

## Land Value Capture

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### Summary

#### Introduction

S1 Land value capture has no technical or legal meaning. For present purposes it can be described as:

*Mechanisms for transferring from landowners to public authorities or others the wealth created by the development of their land or of other land*

S2 It is essential to start with asking what might be the reasons for land value capture and whether and why it should be used. That then leads on to the mechanisms available in the field and the extent to which they can be changed successfully.

#### 2. Why have land value capture?

S3 The rationales for land value capture can fall under the following headings:

- Meeting the external costs of development, such as road improvements, additional health and education facilities, and affordable housing
- Recovering betterment due to public spending on infrastructure
- Recovering betterment due to a policy change or planning approval
- Transferring value to public authorities, which is the general reason for taxation
- Reducing house prices, by reducing landowners' returns

#### 3. Mechanisms

S4 The external costs arising from a development project and affordable housing have been recovered by planning obligations and agreements. Whether a planning obligation is necessary and so can be sought is not affected by the land values of the project or its overall viability. Viability becomes relevant as a means of reducing the scale of any planning obligations on the basis that the scheme cannot afford what would otherwise be required of it.

S5 Community Infrastructure Levy (CIL) is a charge on the carrying out of certain development for the purpose of supporting development by funding the provision, improvement, replacement, operation or maintenance of infrastructure. That takes up some matters which would have been covered by planning obligations and goes further, allowing contributions to infrastructure and impacts relating to development generally. CIL levied by the Mayor of London has been a major contributor to the Crossrail project.

S6 Direct charges for the recovery of costs are sometimes available.

S7 General taxation applies to the occupation and disposal of land. An increase in the value of land is a chargeable gain on disposal and is subject to capital gains tax (for individuals and certain overseas companies) and corporation tax (for companies). Property sales are also subject to transaction taxes (formerly Stamp Duty). The occupiers of properties are charged business rates or Council Tax. Subject to the frequency of revaluations, receipts from all of these taxes increase with rising property prices. A supplementary business rate can be levied for particular projects.

#### 4. The Compensation code

- S8 The basic principle in compulsory purchase compensation is that of equivalence: that the dispossessed owner or occupier should be put in the financial position that they would have been in if it was not for the compulsory acquisition.
- S9 Compensation for land acquired falls under three main heads:
- The market value of the land
  - Loss payments
  - Disturbance (essentially loss of profit and expenses)
- S10 The market value is assessed on what the land would have sold for in the open market. This value may derive from the existing use and condition of the land, referred to as existing use value (or EUV). Value may also derive from the price that the market would put on the potential for further development to take place, often referred to as hope value.
- S11 All valuations omit the effect of the scheme for which the authority acquires the land, or the prospect of that scheme. Schemes which are specifically disregarded include new towns, urban development areas and mayoral development areas.
- S12 Loss payments are also made, shared between the owner and occupier at a combined total of 10% of the value of the land but limited to various maximum levels, the highest being £100,000 for each claimant.
- S13 Disturbance is compensation for losses caused by the compulsory acquisition which are not otherwise part of the value of the land. These will include the costs of selling the land, including professional fees and losses reflecting the time spent in the process. Relocation costs are also included. Commercial claimants will recover the loss from extinguishing the business (in whole or in part) or any loss of profit due to the move.

##### **5. Planning and compensation – a brief history**

- S14 Legislation has grappled with the financial harms and benefits of planning since 1909. The Town and Country Planning Act 1947 Act contained three principal, and heavily related, financial provisions:
- A development charge, levied on the increase in the value of land due to the grant of planning permission. This was set at 100% of the uplift;
  - Compensation for the removal of rights to develop, but limited to a national fund of £300 million and the overall effect was that full compensation was not paid for the removal of the right to develop;
  - Restricting land value for compulsory purchase purposes to existing use value.
- S15 The development charge had acted as a break on sites coming forward. It was abolished and payment of the £300 million fund suspended by the Town and Country Planning Act 1953.
- S16 Abolishing the development charge restored the landowners' incentive to develop. It also led to what was referred to as 'the two-price system'. Sales to public authorities under the threat of compulsory purchase were conducted on a compensation code basis, close to existing use values, whilst sales in the private market took into account the development potential of the land. There was a political consensus that there had to be a reversion of compensation to market value in 1958. Additionally the Franks Committee considered that there would be 'far fewer' objections to compulsory purchase if compensation was based on market value.
- S17 The first ten new towns were able to take advantage of the restricted compensation regime between 1947 and 1958. However the 11 other new towns, including Milton Keynes, were

only designated between 1961 and 1970. Land for the later towns was assembled at market values but assuming that the new town proposals were not taking place.

#### **6. Can reducing compulsory purchase compensation promote more housing development?**

- S18 A feature of recent debate about land value capture have been suggestions to change the basis of compulsory purchase compensation from market value to existing use value or a multiple of it.
- S19 However the present system of valuing the land without the scheme does prevent values being inflated by major public schemes as the experiences of Milton Keynes and the Olympics show. It is unclear how far compulsory acquisition costs as a whole will be reduced, although there would be some large individual falls.
- S20 A reduction in compulsory purchase compensation will not affect land values in private deals where there is no threat of compulsory acquisition which will still reflect any potential for development. That is why the two price system emerged in the 1950s and the restriction on compulsory purchase compensation to less than market value proved to be unsustainable. Any change to the compensation code will have no wider effect on land values or land value capture.
- S21 Some proponents of restricting compensation to existing use value (or similar) have claimed that there are substantial sums that could be secured as a result. That fails to appreciate that compensation changes will not affect the private market, but the 'land value not captured' figure appears to be a very considerable overestimate:
- The value of land with residential planning permission is significantly overestimated as it assumes the easiest sites, for example, without land take for infrastructure or open space;
  - The existing use value taken for previously developed land is for vacant land with planning permission for industrial uses. Many sites will be in existing commercial uses (with occupants to displace) or residential use. The 'existing' value is understated;
  - The contributions from planning obligations and Community Infrastructure Levy are understated. Commitments are currently estimated by central government at £6 billion;
  - It omits the need for an incentive for the landowner to sell.

#### **7. Fairness and Human Rights**

- S22 Restricting compensation to less than market value raises some pretty stark issues of fairness. Market value is after all what something is worth because it is what someone would pay for it. This may include the land's potential for development in accordance with the public interest. The land may have been bought with that potential in mind. A dispossessed owner could therefore be facing a cash loss because of the reduction in the right to compensation. The first question is whether the individual should suffer that loss.
- S23 Secondly a two price system would develop again, with private market transactions reflecting the potential for development whilst deals under the threat of compulsory purchase were depressed. That was recognised across the political spectrum in the 1950s as being unfair.
- S24 Under the European Convention on Human Rights caselaw an amount an amount reasonably related to the land's value must be paid in compensation. Legislation which limited compensation to existing use value (or EUV plus some increment) might be lawful (without expressing a firm conclusion either way) however it would have to be exercised in

accordance with the Convention. A particularly large shortfall between market value and existing use value in a particular case might give rise to a breach. In such situations the compensation would have to be somewhere between EUV and market value to comply with the Human Rights Act.

## **8. Planning Obligations**

- S25 The need for planning obligations is decided not on the basis of land value but on the impacts of the scheme which need to be addressed. Land value only becomes a factor in ensuring that the affordable housing target in policy is realistic and at the development management stage in reducing the level of contributions. The use of viability assessments to cut contributions has caused concern, some of which is well justified. Secrecy about the contents of such assessments has to end. There is also a risk that the costs of acquiring land which are used in viability assessment assume that the scheme will not provide the full contributions. That drives up the land price, meaning that the scheme has less money available. Essentially, an assumption that non-policy compliant development will be allowed becomes self-fulfilling.
- S26 Considering the price that has to be paid for an owner to sell up when it was not otherwise proposing to dispose of the land is a part of the exercise. This Existing Use Value plus approach is one factor in the process. Even judged objectively, rather than by the attitude of a particular landowner, the incentive required will vary and is not simply a fixed percentage of EUV. It may be a necessary corrective to comparable sites which appear not to be policy compliant, but cannot be an arbitrary exercise in picking a price for a landowner.

## **9. Levies and taxes**

- S27 Keeping levies and taxes simple, rational and realistic is essential to making them work and ensuring public acceptability. Whether the Community Infrastructure Levy is able to overcome its inherent complexities remains to be seen. The Liz Peace recommendations do at least push in the right direction. Contributions from existing developments are in practice available to be recovered by an incremental process of rates and council tax, revaluation and the taxation of capital gains.

*This paper is based the Compulsory Purchase Association's Annual Law Reform Lecture, delivered by Richard Harwood on 26<sup>th</sup> April 2018.*

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June 2018