyer and one seller. For these reasons, planning obligations and agreements may not result in full compensation for the impact of development proposals. Moreover, it was argued to us by one developer that many local authorities do not have the in-house expertise available to negotiate planning agreements effectively, which may result in poorly informed or conducted negotiations.

3.28 In England it is estimated that less than 1% of planning consents are subject to planning obligations (Lichfield and Connellan, 1997, p.40), mainly applying to larger developments in areas of high land value. Nevertheless, in these cases the sums of money involved may be significant, often involving millions of pounds, and this has led to suggestions that some local authorities may be tempted to over-ride planning judgements in order to secure financial gain. This has led to the accusation that planning obligations may be regarded as the 'selling' of planning permissions. However, it should be noted that the Nolan Committee on Standards in Public Life did not find any evidence to substantiate this claim. In contrast, a recent study found evidence that in some local authorities 'both the designation of sites in the development plan and the preparation of development briefs were influenced by the propensity to extract planning gain' (Campbell *et al.*, 1999).

3.29 One of our participants representing a housebuilding company suggested that planning obligations work well on issues such as the replacement of habitats affected by the development, or when equivalent community benefits are negotiated to compensate for development impacts. In contrast, obligations involving the payment of sums of money, for example as payment for school places or road improvements, tend to be more difficult to negotiate. As the RICS points out, although Circular 1/97 appears to set precise guidelines as to what constitutes a justifiable obligation, stringent controls over public spending have created growing pressure upon local authorities to press for what might be considered 'unreasonable' planning obligations, often leading to planning appeal or judicial review (RICS, 1998a). Furthermore, the RICS estimates that in many instances, only approximately 10% of the final obligation goes to the local planning authority, with the larger part going to other bodies such as the highway authority, the education authority or the waste management authority. RICS comments that 'such 'hard infrastructure' is more tangible and therefore easier to negotiate and quantify, but often has a more remote relationship to the planning authority's local plan and the objective of mitigating the impact on the local community' (RICS, 1998a, p.3).

3.30 Whilst recognising these difficulties, many of our contributors emphasised the flexibility of planning obligations. Given the diversity of development proposals and the wide variety of local circumstances, it was felt that the element of discretion inherent in Section 106, and the capacity to negotiate in response to local needs and conditions, was very valuable. Moreover, the importance of planning obligations as a locally-controlled source of revenue or in-kind provision was recognised. Developers emphasised the desirability of ensuring that payments or benefits in kind were spent locally, preferably relating directly to the development, rather than being taxed away for some other purpose. It is also important to note that in the south of England and some other areas of high land demand, planning obligations have been utilised to facilitate the building of social housing, normally by housing associations.

3.31 Some commentators have argued that a system of impact fees might be a more effective and predicable mechanism for mitigating the effects of development proposals than planning obligations. The Urban Task Force has suggested impact fees as a possible policy mechanism for smaller developments, reserving negotiated planning obligations for larger schemes. We consider both impact fees and the related instrument of environmental impact fees elsewhere. Nevertheless, it is clear that although impact fees and planning obligations do have distinct distinguishing characteristics as policy instruments, there are commonalties to the extent that in certain circumstances planning obligations may take on many of the characteristics of impact fees. The case of East Dorset District Council is instructive here (see Box 2, below)

3.32 In its recent publication *Planning for Quality of Life in Rural England*, the Countryside Agency (CA) argues for a reformulation of planning obligations 'with their heavy overtones of a burden imposed upon developers' by

Box 2: The Case of East Dorset

East Dorset District Council has established a formalised system of developer contributions, agreed through Section 106, which are applied in the Verwood and Three Legged Cross local plan areas. The local planning authority requires developers to agree to contribute a sum of money per acre, in the case of larger schemes, and a figure per dwelling for smaller schemes. The sums raised are to pay for infrastructural investment necessary to support the proposed housing. The sums required are known by developers before devising a development proposal, and there has apparently been only one developer objecting to the scheme. The development industry contributors to our seminar who were aware of the scheme approved of the predictability of the arrangements, and of the fact that expenditure is retained locally.

The scheme does not exclude the possibility of extending conventional planning obligation negotiations if a development proposal requires this to occur. We are informed that the Government Office for the South-West initially objected to the proposals, but that a form of words dealing with these arrangements has now been agreed for inclusion into the local plan. East Dorset District Council emphasises that its contributions policy arrangements are planning obligations conducted under Section 106, and that they are not, and should not be, represented as impact fees. However, it has to recognised that many others see these arrangements as having distinct similarities to impact fees.

'development obligations' which 'define the things that a development must supply to deal with the impacts on the community and the environment where it takes place' (Countryside Agency, 1999). The CA sees this approach as consisting of three interlinked elements:

- *policies for development obligations included within development plans* – without this framework contributions from developers will be seen as opportunistic;
- *a method for calculating the obligations* – the CA suggests the techniques developed for assessing environmental capital; and
- a *mechanism in planning law to enable and enforce it* – Section 106 and Circular 1/97 provide the legal and policy backing.

3.33 This approach is more than simply a process of re-labeling. Combined with the experience of East Dorset outlined in Box 2, this promises an opportunity to re-direct the planning obligations process in a direction that many observers and indeed many of our seminar participants recommend. Indeed, a Rowntree-funded study of planning agreements published in the early 1990s (Healey *et al.*, 1993) clearly argued for a greater systematisation of agreements. The CA proposal for *development* obligations clearly emphasises that the process is to be utilised to deal with development impacts – including environmental impacts – which can be seen to result from the development. The introduction of a mechanism to assess the environmental effects would shift the emphasis away from one where local authorities seek to extract what they think the developer can afford, to one where the costs of the individual development are recognised as a necessary precondition for accepting the development, regardless of ability to pay.

3.34 Planning obligations have now been part of the UK development process for approximately 30 years. There is considerable experience in negotiating and implementing such agreements, despite the difficulties noted above. The development industry has reservations over the way in which the process operates, but in general this stops short of a call to abolish planning obligations. As was noted above, the Royal Institution of Chartered Surveyors regards planning obligations as the least unattractive method for securing developer contributions despite flaws in the process. Local planning authorities in areas of high land demand would be likely to object to the removal of a locally-controlled source of income in cash or in kind, although this would clearly be less of a concern to those local planning authorities where demand is low.

3.35 Planning obligations cannot be seen as a national instrument, in that they are not applied consistently throughout the country, and in any event they are currently employed in only a tiny minority of cases. Moreover, planning obligations do not permit (and were not intended to permit) the transference of resources from wealthy to less favoured areas. However, they do provide local planning authorities with a locally-controlled mechanism which enables them to respond flexibly to local market conditions and circumstances.

The central problem with planning obligations is that there is an inevitable tension here. On the one hand, they are, in effect, a mechanism for extracting betterment 'by the back door', whilst on the other they are a planning tool for ensuring that the local impacts of particular development proposals are addressed. There is a need to other seek mechanisms to fulfil the former role, whilst utilising planning obligations to address development impacts.

Impact Fees

3.36 At present the adverse effects of housing developments can be tackled by conditions on planning permissions and, where conditions are an unsuitable mechanism, by negotiated planning agreements to mitigate, remedy or compensate for the difficulties the development would generate. Apart from adverse effects, some developments involve a requirement in parallel for investment in infrastructure by parties other than the housing developer, such as road or junction improvement, or investment in new pipework or even in water or sewerage capacity. These are generally outside the site of the development. Because developers cannot provide these themselves, the normal arrangement is for the developer to fund the relevant agency to provide the facility. This can be achieved by a flat rate fee to the agency (for example a fee to the water company for a dwelling to be hooked up to the water supply) or by negotiation. In the latter case, provision could be insisted upon by the planning system by means of a 'Grampian' planning condition (precluding occupancy of the development until the associated off-site facility is ready) or a planning agreement specifying the steps that each party will take as part of the permission.

3.37 There is little disagreement with these principles: developers should pay for the costs of implementing their own schemes and for overcoming the immediate local adverse effects for which particular schemes can legitimately be held responsible. Planning law limits the scope of planning conditions and planning agreements to contain the onus which can be placed on developers. There are, however, a series of difficulties arising from current practice with negotiated planning agreements which have been outlined above.

One response to these difficulties has been a plea for more certainty in the planning process about the amounts which developers should have to contribute to deal with the knock-on effects of their schemes. Fixed and predetermined amounts would make the process more efficient for everyone, the argument runs. The mechanism to effect this would be the 'impact fee'. For example, the overall level of additional traffic likely to be generated by a particular volume and type of housing could be calculated, and the road investment needed to absorb it similarly calculated: the one could be divided by the other to give a charge per dwelling (or per square foot) for new road investment, which would then be paid to the highway authority. Carried out across a range of facilities, a tally for any particular development could be calculated. This could be done in advance of a scheme being proposed and taken into account in the negotiation between landowner and developer for the sale of land for housing development. This is the approach adopted in much of the USA. It is quick and easily understood.

3.38 The Urban Task Force has gone one step further than this by recommending that new development be required to contribute through an 'environmental impact fee', designed to tackle a series of issues which have historically been considered outside the scope of planning control over development. These externalities include increased air pollution caused by increased road traffic, soil erosion and loss, and a variety of other environmental impacts. The Task Force considered that the fees should be designed to tilt the balance in favour of brownfield rather than greenfield development. In outline, they argued for the payment of environmental impact fees by larger developments which have a 'negative environmental impact'. Most of the money should be removed from the locality. The system should be super-imposed on top of the current system of planning gain.

3.39 The main issues which would need to be addressed in devising a system of impact fees would be as follows, some of which are brought into sharp relief by the proposals from the Urban Task Force:

- Where is the dividing line between what can reasonably be attributed to a development and what cannot? For example, is there a case for social housing provision in a proportion of new development to ensure a mixed community, or is this going too far because the need for social housing is unchanged regardless of whether a private housing development proceeds?
- Can all the relevant impacts be covered by an impact fee, or will there still be a need for planning agreements in some circumstances? If planning agreements are still allowable, will the last state be any better than the first, since transparency will be lost, and there will remain the scope for delay, uncertainty and, frankly, arm-twisting?
- Can or should impact fees be manipulated to achieve objectives other than obliging developments to pay for their direct and indirect effects, such as to promote brownfield development?
- Is it possible to allow a development to proceed where the effect of the impact fee would be to make the development uneconomic but the scheme is desirable for other reasons (i.e. despite having a negative environmental impact, other issues such as housing supply are considered more important)? Who should then pay the impact fee, or should it be waived?
- Even allowing for differences between places in their ability to afford impact fees, is it appropriate to assume that all places are much the same as each other when calculating the effects of development, or is a more fine-grained approach needed with local flexibility? In short, do impact fees 'dumb-down' the planning system?
- Should impact fees be set nationally, or, as in the USA, locally? If set nationally, this would reinforce the attractiveness of developing in areas already under pressure with high land values, since they could absorb flat-rate costs more easily. If set locally, this would set up an element of competition between areas to attract (or indeed resist) development, in which the impact fees would quickly become not a means of paying for development but a means of supporting planning policies. Using a fiscal method of support for planning policies may be no bad objective, but is an impact fee the best way of doing it?
- Should the money be retained locally, which was the principle in the first place as a device for dealing with local effects of development, or should there be any redistributive element, or a subvention for widely applied national measures (as the Task Force envisages)? If there is a redistributional element, is an impact-related fee on new development the best way of raising the money?
- Where is the dividing line between facilities which should be paid for by all developments, including 'old' ones, and those which only new developments should pay for. In short, should costs be borne generally through user fees paid by everyone rather than by capital charges paid by new developments that happen to be coming along at the time the facility is needed? What proportion of the cost of a facility should be paid by new development, and what proportion by all users of the service (for example as is currently the case with road tax)? Current experience overseas is that impact fees from new development contribute only a modest proportion of total new infrastructure costs.
- If impact fees were to cover more than just meeting the requirements which enable a development to go ahead, and contribute to the wider needs of a local community (i.e. to substitute for planning gains), the process of drawing up the list of needs and allocating the costs to development would itself be time-consuming and could be overtaken by events as particular needs are fulfilled and new ones emerge.
- Where is the boundary to be drawn between issues which should properly be taken into account in making the planning decision on a proposed development and issues which should be wrapped up in the payment of an impact fee? At one extreme, so many issues could be covered by a fee that the development ought to proceed on payment of the fee, as if it was a performance

standard; but at the other end, as at present, all the issues worth evaluating could be held to be matters of judgement relative to one another and reasonably the subject of evaluation by planning committees.

- Impact fees by their name and operation assume that development simply has wider effects which would be undesirable unless remedied by the financial payment. However, development can have positive effects, not only socially and economically but sometimes environmentally, so in principle there ought to be a mechanism to pay the developer to undertake them. Also, money may not remedy the adverse impacts, and the compensation or mitigation needs to be environmental rather than economic (for example an alternative bat roost to one to be demolished might reasonably only be provided on the site of the new development, so giving the local authority the money to provide one elsewhere would not be adequate). Could an impact 'fee' be expressed as a required action in environmental compensation? What should happen when the environmental asset lost is irreplaceable, like a bluebell wood? At this point, the usefulness of impact fees appears to break down, and an alternative concept such as sustainability appraisal would seem superior as a means of informing the decision on how development should or should not proceed.

3.40 Our seminars distinguished two separate debates on impact fees. One was their role in tying the provision of infrastructure and off-site services to new development at the local level. The other was environmental impact fees in which funds raised were used for wider purposes outside the locality and there was a redistributional element. Most contributors considered that impact fees would be a poor way of generating funds for redistribution (for example to brownfield redevelopment). In particular, the wider the impacts, the less measurable they become, and the less significant is the role that money has in relation to the issues being assessed. We agree with that view, and consequently doubt the practicality of the Urban Task Force's recommendation. There was more support in principle for impact fees at the local level to provide transparency, speed and predictability to the planning process, but our feeling on reviewing the evidence is that even here the advantages of impact fees in theory turn out to be illusory in practice.

They would shift rather than resolve many of the problems experienced under the present system and cause some useful advantages of the present system to be foregone. One set of inefficiencies would be replaced by another set. The simplicities would be a problem, not a solution: many reasonable consequential effects of development would inevitably be omitted from the scope of the fee, yet if the fee system was not prescriptive it would open the door once more to negotiation and produce a system of impact fees *plus* planning gain. The local planning system, with its ability to balance all the issues at once, the advantages of a scheme and the disadvantages, and with its checks and balances, is basically a superior method for deciding amongst difficult competing interests, and is sensitive to each locality. Systems of financial measurement would inevitably fall short of this. Impact fees would fall particularly harshly in areas with low land values.

3.41 As our section on planning obligations shows, we also consider that there are ways of reducing some of the current difficulties with planning agreements. These, coupled with other initiatives to generate funds for redistribution to brownfield development, could obviate some of the case for introducing impact fees. In particular, a strict requirement that planning obligation negotiations should be limited to the scope of issues flagged up in advance in the adopted development plan would go a long way to meeting the legitimate criticisms of current practice and dampen the case for impact fees.

Environmental Compensation

3.42 Under this heading we consider those policy mechanisms and initiatives which broadly seek to ensure that developments meet the full environmental, as opposed to infrastructural costs imposed by the development. Impact fees and planning obligations are generally viewed principally as mechanisms for meeting infrastructural cost (although planning obligations can also address environmental costs) and these are considered elsewhere.

3.43 The Urban Task Force recommendation 63 states:

> 'Consider options for reflecting the full environmental costs of new development through the use of economic instruments. Particular attention should be given to the feasibility of introducing a system of environmental impact fees though the planning system.' (p.223)

The Urban Task Force Report suggests that a single planning levy or impact fee, possibly levied as a percentage of estimated value, could be used for all smaller developments (under £1 million estimated end value). However, the report is unclear as to exactly how this might be implemented. We interpret the report as suggesting that government consider introducing an *environmental* impact fee, covering a wide range of environmental impacts which are not currently covered by planning obligations (such as air pollution, greenhouse gas emissions or pressure on waste and water systems) in addition to reflecting the general infrastructural costs caused by new development. The report suggests that such fees should be used to complement rather than replace planning gain.

3.44 We have considered impact fees above, and much of this discussion will also apply to *environmental* impact fees. However, it is important to emphasise that our contributors were very clear in their view that it is necessary to clearly distinguish between:

- charges upon developers which can be made by a local authority in order to reduce or alleviate development impacts which clearly affect the development site or its immediate vicinity; and
- charges of a more general nature which are levied as a general environmental tax, for example to contribute to waste reduction schemes, or to support nature conservation, whether this is done locally or is spent as part of a centralised budget.

Our contributors took the view that the second of these was problematic in that such charges would be difficult to justify and had significant difficulties in terms of operation. It was put to us that any attempt to calculate the environmental costs of individual developments was doomed to failure, partly because the environment is not site-specific; because such costings are notoriously controversial and difficult to specify; and because of the inevitably time-consuming (and thus costly) nature of administration. Furthermore, although such fees might be practical in areas of high land demand, in other areas they may discourage badly needed development.

3.45 It was felt that the only possible approach would be a standard fee, probably on a banded or sliding scale related to land or end value. Such fees might be retained centrally or have a locally retained element, but in any case it was argued that such fees would be regarded as general taxation, and therefore widely seen as illegitimate as a targeted property or development tax. Moreover, it was argued that the planning system was the most appropriate mechanism for ensuring that development proposals were of an appropriate environmental standard.

One dissenting voice was Nathaniel Lichfield, who argued to us that it might be possible to extend the principle of environmental assessment to all development applications, through a simplified process provided by the developer. We were reminded that a similar system is operated in New Zealand under the Environmental Resources Act, but Lynda Addison argued to us that this system was not working well, and in any event the UK situation was not comparable because of size/number of development applications, and because of the distinctively different planning regime (Grundy and Gleeson, 1997, 1998)

3.46 It should be emphasised that this discussion of policy mechanisms should be set in the wider context of work undertaken to assess approaches to environmental capital such as that carried out for the Countryside Agency (CAG, 1997). Furthermore, there is a substantial body of work which examines the process of environmental compensation or environmental offsets (e.g. Owens and Cowell, 1994) and various initiatives which seek to develop the concept of sustainability appraisal. Overall, this work is concerned to wrestle with the various problems of environmental 'stock maintenance'; the definitional difficulties inherent in the divisions between 'critical', 'constant' and 'tradable' natural capital; the problem of non-substitutability; and the difficulties inherent in the valuation of environmental goods.

This work is important and extremely promising, and it is beginning to filter into policy debates. However, there is some way to go before there is general agreement over the form and content of policy mechanisms directed at environmental capital and compensation. Moreover, it is not clear that some kind of environmental impact fee would be the preferred mechanism. On the contrary, the flexibility of planning conditions or development obligations might be the most effective way to translate these emerging approaches into policy.

Policy Instruments Designed to Recover to the Community the Increases in Land Value Created through the Award of Planning Consent for Housing

Capital Gains Tax

3.47 Several of our contributors felt that capital gains tax (CGT) may be an effective mechanism to secure recoupment of development value. This position was most forcefully put by Wyndham Thomas, who argued that there is an urgent need to focus policy upon the recoupment of development value, and given that CGT is currently payable upon gains in land value, an updating and strengthening of the tax should permit a substantial uplift in the tax take on land value increases, which would, in effect, be a tax on development value (or 'betterment'). (It was recognised that CGT cannot be used to pay for development impacts.)

The Inland Revenue does not publish figures showing the proportion of total CGT revenue from land. Wyndham Thomas's estimate is that the figure is around £200 million per annum, and he went on to argue that by removing the various off-sets, roll-over and other mitigation advantages with respect to land, plus over time increasing the taxation percentage on land, this could result in a substantial revenue stream, underpinned by the ethical case that it is legitimate for the state to tax away benefits that have been created through public actions.

3.48 Several other contributors accepted the argument that CGT would be a politically more acceptable mechanism for taxing development value than a re-introduction of a betterment tax. However, any proposal to raise CGT rates would run counter to the thrust of the Chancellor's March 2000 Budget, which announced reduced rates specifically to assist small businesses. In particular, assets held for just four years (compared with the previous ten years) will now incur CGT of only 10% on sale compared with the usual 40% for sales after only one or two years (and relief will taper through 20% on sales after three years). Also, purely in the context of this report on economic instruments to support the planning system, it should be noted that CGT has a less strong connection to the planning process than many of the other mechanism considered: the tax is on the profit resulting from the capital appreciation, which is an additional step removed from the sale price of either the land or the housing (and thus the influence of the planning process).

3.49 Capital gains tax has a clear potential role as a means of collecting a betterment tax, and a proportion of the money raised could find its way back to supporting land use planning policies and brownfield site redevelopment. However, there is no fundamental reason in principle why capital gains from development of brownfield sites should be taxed any differently from capital gains from the development of greenfield sites. The basis for intervention would be that a reduced level of tax on certain kinds of activities, such as brownfield redevelopment, would make those activities more attractive to the market, but the tax would have to be specified very carefully to ensure that tax advantages were targeted on just those marginal cases. It is doubtful that a distinction only between, say, 'greenfield' and 'brownfield' sites would be sufficient. The report by KPMG for the Urban Task Force noted the scope for measures to encourage sites to come forward quickly (such as a tax holiday for gains realised on the sale of brownfield sites, and a three-year window before CGT rates are raised). However, these ideas were not taken up by the Task Force, which instead preferred measures which focused more directly on the specific features of the urban regeneration process. Although we have not studied the options in detail, there is much to be said for the thrust of the Task Force's targeted approach, and we suspect that differential application of CGT would offer only a blunt instrument in support.

Betterment Taxes

3.50 Betterment is usually defined as an increase in site value caused by improvements carried out at public expense, and in the context of the development process, this is mainly interpreted as the increase in the value of land consequent upon the granting of planning consent. In this case, the sums of money involved may be quite substantial. In the South East of England, for example, the typical value of agricultural land is £8,000 per hectare, while land with planning permission for residential development has an average value of £1,370,000 per hectare. The development value (the value of the existing use of land deducted from the value of the same plot of land with residential consent) is therefore around £1.3 million per hectare. Clearly, there are considerable variations both within and between regions (the comparable figures for the North East of England are £7,400 per hectare for agricultural land and £530,00 for residential land), but these figures serve to show the magnitude of windfall gains which accrue to landowners on the receipt of planning permission (all figures from Valuation Office, 1999, quoted in RICS, 1999a).

3.51 This increase in the value of land, or betterment, is often referred to, following John Stuart Mill, as the 'unearned increment'. The land has not changed or been improved in any way, but the landowner has benefited through public action. Consequently, there has been a longstanding view that there is a strong ethical case to be made to tax all or some of this betterment away on the basis that it belongs to the community as a whole.

This view was central to the three previous post-war legislative attempts in Britain to recoup betterment through taxation in 1947, 1967 and 1974. The history of these attempts and the reasons for their subsequent repeal is well-documented and need not be rehearsed here. However, given the centrality of development value to most aspects of this investigation, several points warrant emphasis.

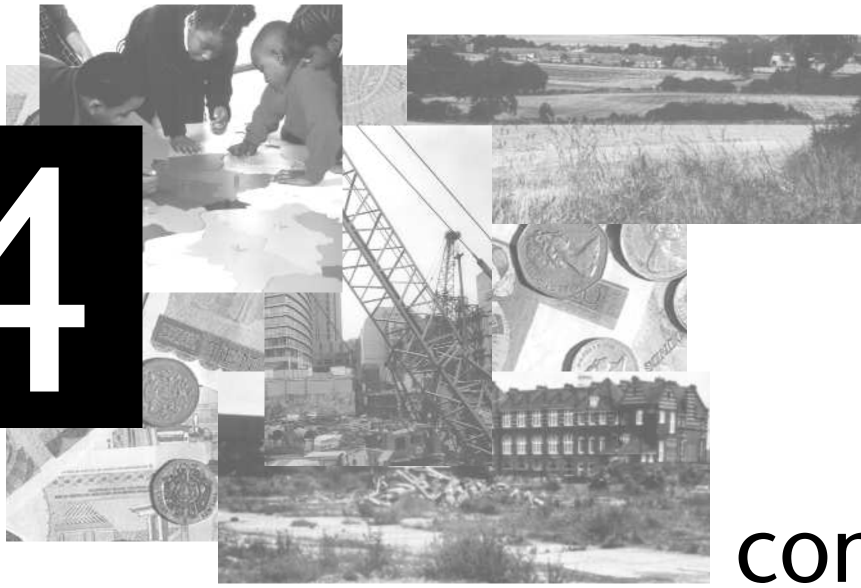
Although a betterment or development tax is based primarily in considerations of equity, it is important to recognise that the report of the 1942 Uthwatt Committee, (whose recommendations heavily influenced the 1947 Town and Country Planning Act) viewed the recoupment of development value through a development charge as a process which would eventually result in the trading of all land at existing use value, thus enabling the newly created national town and country planning system to intervene in the market in a positive manner to purchase for community purposes, and to designate land regardless of the price placed upon it by a market guided by 'hope values'. In this sense, the betterment provisions of the 1947 Act were as much about planning objectives as about equity.

3.52 The three attempts to capture land value from development value in Britain were repealed for a variety of reasons. Inevitably perhaps, the taxes tended to deter development, partly because landowners were confident that a succeeding Conservative administration would repeal the legislation. However, although supporters of these schemes have argued that none was given sufficient time to 'settle down', it seem likely that the complexity of the schemes and the associated administrative difficulties did not assist their perpetuation.

All three attempts were concerned to capture value at the point of development, and in this sense betterment levies or taxes must be seen as distinct from more ambitious measures for land value taxation, such as site value rating. The Henry George Foundation (HGF), which campaigns for LVT in Britain, argues that a betterment levy or development tax is 'in the right spirit but the wrong form' (Vickers, 1999). A betterment levy is, argues the HGF, a second-rate tax when compared with a tax levied annually on the market value of land, in that the former will tend to deter development or the seeking of planning permission and will not have the long-term effect of incentivising development, particularly in urban areas. We have commented above on LVT proposals.

3.53 In our seminar discussions there was little enthusiasm for the re-introduction of a betterment or development tax, although many contributors were convinced of the ethical arguments underpinning such taxes. In major part, this may be seen as consequence of the experience of the three previous attempts, and of the probability that such an initiative would be likely to again become a political football. Betterment taxes are clearly complementary to the planning system and have a high degree of predictability. And, since the tax will come from the development value and thus from the land price, they should therefore not result in an increase in house prices. On the other hand, a central problem of the three previous attempts to capture betterment has been the administrative complexity and cost of the process. Furthermore, the re-introduction of betterment taxation would mean the end of planning obligations and the local income and control that this represents for some local authorities. Given the history of betterment taxation, considerable political opposition to its introduction and implementation can be anticipated, and this will inevitably be exploited by opposition parties with a high probability of repeal at the first possible opportunity.

3.54 We do not find the case for a re-introduction of a betterment tax convincing. As we have indicated above, a longer-term solution to the development value problem is more likely to be found in schemes for land value taxation. In the medium term, we would prefer to look at other policy mechanisms which recoup some betterment, pending a review of longer-term approaches.



4 conclusions

4.1 'You don't want to start from here', goes the music hall joke. For good or ill we have to: much as we were attracted by the intellectual stimulus of starting with a 'clean sheet' on which to build up a system of development taxation and associated policy mechanisms, we have opted for a more pragmatic approach in the hope that this will generate a nucleus around which support for change can build. We would prefer an implementable package with rough edges to a neat but politically irrelevant sea-change. This has encouraged us to focus on economic instruments which would require either adjustments to existing legislation or new legislation that is well within the tramlines of current debate. Implementation should be a practical proposition in parliament, not a war of attrition with an uncertain outcome.

In this concluding section we review the various policy initiatives under the three aims outlined at the beginning of this report. We then conclude with a summary of our recommendations for future action.

Shifting the Balance of Housing Development from Greenfield to Brownfield Sites

4.2 We are satisfied that the best way of encouraging more development on brownfield sites is by making this more attractive to investors. Constraining development on greenfield sites is likely to have some limited effect in making developers look harder for brownfield sites, but choking off greenfield development may simply reduce the overall level of housing provision rather than generate an equivalent level of brownfield activity. Also, any limitation on greenfield development should be guided primarily by the planning system rather than by economic instruments, so that the greenfield development which does proceed is in the most suitable places. Implementing the priorities of the planning system should be facilitated by more enthusiastic use of Compulsory Purchase Orders if necessary.

4.3 Greater economic stimulus to brownfield development will derive mainly from tax exemptions or financial assistance provided, so the role of economic instruments in this sector is primarily to find sources of finance suitable for redistribution to brownfield sites. (These will of course work in tandem with other efforts to smooth the path of urban renewal, using other kinds of stimuli outside the scope of this study.) We were pleased to find from our studies that economic instruments to assist planning objectives will generally achieve more by the funds they generate for reapplication to assist desirable development than by the disincentive effect they have on greenfield development. This is because the increase in land value generated by the grant of planning permission is likely to be sufficiently high in most cases not to discourage development from proceeding. Even a greenfield tax would only choke off a little development at any reasonable rate of tax likely to be applied.

4.4 Our special interest has been to find economic instruments which dovetail with the development process, rather than to seek funds from general taxation, so that there are reasonably clear relationships both between the source of the funds and the way they will be spent, and between planning policy and the economic instrument. This approach raises a wider question of the chance of persuading the Chancellor to adjust general taxation measures, like capital gains tax, value added tax, stamp duty, uniform business rate etc., to provide specific assistance to the achievement of land use policy, such as greater use of brownfield sites. Our view is that the tax system is sufficiently sophisticated to be capable of doing this: revenue-raising is not a one-dimensional activity but closely examined for its economic and other consequences, and we see no reason why land use objectives should not feature in the package of issues which the Treasury takes into account. The relevant test should be clarity of relation with land use objectives, not the history of the vehicle proposed for collecting the money.

4.5 There is no doubt that the main pot of money potentially available to supply funds to urban brownfield development is the increase in land value created by the grant of planning permission on greenfield sites, especially in the more economically buoyant parts of the country. The gain in value is often so great that even a significant reduction in the sum payable to the landowner would not dissuade that landowner from selling for development. (The main risk is that the landowner may prefer to wait, in the hope that any law clawing back the land value by the Exchequer will be reversed by a future Government: hence our support for a consensus-based approach to economic instruments.)

4.6 The search is for an economic instrument which can raise money almost entirely out of land value. Development would probably not proceed if there was a threat of either an increase in the price of the development to the eventual buyer (as prices obtainable are set not by the costs of supply but by the market in 'second-hand' property), or a significant reduction in the developer's profit (causing a loss of interest). The costs of an economic instrument must therefore be clear and known in advance, so that they can be taken into account in the developer's negotiation on the land purchase or option agreement.

4.7 We also appreciate that money can only be taken out of land value where it exists. Some sites suitable for development have a low land value, or even a negative value (for example due to contamination), and these will obviously be unable to contribute to the pot for redistribution. Indeed areas with weak markets might expect to be recipients of funds from that pot. The greater the recovery of land value for redistribution, the larger the number of marginal schemes which will become uneconomic to develop, but the more the Exchequer will receive from developments which do proceed and which therefore provide for support elsewhere. In effect, this approach, based on ability to pay, would offer a progressive measure for redistributing funds from areas under pressure for greenfield development to areas needing regeneration. That wholly supports the thrust of current planning policy. The measure chosen would need to apply only to those areas which can afford to pay, or, if applied universally, would need to be accompanied by devices which supported weaker market areas. Fund-raising out of land value will be most effective on greenfield sites where there are no competing alternatives to the housing development to be taxed (for example where the landowner cannot realistically abandon housing development in favour of, say, retailing owing to a tax on housing development).

4.8 Given that development on greenfield sites should be the main source of revenue for redistribution, we were tempted by the simplicity and clarity of a greenfield tax. However, we felt that this lacked flexibility and missed an opportunity to intervene more comprehensively in the tax system to achieve more objectives. It had the disadvantage of requiring a completely new tax, although this could more readily than most be presented in a politically and publicly acceptable way. We would expect the Government to have difficulty in legislating for the tax as a national tax, although this would be essential to avoid perverse incentives to develop greenfield sites to raise revenue for local use. There could also be problems with land valuation – a difficulty shared by betterment taxes. In effect, a tax on greenfield sites remains the main concept, but that particular method of collection clearly has some limitations. We considered capital gains tax too remote from the development process and raising stamp duty completely independent of it, although both had their merits. Vacant land tax and property taxes based on the rating system had real advantages in particular circumstances, and deserve to be pursued, but would not achieve the redistribution of funds on the scale necessary to achieve major urban renewal.

4.9 Our preference by a distinct margin is for introducing value added tax on the sale price of all new housing development on greenfield sites at the full rate of 17.5%, coupled with some adjustments within the VAT package to achieve further advantage. VAT would be a predictable cost of an intended development scheme with known sale prices. This could be taken out of the land value provided sufficient notice is given of the introduction of this extension to VAT. In opting for VAT on new greenfield housing, we recognise the potential difficulties that may emerge in defining the categories of greenfield and brownfield. However, on the basis of the definitions in PPG3 and the discussions mentioned above, we feel that this will not be an insuperable problem.

4.10 VAT at the standard rate on new greenfield house building would generate a significant revenue stream, which we estimate to be in the order of £1 billion per annum using UK data (see Box 3, on the facing page), although this would of course increase if the Chancellor chose to raise the tax figure above 17.5% at some future date. The sums involved are capable of being absorbed within the general capacity of development land values, although with VAT at 17.5% development would be unlikely to proceed where land values comprise less than about 20% of the cost of a house. Greenfield development would not therefore proceed in areas where land values are very low. These are generally places where development pressure is limited and where regeneration on brownfield sites is likely to be desirable in any event. The VAT package would need to be devised with an eye to its impacts in areas of low land value, perhaps including some carefully limited exceptions, but bearing in mind the likelihood of these areas being the beneficiaries of additional revenue expenditure.

4.11 The measure would provide an important increase in tax revenue. We consider that some of the funds raised should be retained for adjustments within the VAT regime, focused on a reduction in the VAT payable on refurbishment, repairs and maintenance through the whole built environment. This would reduce the gross level of additional tax. We consider that about £500 million could reasonably be reserved for this, almost all of which would be used within existing urban areas. There are currently substantially differing views on how far this money would stretch: the Treasury, for example, considers that levying VAT at 5% instead of at 17.5% on all repairs, maintenance and refurbishment would cost £1.1 billion per annum (Parliamentary Answer, 4 June 1998), whereas the Joseph Rowntree Foundation estimates that the effect could be between a cost of £400 million and a gain of £115 million per annum (the Foundation's latter figure would arise due to much reduced VAT evasion and avoidance plus an increase in VAT-paying construction activity). If £400 million per annum was allocated to subsidise VAT reductions on repair, maintenance and refurbishment under our scenario, which is about the midpoint between the most optimistic and pessimistic assumptions noted, then about £600 million per annum of net revenue would still be available for other urban regeneration work.

4.12 Our other proposed adjustment is that housing development by housing associations and charities should remain zero-rated on greenfield sites as well as on brownfield sites (and our calculations of revenue raised are based on private house sales only).This would give them a significant advantage in their efforts to acquire land for affordable housing. It would also help to uncouple the provision of affordable housing from the cross-subsidy of individual private housing developments. This would be a particularly desirable move because reduced land values, generated by the new VAT arrangements, would significantly reduce the ability of private developers to assist the provision of affordable housing. Our proposals would offer a relatively painless way for the Government to increase its assistance to the affordable housing sector, and would have an impact at the most valuable point in the development process. In addition, this proposal would go some considerable way towards addressing the potential reduction in social housing constructed by developers as part of planning obligation agreements, which could be well funded in some parts of the country under these new arrangements.

4.13 Introducing VAT on newly built dwellings would bring the UK into line with most of the rest of Europe. The Chancellor would have scope to vary the impact of the measure at different stages in the development cycle (over and above fluctuations in income with the housing market) by adjusting the volume of money recycled to urban renewal or retained for other purposes. This approach would be substantially easier and less damaging to the development process than changing the VAT rates on new building (or the scope of the

Box 3: The Impact of 17.5% VAT on New Build Housing

Income from VAT at 17.5% on new build on greenfield sites:

The income would be based on:

(i) Private sector UK completions in 1998: 154,380 dwellings (all assumed subject to VAT payment; *source:* Housing and Construction Statistics);

(ii) 40% private completions assumed on greenfield sites (cf. 47% in 1997);

(iii) Average price of all new private houses sold £85,000 (at March 2000, which is assumed to be the same average on greenfield as on brownfield sites; *source:* Halifax Building Society); and

(iv) VAT rate = 17.5%.

Multiplying these gives an annual income of:

154,380 x 0.4 x £85,000 x 0.175 = £918.5 million

How to use the money:

The collection costs would be small. Evasion would be nil or virtually so and therefore most of the income raised would be available for redistribution, either to reduce the overall scale of taxation by tax reductions elsewhere or to provide grants.

This calculation already assumes that social housing providers will be exempt. Beyond this, we would expect funds to be made available to support a reduction in VAT on refurbishment, repair and renewal of existing property. It might be possible to offer up to £400 million to be made available for this. (The economic effects of reducing VAT rates on refurbishment, repairs and maintenance are uncertain because of the potential changes in practices such as VAT registrations, VAT evasion and the overall volume of work carried out. Under some scenarios the change by itself might increase tax revenues, although the Treasury assumes a significant loss in revenue.)

related adjustments). In addition, since it is likely that the introduction of VAT will reduce the sums negotiated through planning obligations for social housing provision, it may be necessary to make additional financial provision to housing associations.

4.14 The linkage between revenue-raising and revenue expenditure is clearly integral to this approach. Although the Treasury may have reservations over direct hypothecation, some relationship between taxation revenue and expenditure is likely to be widely understood and supported. If direct hypothecation is not permissible, we would suggest a process of 'expenditure equivalence' through which Government assigns an annual sum in support of urban regeneration which is broadly, but not directly, equivalent to the revenues from VAT on new house construction. This looser relationship between revenue and expenditure, rather than a pound-for-pound hypothecation, may prove to be more acceptable. We have not identified the most appropriate vehicle(s) for disbursing funds to housing development on brownfield sites, although the regional development agencies are one obvious candidates for the task.

Ensuring that Developers Pay for the Social, Economic, Environmental and Infrastructural Costs of Proposed Housing Development

4.15 We consider that the impacts of development should for the most part be handled by arrangements between the utilities and housing developers (for example hook-up charges) and by conditions on planning permissions. The latter can already be extensive in nature, including the precluding of occupation of dwellings until specified actions have been taken ('Grampian' conditions) – potentially involving the developer in paying others to take those actions. There remain some kinds of measure to overcome, mitigate or compensate for the impacts of development which will still benefit from the power for the parties involved to reach a legal agreement. In short, we cannot see an effective alternative to planning obligations; equally we anticipate that this power will be used sparingly, as it is at present.

4.16 The main difficulty which the retention of planning obligations creates is the opportunity for abuse of the system:

- causing delay to development while haggling over the terms of the gains;
- more extensive claims on developers in areas where land values can most readily absorb them (rather than in relation to real needs for the gains); and thus
- regressive regional differentials in the quality and impact of development.

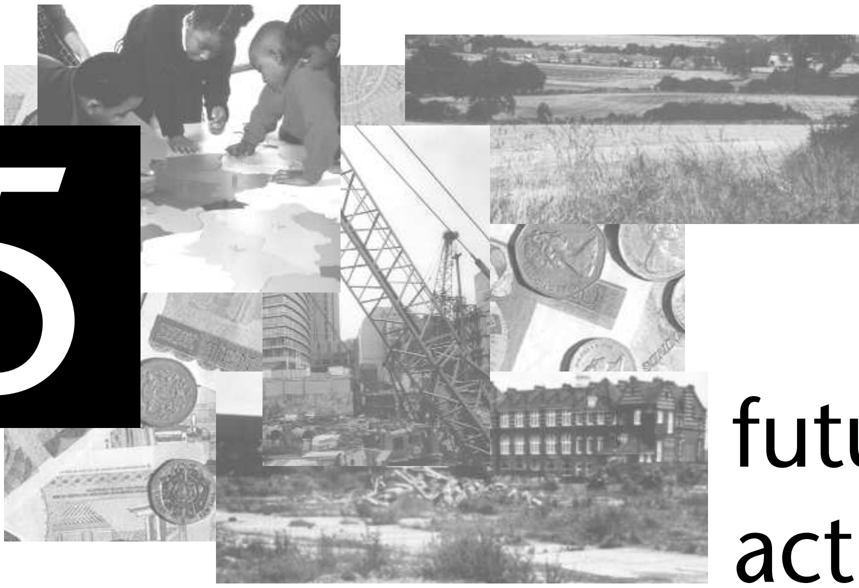
Experience over decades shows that limiting the use of the power to make local legal agreements is unlikely to be wholly effective. We do consider, though, that the imminent review of planning obligations (through a DETR consultation on a review of the relevant policy circular) would be a good opportunity to bring better controls to the process and a clearer association between individual agreements and planning policy. We are impressed by the proposals from the Countryside Agency, and in particular we consider that there should be a restriction on planning gains to benefits foreshadowed in an adopted development plan. The East Dorset experience deserves careful examination.

4.17 We see no role for impact fees. Although these would have the apparent attraction of even-handedness to all developments, and predictability, they scarcely deal with the subtleties of individual developments and would simply replace the current problems with others. The reasons for our disenchantment with impact fees are set out in more detail above. Furthermore, we are not convinced of the argument for a distinctive *environmental* impact fee. Environmental assets are notoriously difficult to value, and flat-rate fees could not realistically be assigned to particular impacts. We feel that the best way of addressing these issues is through a revitalised development obligations process. If sustainability appraisal or environmental capital techniques become demonstrably effective they could be used to inform both the development obligations and planning conditions.

Recovering to the Community the Increases in the Value of Land Created Through the Award of Planning Consent for Housing

4.18 VAT on newly built housing would be taken from the land value and therefore could reasonably be conceptualised as a betterment tax on housing development. If a future government chose to implement a land value taxation scheme such as site value rating, this would over time effectively 'solve' the 'development value question'. In this case a government would have the option of reducing or removing value-added taxation on housing if appropriate.

4.19 A more vigorous capital gains tax regime could recover more land value increases than at present. This option would not contradict the VAT proposals outlined above, since any capital gains remaining after the payment of VAT would still be liable to CGT. In addition, CGT would still be a mechanism for recovering a proportion of development value in the case of non-housing development. However, the payment of CGT is somewhat remote from the land transaction, making it a poor second to land value taxation as a means of collecting land value gains.



5 future action

5.1 The economic instruments recommended below must be seen as supporting the planning system. It is the planning system which decides what development can take place and where. Furthermore, through planning conditions supported by government guidance, the development control system has the capacity to ensure that development only takes place when it meets clear and established social, economic and environmental criteria. It is the planning system which is the principal mechanism for dealing with the impact of development proposals. In the light of this we recommend the following.

Recommendations

1 That value added tax be raised to a rate of 17.5% on all new house construction on greenfield sites.

2 That new social housing and housing built by registered charities should remain zero rated for VAT everywhere.

3 That a package of development incentives be created, including tax breaks encouraging investment in new development, building repair and conversions on brownfield sites, focused particularly on limited areas needing regeneration, such as the Urban Task Force's proposed 'Urban Priority Areas'.

4 That a principle of 'expenditure equivalence' be established to permit additional government investment in 'Urban Priority Areas' at a level broadly equivalent to the tax revenues from Recommendation 1 above.

5 That the 'planning obligations' system be restructured as 'development obligations', with a plan-led framework and a clear emphasis upon dealing with the local impacts of development.

6 That the Government seriously examine the case for establishing a system of land value taxation in the UK in the longer term.

5.2 All our proposed economic instruments relate clearly to development; they demonstrably assist the implementation of planning policy; they increase the transparency of the policies and costs associated with development; they cause costs to be borne almost entirely out of land values (thereby minimising the disincentive to new development in total); and they would be relatively easy to introduce in legislation (all through adjustments to existing laws). Any change creates winners and losers, and a package worth probably about £1 billion per annum will be closely scrutinised. We are confident that our package offers a nucleus for wide agreement on how to take forward the economic framework for sustainable housing development.

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Dr Bob Evans is Director of the Centre for Local Environmental Policies and Strategies at South Bank University, London. He is author of *Experts and Environmental Planning* (Avebury, 1995) and co-author of *Local Environmental Policies and Strategies* (Longman,1994); *Environmental Planning and Sustainability* (Wiley, 1996) and *Town Planning into the 21st Century* (Routledge,1997). He is co-founder and co-editor of the international journal *Local Environment* and he has worked as a town planner in the public, private and voluntary sectors.

Richard Bate MA, MPhil, MRTPI is a partner in the planning and environmental firm Green Balance, which specialises in the development of national planning policy and its local application. He is also the standing specialist advisor on planning to the House of Commons Environment, Transport and Regional Affairs Committee.

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