The Raynsford Review of Planning
Provocation Paper 3: Do we need a betterment tax?

[Draft October 2017]

"Debate has raged in this country over the right way to recoup the share of the profits from land development that rightly belongs to the community, since public agencies have had to provide much of the physical and social infrastructure, and since the land values arise in large measure through the grant of planning permission. What has eluded us is…to find a way of capturing the added value that is effective, efficient in operation and politically acceptable enough to be stable over time" (Peter Hall and Colin Ward, Sociable Cities ,2nd edition, 2015)

Introduction

For those with limited time, Peter Hall's quote is perhaps the most direct expression of the complex betterment tax debate. This debate is not new but it is often surrounded by confusion about the source, collection and distribution of the values, which arise from development of land and property. The issue is particularly important to the Raynsford Review because the regulation of land in the public interest has a direct impact on land values. The English planning system has employed multiple ways of capturing these values since 1947[1] but has ended with a system which, while yielding some significant benefits, lacks transparency and tends to reinforce inequality. Since land use regulation and betterment taxation are inextricably linked, and because land value capture could support positive planning, the review will need take a view on the principles of an effective system.

The Review's Background Paper 2[2] sets out the broad history of betterment taxation as part of a wider investigation of the development of modern planning. This provocation paper seeks to provide a high-level introduction to some of the key issues around the land and betterment tax question. It sets out the background to land values and the components of the current trader model of development which dominates the housing market. The paper summarises the differing forms of land and betterment taxation, providing a brief background on the implementation of these models. As a summary paper, we cannot do justice to the wealth of expert literature on this issue. A wide variety of experts[3] have written on this subject but 'Planning Gain' by Crook, Henneberry and Whitehead (2016) provides an excellent summary of the historical, international and contemporary issues around development taxation.

Where do land values come from?

Land values are generated from societal demands for goods and services, which each depend on for the development of land (including everything from food production to housing). The regulation of land impacts on how land values are distributed by controlling the uses to which land can be developed. Both giving consent and investing in infrastructure by public bodies generates values know as 'betterment'. Taxing these values for the public benefit would seem to be a straightforward proposition. However, the debate on how to capture these values has become both popular and confusing in equal measure.

Where do developers' profits come from?

"The vast majority of house builders follow the "current trader" business model which consists, in essence, of cycle of land acquisition, development and outright sale. Profit

[1] Forms of betterment taxation go back to at least the 1909 Planning Act

[2] Raynsford Review, June 2017, Background Paper 2: The rise and fall of town planning

[3] Including Hall (1965), Parker (1987), Prest (1981), Grant (1992) Faulk (2016), Hill (2017) Walker (2014), Barker (2004)

is the margin between sale price and development costs; the developers retain no long-term interest in the property"[4].

Development costs are made up of range of factors, from materials and labour to the cost of land[5], borrowing and planning requirements. The cost of borrowing can be higher for developers because of the perceived risks of the planning and development process. (There is an active debate about the extent of this risk. While market volatility is a real risk, the claim that regulation generates risk is less compelling in the context of 80% — plus approval rates for housing schemes of which more than 80% are approved on time[6].) After accounting for all of these costs, housing developers often seek profits of between 20% to 30%. This is relatively high in relation to other major domestic commodities, a factor that the industry say reflects the inherent risk in the business.

Many of challenges of the planning system on quality, affordability and long-term stewardship flow out of this dominant development model, but two issues are particularly relevant for the land tax question:

1. In theory if higher requirements are placed on developers for quality outcomes then developer will seek to preserve their profit margin by paying less for land.
2. The commercial expectation of relatively high profit margins means that developers will simply not build if requirements or taxes are set at too higher level. This is at the heart of the NPPF viability test, which was written specifically to support the current trader business model.

In short, it matters when the burden of taxation falls between landowners and developers. It also matters that methods for land value capture are understood before land is purchased or optioned. Finally, any debate about the current trader business model needs to consider that the model is subject to very substantial public subsidy through direct support for owner occupation through schemes like Help to Buy and through wider investment in infrastructure where the costs are not fully met by the private sector.

Getting to the heart of betterment

Betterment value results from the actions not of the landowner but of a public authority. The best description of the betterment question remains the 1942 Uthwatt Report. Previously described as the 'unearned increment', betterment values arise continuously across society by the provision of public services. The most obvious example is through the provision of new transport infrastructure leading to increased property prices. Transport for London has explored mechanisms for capturing these values including TiF.

Betterment also occurs through any system of land use control where the right to develop land rests with the state rather than with the landowner. Gaining planning permission from a current use to a new- and higher-use value changes the price of land. This change can be up to 100 times the current use value of the site.

It is worth reinforcing the legal reality that development rights were nationalised in 1947. **Landowners do not own the right to develop their land.** It follows that they have no legal 'right' to the value created by the grant of permission. This was the powerful logic of the 1947 betterment taxation regime, which recouped betterment at a rate of 100%. The subsequent practical experience illustrated that this logic was unworkable in a market economy where the supply of land depended on willing sellers. That is why extreme care is needed when setting

[4] The Callcutt Review of House Building, HMSO (2007)

[5] The cost of land as a proportion of the development cost has risen over time.

[6] According to DCLG statistics on planning applications decided, granted, performance agreements and speed of decisions on major and minor residential

the level of any tax or charge at a rate which does not extinguish the land market and/or give public authorities a much greater role in development.

It is also important to recognise that land value uplift is not an abstract 'money tree' which can be tapped for public good. Such values depend on wider societal demands for development, and any intervention in the market to recoup these values will impact on market conditions for land. Finally, the development of land is special and unlike most other commodities. No development happens without a relationship between the public and private sector in terms of wider patterns of infrastructure. Nothing but the most minor forms of development can be seen to be purely a private sector-dependent operation.

Four models of land tax

In simple terms, we might distinguish between the four models of land value capture which have been deployed in the UK.

1. The general model.
Land/property taxes as a general aspect of wealth and income tax seeking to recoup the overall increase in the value of land and property.

A range of taxes already exist which imperfectly capture aspects of land and property value. Income tax, capital gains tax and corporation tax are capable of recouping the wealth generated by land. Council tax is closely associated with property value but the most direct measure is in fact Stamp Duty Land Tax (SDLT) which relates to both property and land over certain thresholds. This tax is payable by the buyer of land and so only applies when a transaction takes place. It is fair to say that, taken together, this regime is less than coherent and does not deal efficiently with the kinds of betterment value discussed below.

2. The garden city model
The capture of rising land and property values that results from the development of land for higher-value uses.

This capturing of development values and their mutualisation for the benefit of the community through control of leaseholds and rents was at the heart of the garden city conception of development deployed at Letchworth It is the distribution of values which is unique and mechanism of 'capturing the value' is through the direct control of the development process through a mutualised development company.

3. The Uthwatt/new town model
The direct taxation of betterment values accruing to landowners from the investment decisions or development consent of a public authority.

These two ideas are interdependent but have led to two distinct mechanisms for capturing betterment values:

a. The 1946 New Towns Act model: The 1946 model allowed a development corporation (DC) to purchase land at its current use value and to use the profits of the development process to finance infrastructure and pay debt. Values were derived by both forms of betterment described above and rested on the use or threat of compulsory purchase. The model proved highly successful until changes to the compensation code in 1959 introduced 'hope value' into the compensation formula, giving landowners a much greater share of the betterment. This is the model most discussed today and is at the heart the NEF/Shelter/Centre for Progressive Capitalism/ TfL policy proposals. (There are important graduations of this model, including John Walkers' work around SLICs, which rely on the power of a public authority to trade development certainty for landowners against deferred payments for land.) This form of land value capture is

popular and relates to other European models, being politically more acceptable by limiting the tax to particular kinds of development in particular places. The powers of DCs still exist but, despite some changes to the compensation code, the issue of hope value **has not been dealt with**, neither does this model have any capability to spatially redistribute resources[7].

b. The 1947 development charge model based on the recommendations of the Uthwatt Report. This model was a general development charge (with exceptions) designed to ensure both a fair distribution of development values and reduce land speculation. The method was to tax any increase in land values generated by the grant of permission at 100%. The money was collected centrally and distributed to support development by a central land board. The 1947 model could have been much more significant in overall income generation than the 1946 approach and was capable of having a redistributive effect.

4. The contemporary 'planning obligations' model

The final end of any form of national approach to betterment taxation came in the 1985 budget when the remaining elements of development charge were removed from the capital gains tax formula. There then followed an almost 20-year gap before Kate Barker's 2004 recommendations for a 'Planning Gain Supplement' reignited interest in explicit attempts to tax landowners at the point permission was granted. Barker articulated the same basic call for tax on the windfall of betterment values accruing to land owners[8]. After much debate and scrutiny this system was not introduced partly because it was perceived to remove local flexibility.

Instead an ad-hoc system of legal agreements has evolved around Section 106 agreements. These agreements are contracts between the developer and the LPA, and can involve lengthy negotiations and provide highly variable yields to localities[9]. You simply get much less 'planning gain' in low demand areas. Section 106 agreements, which can include in-kind provision of affordable homes, are generally related to development costs rather than values and can be viewed as charges or 'impact fees' rather than taxes. The costs accrue to developers rather than landowners. Section 106 agreements are, therefore, in principle, regressive taxation mechanisms and are inefficient in terms of capturing betterment because they tax development values rather than land values. Section 106 agreements survived the introduction of CIL with some restrictions, and crucially they appear to yield much greater levels of direct and in-kind benefit, particularly in relation to 'affordable' housing provision. In 2011/12 the total value of 106 agreements in England was estimated to be £3.7 billion, a reduction from £4.80 billion in 2007/08[10]. The increasing dominance of the NPPF viability test along with the power to renegotiate affordable homes may have reduced this figure.

Widespread concern about the lack of transparency of Section 106 agreements for the public and the transaction costs for the private sector led to the development of a more codified-impact-fee approach in the CIL regime introduced in 2008. Again, the stated logic of CIL was not to tax betterment but to provide funds for infrastructure costs that resulted from the impacts of new development.

The CIL regime was comprehensively reviewed in late 2016 by a review group led by Liz Peace[11]— and two headlines seem particularly relevant to the Raynsford Review. First, by October 2016 only 130 LPAs had CIL charging regimes, and these were focused in high-

[7] In theory LPAs could still act as master developers on land they have allocated in their development plan. Disregard for the scheme applies to such allocations but the issue of hope value would still apply.

[8] Barker,2004 p.7)

[9] See Crook et al (2016), page 185, Table 7.1

[10] DCLG, (2014), Section 106 Planning Obligations in England, 2011-12. Report of study

[11] The CIL Review Group, (2016), A new approach to Developer Contributions.

demand areas. Many low-demand places have no scheme and no intention of applying one. Second, the amount generated by CIL was much lower than anticipated, with an expectation that it might yield between £470 and £680 million p.a., whereas by March 2015 it had yielded £170 million. The estimate of the contribution of CiL to local infrastructure is between 5% and 20%[12] of the total cost.

This picture reinforces two significant points:

1. The current method of recouping development values relies on the voluntary implementation of CIL and the ad hoc use of Section 106. Both are regressive taxation measures.
2. The approach does not cover the cost of the majority of infrastructure investment and must be provided by public sector[13]. Given that house building is also subject to very significant public subsidy, it is interesting to reflect on the wider question of fairness between taxpayers and those who profit from betterment values.

Both Section 106 and CIL charging schemes must be set in the policy context of the NPPF viability test, which preserves the expectation of high developer profit margins. The CIL review group recommended changes to CIL and Section 106 regimes to reduce complexity and distinguish between a low-level flat rate charge and bespoke measures for larger sites. The team was not given the brief to go beyond the impact fee regime nor to consider the regressive nature of the system.

For completeness, it is also important to note that some commentators have argued that the simplest and most direct method of capturing development values is to set ambitious policy in local plans for a range of public goods. These requirements will have the effect of driving down land prices in the way described above. This is a powerful proposition but questions remain about how it might operate in the context of viability testing and in the ongoing conversation about legal weighing of the development plan.

Trying to summarise our current approach to land value capture is not easy. A range of taxes and charges relate to development values falling at different stages of the process and on differing players. We no longer apply the second and third taxation models set out above, so in practice we have a combination of general taxation measures which relate to land values but do not focus specifically on betterment, and on impact fees which, while both inefficient and regressive, do yield substantial sums. However, the framework does not appear to yield enough return to cover the costs generated by development in terms of wider infrastructure. This contributes to one the strongest criticisms of the planning system: that it can’t drive effective delivery by unlocking sites, which need upfront infrastructure investment. All of this suggests a failure to effectively balance the needs of society and taxpayers with the needs of landowners. **The prize amongst all this detail rests in aligning a betterment tax regime and planning regulation to enhance the delivery of high-quality outcomes.**

Implementations issues past and present

While in principle land value capture is fair and logical, there have been a set of important implementation issues. The Review team is examining international examples which demonstrate the practicality of differing approaches, but there are also three dominant lessons from past attempts to introduce specific betterment taxation:

1. The rate of betterment taxation.

Historically betterment taxation rates were based on the laudable principle that all the value created by the state should be recouped by it. Experience after the 1947 Planning Act illustrated that such a 100 per cent levy effectively killed off the speculative market in land, reducing supply

[12]The CIL review team (2016) A New Approach to Developer Contributions

[13] CIL is also subject to wider ranging exemptions and reliefs

to a very low level. One might argue that in an era when it was assumed that most development would be delivered by the public sector this was not a problem. The repeal of betterment taxation in the 1950s led to a resurgence of private sector development and it is clear that a future betterment tax would have to be set at a socially acceptable level. This figure would need take account of the fact that the private sector is already paying considerable and complex informal taxes through planning gain deals.

2. A lack of cross-party consensus
The reintroduction of betterment tax in the 1960s and again in the mid-1970s under several Labour administrations failed largely because the opposition made clear that they intended to repeal the legislation if they came to power. Landowners therefore horded land in the hope of receiving the full value later. In the future, it would be vital to have a consensual approach to setting taxation rates at levels which do not destroy the land market.

3. Estimating land values
Any betterment taxation system is founded on the ability to achieve accurate assessments of land values in particular localities and, potentially, for differing development sectors. Calculating land values is complex[14] but is already being achieved for commercial and taxation reasons which reflect regional variations.

The relationship between taxation regimes and the status of development plans

There is very useful literature[15] on the international approaches to land tax, but this commentary notes the difficulty of transposing approaches, which are often based on zonal planning systems, into the discretionary English system. Taking forward the German system, where land values are frozen at current use value when allocated in plans, would be more problematic for an English system where the plan has a lesser status in final decisions. The point here is that there is an interesting and potentially positive benefit from strengthening the status of the local plan in terms to the certainty it might bring to new forms of betterment taxation.

The case for modern Betterment Taxation

Recouping a public asset
The inter-relationship of the property development market and the land-use planning system as well as direct public investment in infrastructure creates a substantial and unrecouped public asset. This betterment asset should, as a matter of principle, be used prudently for the public good in ways which support public interest objectives. This is principally an issue of equity, but the use of such an asset for infrastructure has obvious benefits for the wider economy and society. Conversely, giving away betterment values to landowners drives a highly speculative land market which can reward inactivity and contributes to the adversarial culture of the current system.

The social policy benefits of betterment tax
Betterment taxation could influence the consumption of sites to achieve an environmentally and socially more benign land-use pattern by imposing graduated tax rates by, for example, zero-rating social rent or using brownfield sites. This graduation would need to address the spatial variations in the strength of the property market; differences in the different elements of property development, for example between office and industrial development; and finally would need to be hypothecated so revenues were applied in a way to facilitate the regeneration of urban areas or mitigate environmental harm. The need to set betterment at a politically acceptable rate may also limit its effectiveness.

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[14] Crook et al (2016)

[15] Ibid and see Faulk (TCP 2016)

Reducing market volatility
Some commentators have argued that betterment taxation may lead to a slight reduction in the cyclical nature of the property development market. Such a tax is likely to suppress volatility to some degree by decreasing the elasticity of supply of land.

The case against a betterment tax

A betterment tax would impact on competitiveness. The degree of this impact is dependent on the rate at which it was established and how far graduation measures conflicted with market behaviour. It would also depend on where the tax burden fell. For example, if costs fell on land ownership interests rather than the built development industry, the effect on competitiveness would be reduced. The tax would need to overcome the very significant problem of establishing and collecting the true development value for each project, a process likely to create additional administrative burdens on the development industry. It should be noted, however, that considerable complexity and inefficiency already exists in the current system of planning obligations particularly with regard to the valuation of proposed developments.

Where next for betterment taxation?

The Review team may wish to consider three principal land taxation approaches:

1. Impact fees which deal with specific consequences of developments.
2. Extension of existing general taxation instruments such as Stamp Duty or Capital Gains tax to capture betterment.
3. Betterment taxation both through a general charge and through the action of public authorities buying land at current use value.

The objectives of a new regime

Development taxation could have five principal objectives:

1. Provide a way of mitigating the direct impact of development on infrastructure or the environment.
2. Recoup the betterment values created by the grant of planning permission or other investment by the state.
3. Encourage the objectives of sustainable development by reinforcing a set of ‘good’ behaviors such as support for the plan-led approach.
4. Be defined by progressive taxation principles requiring a redistribution of resources to support investment in regeneration.
5. Retain public legitimacy by being transparent.

The components of new system?

Developing a new betterment tax regime requires more detailed analysis but if we assume a system must be progressive; efficient in focusing tax directly on those who accrue betterment (i.e. landowners); and retain some form of local flexibility, the system might have three components:

1. A flat-rate betterment charge levied on land owners at the point of planning consent and based on a modest proportion of the increase in value between current use and consented use. This is crudely the reimagining of the ‘Planning Gain Supplement’ proposed by Barker. Exemptions would apply to a wider range of minor domestic and commercial development. The revenue would be collected locally by LPAs and hypothecated for a broad range of development activities. A national infrastructure contribution would be paid by LPAs to Treasury to generate a fund to support investment and growth in areas in need of regeneration.
2. The continued ability for developers and LPAs to enter into Section 106 agreements on large sites where there were specific mutual benefits.
3. The greater use of development corporations to deliver large sites based on their ability to buy or CPO land without the application of speculative hope values. Instead landowner

should be paid a flat rate of compensation based on CUV plus a percentage of consented use value. (Extending this approach to land allocated in development plans also has significant potential). This implies the abolition of CIL and changes to the compensation code. It would not restrict public authorities from adopting area based betterment system for new infrastructure although such systems, such as being considered for transport investment, would have to avoid double counting the betterment impacts and creating unfair tax regimes.

Questions for debate

While the introduction of a betterment tax will not be easy, its desirability must be seen in the light of current policy. The current system of planning obligations yields real benefits but also causes major drawbacks, notably their regressive nature in terms of the spatial distribution of gains; their procedural complexity; their inefficiency in meeting the costs of infrastructure; and finally the public perception of such obligations lacking transparency and accountability. Part of these problems derive from a regime, which makes a charge on overall development values rather than land values. Estimating the former is more complex than dealing with land as witnessed by the endless arguments over viability testing.

The introduction of betterment taxation would provide a mechanism for resolving much of the complexity of the current system providing certainty to the development sector (assuming rates were not draconian) and transparency to the general public. Betterment taxation would, in principle, be equitable, allowing distribution of revenues on the basis of need rather than market circumstance. A graduated betterment tax could reinforce the achievement of socially inclusive place making. But betterment taxation alone would remove the aspect of local flexibility and direct hypothecation that is currently enshrined in the planning obligations system. The question is how to strike the right balance between these competing objectives.

- What is the primary objective of betterment taxation?
- How can such a system meet the tests of an efficient, progressive and legitimate regime?
- How far must local flexibility be preserved in any new system?
- Can any new taxation system be graduated to support wide policy objectives?
- What rate should a betterment tax/charge be levied?
- What is the realistic prospect of changes to the compensation code?
- Would enhancing the status of the development plan help in framing new approaches to betterment taxation?

Further information and contact

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