

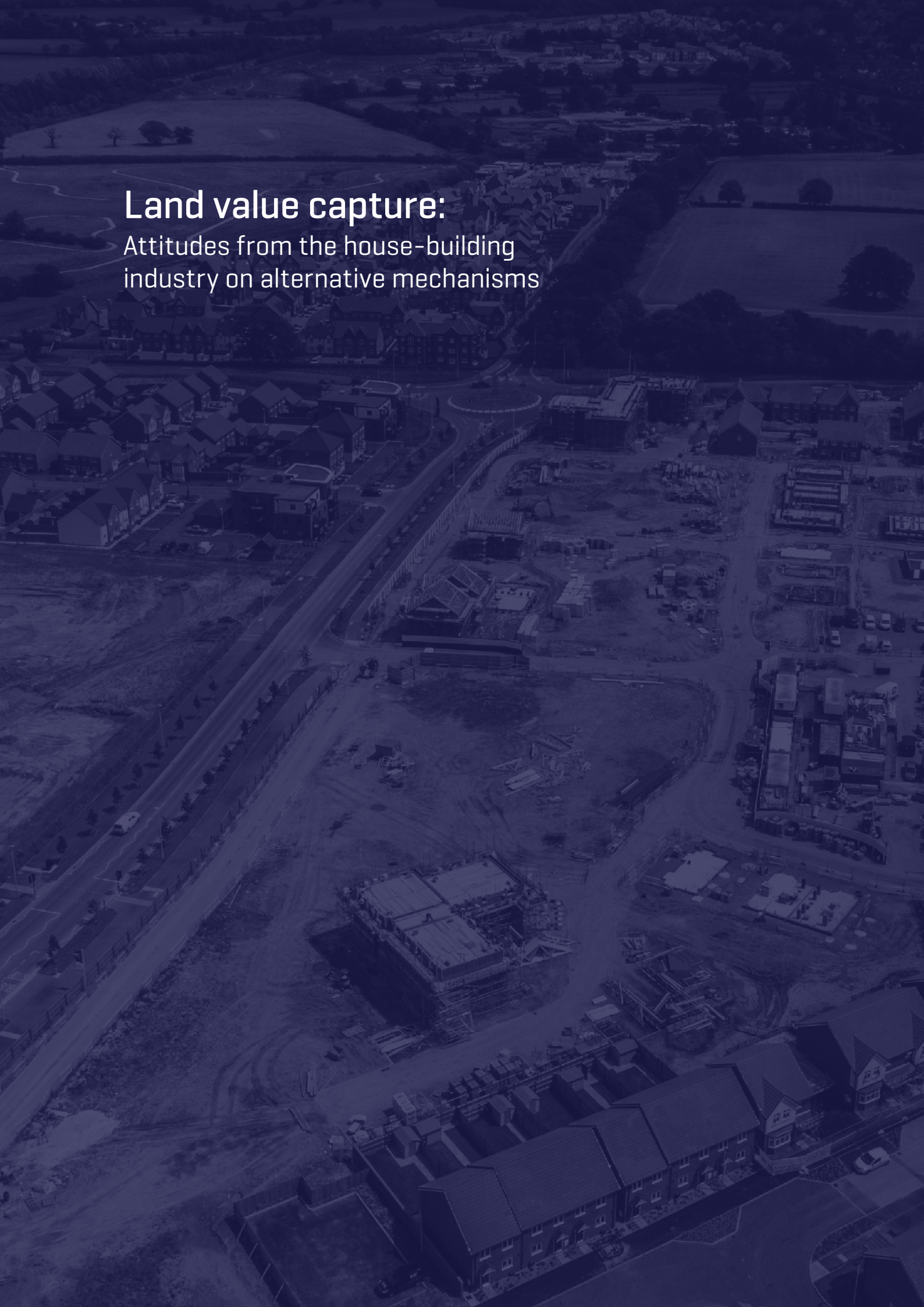


August 2020

Land value capture:

Attitudes from the house-building industry on alternative mechanisms



An aerial photograph of a residential development. The image shows a mix of completed houses and several large construction sites. A road with a median runs diagonally across the middle. The overall scene is in shades of blue and grey, with the text overlaid in white.

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Executive summary



Over the last five years the house-building industry has built an average of 140,000 new dwellings per annum in England (Ministry of Housing, Communities and Local Government (MHCLG), 2020); National House-Building Council (NHBC), 2020). It has also contributed an estimated £4 billion per annum in developer contributions (estimate based on Lord et al., 2019) as well as other contributions to public finances through taxes, such as capital gains tax (CGT) and corporation tax. However, there is interest from across the political spectrum (e.g. Peace, 2017; Department for Communities and Local Government, 2017) and media in reviewing the contribution that house building is making to public finances and infrastructure, leading to calls for new mechanisms of land value capture (LVC).

This research responds to the need to understand the impacts that alternative mechanisms of LVC might have on the geography and scale of residential development. The authors explored attitudes towards existing taxation, planning obligations and the community infrastructure levy (CIL) with 20 house-building industry practitioners from England and Scotland. These interviewees represented some of the largest house builders, surveyors, planning consultants, landowners, and land promoters in England and Scotland. The findings were triangulated by means of a roundtable discussion with house-building sector representatives.

The research primarily explored four alternative LVC mechanisms:

1. The current situation of negotiated planning obligations (e.g. s106) combined with the CIL.
2. A fixed flat tariff based on local infrastructure requirements (per unit/square foot) regardless of scheme impact.
3. A fixed flat tariff based on expenditure to mitigate the scheme.
4. Negotiated fee based on local infrastructure requirements.

Through this research the authors show that the housing development industry comprises a highly diverse array of actors with discrete attitudes and corresponding behaviour towards LVC in housing markets. Although the industry is routinely discussed as a single entity, there needs to be greater clarity on the different roles played by landowners, land promoters and house builders in delivering housing and paying for LVC. Accordingly, anyone considering changes to LVC mechanisms needs to be aware of the short-term behavioural consequences that would affect the different types of actor involved (including landowners withdrawing land from the market), and the longer-term impacts of adaptation.

Some house-building actors expressed an ability to respond to major changes in the operation of LVC, for example, through local authorities taking an active role in land assembly by way of compulsory purchase, the creation of infrastructure and the auction of serviced land. While interviewees welcomed discussions on alternative LVC mechanisms, they asked for clarity on the purpose and function of any changes to LVC mechanisms. The willingness of interviewees to consider both minor and major changes to LVC reveals a flexibility in the system, but also a desire for simplicity and clarity.

In summary, evidence from this research resulted in the following recommendations (discussed in more detail in the Recommendations section at the end of this study).

- a)** There is a moral obligation on the state to clarify the purpose of LVC mechanisms and on the development industry to clarify its contribution.
- b)** Local planning authorities need the right personnel, training and resources to implement locally determined LVC mechanisms.
- c)** Any changes to LVC mechanisms need to take into account the potential impact on the supply of land.
- d)** There is a need for further research to identify who bears the burden of existing and alternative LVC mechanisms (e.g. original landowner, new homeowner) and explore whether tensions between local flexibility of LVC mechanisms and clarity for developers could be eased.

These results provide a platform for further discussion regarding attitudes within the house-building industry towards alternative LVC mechanisms and the impact on development viability and the delivery of 'developer contribution'-funded infrastructure in England and Scotland.

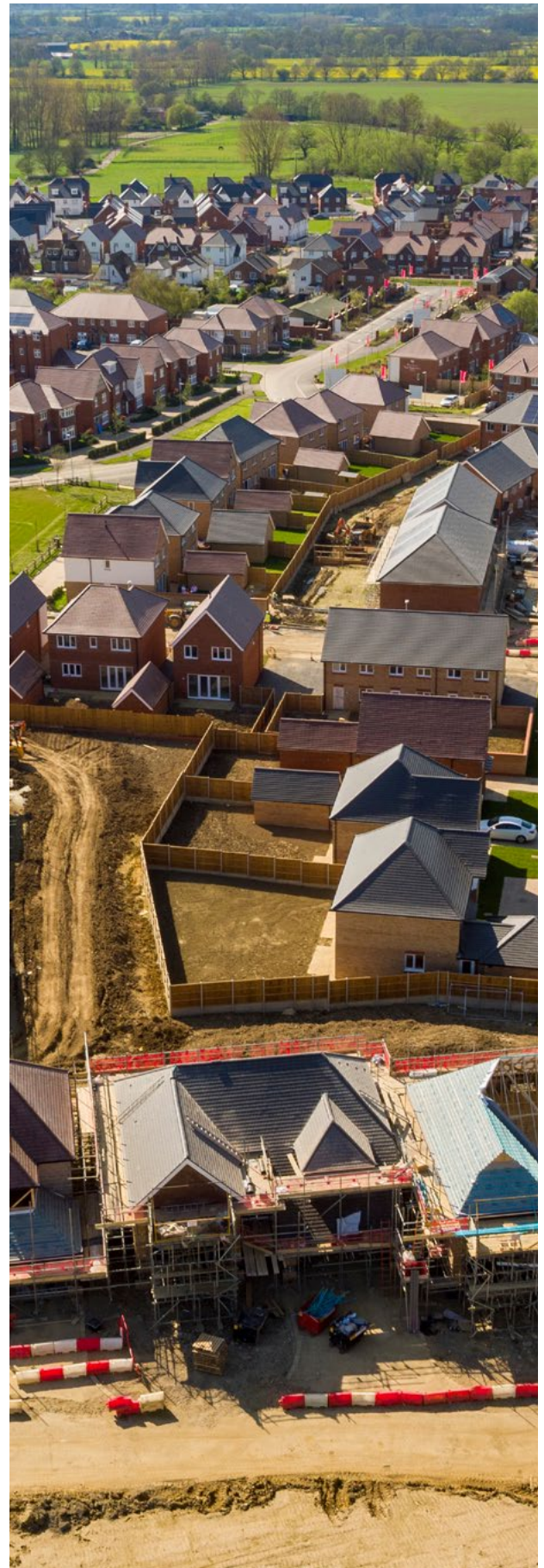


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1.0 Introduction

Current mechanisms to extract value from the development process for infrastructure delivery in England are proving contentious. Accordingly, there have been calls to amend the current structure of developer contributions from minor alterations to wholesale reform, such as property taxation and LVC. As one roundtable discussant who took part in this research stated, ‘the profit of developers proves that it is possible to tax them more’. This, however, raises several key questions.

- How should house builders be taxed?
- Is LVC the right option?
- Which type of LVC would be most effective?
- What would be the implications for the delivery of new housing if LVC changes?

These questions are not new, but they are imperative for the efficient and equitable operation of LVC.

‘The general premise that if the state creates value by declaring land developable, the state should be a beneficiary of that value, is unimpeachable. Knowing exactly what that value might be or when return of it to the state might take place is quite another matter ... How to arrive at land values is a fundamental issue that appears to confound everyone from real estate experts to government officials’ (Booth, 2012, p.89).

The Housing, Communities and Local Government Select Committee concluded in their 2018 Land value capture report, ‘there is scope for central and local government to claim a greater proportion of land value increases through reforms to existing taxes and charges, improvements to compulsory purchase powers, or through new mechanisms of land value capture.’ (House of Commons, 2018, p.47). The committee is not isolated in calling for change and party members from both sides of the House of Commons, think tanks and charities have expressed interest in land value reform. Additionally, these calls for reform are not from just recent governmental administration.

‘With some exceptions, developers in Britain contribute to the provision of public infrastructure through ad hoc, negotiated agreements, generally called ‘planning agreements’ or ‘Section 106 agreements’ after the relevant section of the Town and Country Planning Act, 1990. Dissatisfaction with the workings of planning agreements has led to proposals for reform’ (Goodchild, Booth and Henneberry, 1996, p.161)

The select committee report also states:

‘When considering new mechanisms for land value capture, it is vital that we learn the right lessons from the past...’ and ‘... without undermining incentives to sell or risk holding up the development process’ (House of Commons, 2018, p.47).

While there are interesting examples of LVC internationally, differences in political, economic and market contexts mean that caution is needed before these mechanisms are imported. Recent work on LVC has focused on the outcomes of existing mechanisms (e.g. s106 versus CIL), showing how the incidence and value has changed over time, but little is known about how potential changes to these mechanisms might affect the day-to-day business practices and strategies of residential developers.

It is important to note that this research focuses on residential development rather than commercial development. This is because residential development is the largest contributor to developer contributions in England (Lord et al., 2018).

How much of the uplift in land values created through granting planning permission is ‘captured’ in the UK is unknown. While there are estimates of the total value for planning obligations and CIL in England (around £6 billion in 2016/17) there are few reliable estimates of the average proportion of uplift captured per development. Evidence supplied to the Housing, Communities and Local Government Select Committee when considering LVC found widely variable estimates in the proportion of uplift captured per development, from 25% to well above 50%. It was also noted that market conditions and whether the site is greenfield or brownfield will both have a major impact on the change in land values and the extent to which LVC is possible.

Part of the reason for this limit in knowledge is the complexity in determining when land values change and agreeing practicable methods to value those changes. There are clear guidelines on how to value land in specific circumstances, such as the formal valuation for lending purposes prior to a loan and at regular intervals during the loan’s life. However, development activity and land values change between these specific points in time.

Despite the significant role that landowners, developers, planners or land agents play in constructing and reflecting the prevailing mechanisms for LVC as part of the development process, their attitudes and behaviours are not well documented. The behaviour of private businesses and government planning professionals is often considered as a barrier to the efficient extraction of value, as opposed to an enabler and creator of market value that enables public value to be captured (Adams and Watkins, 2014; Payne, 2013; Lord and O’Brien, 2017).

Landowners and house builders have at times been accused of preventing planning and public value objectives. For example, in the UK it has been argued that residential developers currently negotiate away public contributions when agreeing s106 obligations with local planning authorities (Shelter, 2017) and regularly opposed

new forms of LVC (Crook, 2016). Yet, in many countries, existing LVC mechanisms are being reviewed in terms of alternative options. For example, the UK the government is reconsidering the CIL (Peace et al., 2016).

Therefore, understanding the roles that private and public actors play in constructing effective LVC mechanisms in existing market contexts and the potential fluidity of their behaviour in light of new policies, is of great policy significance internationally. Understanding who pays for LVC and at what point it is extracted from the development process would enable a more efficient mechanisms of LVC to be designed.

The introduction or extension of an existing LVC mechanism occurs at a specific time in the legal, economic and political history of the land in context. This context ensures that perceptions of the mechanism and institutional norms of taxation influence the impact that alternative mechanisms have on land and real estate markets and tax receipts. For example, Goodfellow (2017) found that both the cultural attitudes towards taxation and the behaviour of officials and landowners influenced the impact of LVC in Africa. Therefore, policy and theoretical contributions require consideration of institutional frameworks to enable successful comparative research and evaluation of the potential efficacy of alternative LVC mechanisms.

To understand contemporary attitudes concerning LVC from across the housing development industry in the UK, the authors adopted an experimental research method.

Through interviews with landowners, land promoters, house builders, as well as surveying and planning consultants, this research explored the motivations, attitudes and behaviours of actors concerning the current LVC mechanisms and any potential alternatives.

To identify appropriate LVC mechanisms, the authors explored both current practice in England and Scotland, and alternative LVC mechanisms outside England and Scotland. The remit was to explore the extent of variation before identifying scenarios for the research technique that would be plausible in the short term, but would also test the feasibility of alternative LVC mechanisms.

The mechanisms identified in this report are to some extent a less significant departure from the current situation in England and Scotland than some of the alternatives considered by the MHCLG select committee. This is a deliberate choice: to secure cooperation and interest from house-building industry actors and to achieve a comprehensive understanding of current attitudes.

The following section discusses the history of LVC in England before turning attention to international mechanisms. This approach identifies key variations in LVC mechanisms. These alternative mechanisms are then used in interviews with landowners and property developers to test the impact on residual valuations, and to illicit views on the potential impact of development practices and strategies.



2.0 Theory of LVC



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This section provides an overview of the definition of LVC, the historic precedents and arguments for LVC in England and international examples of alternative mechanisms. The relationship between public taxation and property rights is a well-worn subject and a detailed treatment is beyond the scope of this report. The authors of the report agreed with the roundtable discussant who said: ‘economists almost all agree that there is a moral argument for the taxation of land’, which in part is because taxing land is economically efficient (Mirrlees et al., 2011).

The authors have worked from the premise that, as another roundtable participant stated, ‘the houses that we build benefit the public, but responsible developers recognise that they play a role in meeting wider planning and public benefits’. LVC is only one component of the housing development process that benefits society. However, it should also be noted that one roundtable participant clearly articulated the counter argument that there is no intrinsic moral right to the taxation of private property rights.

This section explains what LVC is, how it has operated historically and the range of mechanisms in practice both in the UK and internationally.

2.1 Defining LVC

The recent resurgence in interest of LVC has highlighted the very different types of mechanisms being applied. As an example, contrast Shelter’s call for compulsory purchase orders to be used without compensating the landowner for hope value (Shelter, 2017) and Transport for London’s ideas to monetise the uplift in land value arising from their public infrastructure investment (Transport for London, 2017).

LVC is a ‘generic term with a variety of meanings’ (Alterman, 2012, p.6) and the definitions of terms relating to LVC are often used interchangeably, and can be contradictory (Crook, 2016).

The Scottish Land Commission argues that LVC ‘is a concept rather than a specific policy proposal and as such can mean different things to different people’ (Scottish Land Commission, no date. p.2).

Use of the term LVC may, therefore, include many alternative mechanisms with varying impacts on the housing development industry and the scale of the land value captured.

In order to define LVC, the precise components of value need to be determined. Hong and Brubaker (2010, cited in Ingram and Hong, 2012) identify five key factors that determine land value, which provides a framework to analyse the concept of LVC:

1. public investment in infrastructure
2. changes in land-use regulation
3. population growth and economic development
4. private investment
5. original use of land.

Ingram and Hong's (2012) argument is weighted towards private rather than public land rights and therefore argue that there is little interest in the public attempting to capture the value uplift arising from factors four and five (listed above) for ethical reasons. This leaves three causes of changes to land values, which resonates with Crook, Henneberry and Whitehead's (2016) definition of 'betterment' (a term frequently used to describe land value uplift):

'Increases in the value of a parcel land that may arise from many factors including:

- (a) *the impact of public investment, such as transport, which increases accessibility, thus raising demand for that parcel and hence increase its market value*
- (b) *the impact of granting planning permission for development, including change of use, which in itself increases market value by allocating development rights*
- (c) *the impact of overall economic performance of the nation and of specific locations which is reflected in higher land values'*

(Crook, Henneberry and Whitehead, 2016, p.16)

This link between land value uplift and betterment is consistent with the influential Uthwatt report's 1942 definition of betterment as:

'any increase in the value of land (including the buildings thereon) arising from central or local government action, whether positive, e.g. by the execution of public works or improvements, or negative, e.g., by the imposition of restrictions on other land.' (Uthwatt, 1942)

However, the link with overall economic performance is lost in this definition, something which is missing in many definitions of land value uplift or attempts at capturing a proportion of that value.

In defence of market-based approaches to understanding LVC and its impact on development, Whitehead (2016) argues that there are three distinct mechanisms for LVC:

- national taxation of housing development
- the purchase of land at existing use value, with infrastructure and planning permission, followed by a sale on the open market
- planning obligations (either financial or in-kind) required at the point of planning permission.

This research is largely limited to LVC mechanisms that occur through the development process, widely considered as 'planning gain' in England and Scotland (primarily public investment in infrastructure and changes in land-use regulations, from Hong and Brubaker's factors that determine land value, referred to earlier).

Other forms of taxation, such as CGT and stamp duty, may also impact the price of land and are therefore a form of LVC, although there is only limited evidence for this. It is interesting that many interviewees willingly broadened the scope of the interviews beyond the four key LVC mechanisms (see page 14) discussed in this report to other, more divergent LVC mechanisms, such as national land taxation and infrastructure and planning permission sales. Given the focus on value uplift through development it is necessary to consider the definition of development value. Tony Crook defines development value in the following quote.

'Development value arises when development (which can include just a change of use as well as physical development) takes place, thereby increasing the income by more than any extra costs so that the residual value rises. Development value is the difference between the value of the land in its current use and its value after development, most often in the public imagination conceptualised as the difference between the value of land in farming use and its value following housing development' (Crook, 2016, p.39-40).



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2.2 LVC mechanisms in the UK

The All Party Parliamentary Group (APPG) on LVC states that 'Land value capture is already an integral part of the UK's taxation framework' (APPG, 2018, p.1), although frequently LVC is considered as something that is yet to be introduced to the UK.

LVC has a long history in the UK, with regular amendments and iterations. There are some indications that betterment taxation was practiced as early as the 15th century by Henry VI to capture the value of land from investment in flood defences (House of Commons, 2018), and some review of attempts at land value capture in the 17th century, but the notion that LVC is recognisable prior to the 19th century in anything near its contemporary form remains contested (Uthwatt, 1942, cited in Hagman, 1977).

The concept of LVC was, however, clearly evident in the UK in the mid-19th century and had exerted enough political pressure to be enacted in the 1909 Housing, Town Planning, etc., Act. The Act made provision (though capture was optional for local authorities) for capturing increases, and paying compensation for decreases, in land value from planning permissions.

'There were objections to 100 percent recapture. The argument was as follows. Previous betterment recaptured flowed from a particular government project. Betterment under a planning scheme may result from future indicated government expenditure, but it also results from non-governmental, market reactions to the scheme. Rather than limit recapture to increases in land value caused by government expenditure, and purely as a compromise, the increase recaptured was limited to 50 percent.' (Hagman, 1977, p.30)

The Act was amended in 1932, to permit local authorities to claim up to 75% of the increase in value within one year of the development. Part of the justification for the increase was that valuations were, supposedly, already below actual value (Hagman, 1977).

1947 was a watershed year for LVC in the UK, as the nationalisation of development rights (requiring landowners to have permission from the state to develop) meant that the state was directly responsible for a change in the value of land (with or without permission). Since 1947, there have been a number of different attempts at capturing a proportion of this change in value. Crook et al. (2016) provides the most comprehensive description of the history of the second half of the 20th century. In short, between the mid-1940s to the extension of planning obligations in the 1990 Town and Country Planning Act, there were four attempts at LVC:

- the 1947 Development Charge Act (following the Uthwatt report, 1942), which was scrapped in the 1950s
- the 1967 Betterment Levy, which was set at a lower rate than the 1947 charge to limit land withholding, but was repealed in 1970
- the introduction of development gains tax in 1974, replaced by the 1976 Development Land Tax Act and
- the 1975 Community Land Act, which (like the 1976 development land tax) set a low initial rate and gave local planning authorities the power to act as a land bank, controlling all developable land.

The post-war new town development corporations may also be considered as a form of LVC. The corporations absorbed both the risk of development and the rewards through direct profit from the development and sale of housing and commercial property. Walker (2016) has argued for an extension of value capture through local authorities absorbing the development risk associated with planning permission.

Planning obligations (for example, S106) may be considered as a 'planning gain' in terms of LVC. Because planning permission has been granted, there is an increase in the potential value achievable from the land and, therefore, it is possible to tax this increase. From 1990 this was an increasingly popular (and valuable) resource for local authorities funding infrastructure (and can include affordable housing). The introduction of CIL and the downturn in development value has had an impact on the rationale and value of this form of LVC.



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2.3 International LVC mechanisms

While accounts of LVC regularly focus on the UK iterations of LVC, attempts have been made in many countries throughout Asia, Africa, South America and Europe to develop their own LVC.

'Betterment levies were used as early as 1921 in Colombia, with some legislation having its origins as early as 1562 in Portugal, 1607 in Mexico's colonial period and 1662 in London, England.' (Smolka and Amborski, 2000, cited in Walters, 2012, p.6)

2.3.1 Israel

A system was developed under the UK administration in the 1930s (and revised during the 1980s). It covered all land in Israel and operated through a 50% planning levy from the increase in land value on approval of a local or detailed development planning consent. A 25% property transaction applies at the point of sale for non-betterment levy taxed sales. This set a historic precedent, with complete geographic and high level of income, but is largely contingent upon a strong market and therefore there is significant variation in the amount of revenue received through this mechanism (Alterman, 2012).

2.3.2 Poland

After the collapse of communism in 1989, Poland instigated a betterment levy on value created from area planning. Although private property ownership is strong in Poland, the betterment levy was unworkable. Much of Poland does not have an area plan and planning permissions are decided on a case-by-case basis, which does not attract betterment tax. The variable tax rate was criticised for being spatially unjust – at the lower end the levy did not cover the administrative costs of collection. The tax operates at the point of sale, expires after five years, but does not operate effectively (Alterman, 2012).

2.3.3 Singapore

Home ownership in Singapore is derived from long-term leaseholds, which enables the government to accurately appraise the rental value. The annual value tax is based upon the estimated rent – regardless of vacancy. Landlords have full responsibility for repair, although there are some exceptions and a rebate is available for lower house values, and a surcharge is applicable for foreign ownership (Chi-Man Hui et al., 2004).

2.3.4 Hong Kong

LVC was used extensively to subsidise mass transportation. In this tightly developed city, where house prices have risen rapidly, all land is leased from the government. The Mass Transit Railway Corporation (MTRC) works with the city government, using LVC to fund construction.

Verougstraete and Zeng (2014) identify six stages in Hong Kong's LVC:

1. identifying new metro routes and possible development sites on the route
2. MTRC purchases 50-year development rights from the government at the existing use (or 'before rail') land premium
3. MTRC sells development rights to private developers
4. private developers take the construction and sale risks
5. the development rights agreement includes a profit-sharing mechanism (based on sale of residential properties and through MTRC retaining right for direct commercial lease) and
6. MTRC supervises construction standards and undertakes civil works.

2.3.5 Rwanda

The high rate of urbanisation in parts of Africa means it is easier to capture increases in land value, from agricultural land to land used for residential/commercial use. In Rwanda, land value is taxed (0.1%) and is based upon a self-assessed capital valuation relating to a self-declared freehold property. There is also a very low incidence of collection (Goodfellow, 2017).

2.3.6 Colombia

Betterment levies contribute up to 25% of local revenue (see Borrero et al., 2011). The levies are only applicable on specific infrastructure projects and relate to the benefits gained for each property impacted by the project (such as a reduction in travel times) and can only be a proportion of development costs. The public has the opportunity to vote on which projects to fund in this manner. This mechanism shows that there is a democratic mechanism to extract land value uplift arising from public infrastructure works. (Walters, 2012)

These international examples show the range of LVC mechanisms in operation. It is relatively common to use international examples when discussing LVC, without referring to institutional arrangements. As one roundtable discussant revealed 'international examples of best practice tend towards alternative land ownership models. Where local government CPOs [compulsory purchase orders] land or can buy it at agricultural values then LVC will be very different'.

The more recent (i.e. post-1990) examples of LVC in the UK are, therefore, quite different to many of the examples cited in internationally focussed literature. The authors have considered a select number of mechanisms that are proximate to the existing LVC mechanisms and arrangements of land ownership and planning policy prevailing in England and Scotland.

3.0 Methodology



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This project aims to understand the residential development industry's attitude towards the potential application of alternative LVC mechanisms across England and Scotland. The authors interviewed 20 professionals from across the house-building industry. The interview findings were presented to participants of a roundtable discussion, including 22 development industry participants, four observers from RICS and three academics.

3.1 Selection criteria

Interviews took place from late 2018 to early 2019. Interviewees were selected using a purposive sampling approach, initially focussing on the 75 largest house builders in England and Scotland (by number of units built in 2018) and the largest land promoters in England and Scotland (by number of units granted planning permission in 2018). Smaller house builders were contacted using a purposive sample based on recent development activity, identified through adverts for new-build properties available in North West England, the Midlands, South West England, South East England and Scotland. National planning and development consultants were also interviewed.

Purposive sampling is a widely utilised strategy in qualitative – rather than quantitative – research to achieve 'information rich' interviewee accounts (Patton, 2002). It is a non-probability approach that is predicated on the judgement of the research team in selecting participants that are suitable, with a high degree of knowledge on the subject in question (Cresswell and Plano Clark, 2011).

In this context the authors sought the views of different types of development industry representatives (by size, geography and type of activity, but not through a formal quantitative approach, which is not congruent with qualitative work of this type).

It is not the intention of this research to provide a statistically robust representation of the differences in the motivations, behaviour and attitudes of actors from across the residential development industry. The purpose of qualitative research is to explore the logic and stories of individuals and firms with regard to LVC mechanisms.

Interviewees were invited via email, which included an overview of the rationale for the research. Approximately 30% of invitations were accepted. Very few landowners responded to the invitation to be interviewed, and those that did were developer-landowners. Although interviewees responded to questions describing landowner behaviour, their views should be treated as secondary rather than accurately representing the views of landowners directly. All the interviewees had more than ten years' professional experience in the house-building industry. The majority of participants were members of a chartered professional body (e.g. RICS or the Royal Town Planning Institute). Nearly all interviewees undertook house-building-related activity in more than one region of England and Scotland, therefore they were aware of the different types of development (e.g. rural versus urban, stronger versus weaker markets). All participants had experience of LVC mechanisms in England and/or Scotland.

3.2 Interview process

The interviews were conducted either in person or by 'phone where it was not possible to arrange a face-to-face meeting. Four of the interviews included multiple participants, for example the CEO of a house builder and the lead negotiator, or strategic land buyer and planning lead. The interviews were all recorded and transcribed. All interview transcripts were analysed by two team members. The interviews lasted between 45 and 90 minutes. Quotes are used throughout this report to illustrate the interviewee's points. The authors do not provide a weighting for the responses as it is unclear what the key causal variable would be for each quote, that is representative of the industry view. The addition of region and industry types included in brackets after each quote are there to help the reader qualify and assess what is said.

The interviews covered:

- the interviewee's experience in the residential development industry
- their current work remit (i.e. what they do and where they are located)
- their perceptions of house building in the current market
- their experience with CIL and planning obligations
- their understanding of the current LVC scheme in England (and Scotland, where relevant) and
- their identification of the strengths and weaknesses of the current LVC scheme.

Interviewees were asked to consider three LVC mechanisms that differ from those presently used and to indicate which their preferred mechanism was for new residential development projects. The mechanisms are shown in Table 1 as options b–d; option a is the combination of mechanisms presently in use in England, while Scotland currently is situation a, but without CIL.

Table 1

LVC mechanisms available in hypothetical project scenario

Mechanism	Negotiation Required	Area covered by the mechanism
a) the current situation of negotiated planning obligations (i.e. s106) combined with the CIL in some local planning authorities	Yes	Scheme and local infrastructure
b) a fixed flat tariff based on local infrastructure requirements [per unit/m ²] based on scheme impact	No	Scheme
c) a fixed flat tariff based on local infrastructure requirements [per unit/m ²] regardless of scheme impact	No	Local infrastructure
d) negotiated fee based on local infrastructure requirements	Yes	Local infrastructure



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A component of the interviews was working through the potential impact of the alternative LVC mechanisms on a residual valuation of a hypothetical site. Research into LVC in England has routinely shown that there is a high degree of heterogeneity in land value uplift through the development process. There are also highly diverse approaches to capturing planning gain through the existing policy mechanisms of CIL and planning obligations. The purpose of the hypothetical residual valuation was to unearth how principles and broad attitudes might impact on land values and variables.

An important part of any hypothetical project scenario approach is the believability of the constructed scenarios around from which interviewees make choices (see Wernstedt et al., 2006). The interviewees need to find the scenario relevant and the scenario needs to contain enough detail for the interviewee to make a choice, but it should not contain so many specifics that it risks being viewed as inaccurate relative to the interviewee's own situation.

The roundtable discussion took place at the University of Liverpool's campus in London in January 2020. A total of 30 participants were invited to attend the discussion, combining invitations from the RICS and from the research team. Invited participants were selected on the basis of private interests in the development industry and the role of LVC, although some participants' clients are both

public and private. Invited participants included landowner representative groups, house builder representative groups, planning and surveying consultancies and RICS chartered valuers. Of the 30 invited 22 industry representatives attended the discussion, in which anonymous quotes and key comments were recorded. The research team presented the results of the interviews before asking questions on four key themes: the moral argument for LVC; identifying who ultimately pays for LVC; how LVC is included in the valuation of land; and the degree of consensus regarding which LVC mechanisms are appropriate to delivery LVC and house building. After these directed questions each participant was given the opportunity to share concluding thoughts. The roundtable discussion therefore acts to triangulate and corroborate the interview process in line with best practice in qualitative research.



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Box 1**Hypothetical project scenario: residual valuation exercise**

You are considering whether to make a conditional offer on a privately-owned site. Please explain to the interviewer what you would do to achieve a profit from the valuation, given the information provided below.

- **Site location:** The site is located within the urban boundary with access to housing markets and materials and labour suppliers and is in relative proximity to all available transport networks.
- **Site ownership:** The freehold of the site is held in the private ownership of one landowner. The site does not present any problematic legal covenants affecting its redevelopment.
- **Site attributes:** The site is approximately 3ha. The site does not suffer from any significant abnormal costs relating to contamination, foundation, surface water attenuation, ecological or arboricultural issues though it has been previously used. The site does not suffer from any topographical issues relating to its shape or elevation. Access to the site is sound and shows no abnormal highways or services/utilities connection issues.
- **Market conditions:** The proposed project is to be undertaken in an area with mid-market values and with assumed house price inflation in line with national (exc. London) trends. It is not expected that any competing proximate sites will come to market during the development period.
- **Policy context:** The site is allocated in the local plan and is subject to a series of planning policies controlling for inter alia density, layout, green space provision and unit type. These are reflected in the development mix.
- **Acquisition terms:** The acquisition of the land by the residential developer is subject to standard industry conditions relating to the satisfactory achievement of a fully implementable planning permission and a satisfactory ground investigation report.
- **Development period:** The expected length of the development period (including a pre-contract period, building contract period and disposal period) is 48 months, with construction starting in month 3 and ending in month 47 and the timing of the first sale in month 12.
- **Development mix:** The proposal is for 150 units comprising a mix of 35 x 2-bed semi mews (55.74m²), 75 x 3-bed semi mews (76.65m²), 20 x 3 bed detached (85.94m²), 20 x 4-bed detached (106.84m²) homes and 300 car-parking spaces.
- **Abnormal costs:** Allowances have been made for standard industry costs of £75 per m² for the site area.
- **Planning obligations:** The size of the scheme means that it will typically not meet the threshold requirements for contributions relating to education, community facilities, health, open space / public realm and public art. Further, because obligations are set by Local Authorities based on what is affordable and viable, the authors have not included any specific costs relating to affordable housing. These will be determined during the interview as they form part of an LVC mechanism.
- **Development costs:** The expected development cost of the site, including construction costs, marketing and disposal, finance (calculated using the rule of thumb), professional, legal and administrative fees is £19.85m. This includes a contingency of 5% (of construction costs).
- **Gross development value:** The expected revenues of the development after construction and disposal is £40.43m.
- **Developer's profit:** In line with industry standards, the authors have assumed a developer profit of 15%.
- **Residual land value (net):** The expected net residual land value of the development is £9.1m.

4.0 Results

For the valuation of a hypothetical development land scenario it is evidently not possible to undertake comparison of similar sale prices of land. Residual land valuation offers an alternative valuation approach in which it is possible to identify a land value through transparent assumptions. The purpose of the exercise is not simply to identify a land value for the hypothetical scenario under the alternative LVC mechanisms, but to be able to discuss how the LVC mechanisms impact the assumptions within the valuation.

4.1 Residual land valuation

Residual valuation is normally expressed as:

$$(value\ of\ completed\ development) - (development\ costs + developers\ profit) = land\ value$$

Within the estimation of development costs, it is possible to incorporate costs (such as consultancy fees to work on planning permission application and site-related costs) and income (including the sale of units over time) as cash flows. This possibility is included in the spreadsheet.

A couple of interviewees argued that it was relatively straightforward to include any planning policy issues, and therefore all the alternative LVC mechanisms suggested, within a residual valuation. They explained that they would simply add the cost (or estimate) to the 'abnormals' or a specific 'planning obligations' input to the valuation. The argument they made was clearly in line with those proponents of LVC, i.e. that extracting value through the development process influences land prices.

'It is up to the planning authorities to set the price of land. If the planning authority wants A, B and C, and if the land price will support that, then we will buy the land on the basis of deducting A, B and C from the land value. The landowner will know that regardless of whether it's developer X, Y or Z, that A, B and C has to be accounted for – and that comes off the price paid for land.' (Large, nationwide house builder, England)

This argument suggests that the impact of LVC mechanisms can be estimated on land values. However, an alternative argument made by some interviewees was that the cost of LVC might not be passed on completely to the landowner but reflected in the final sale price paid by households.

Figure 1

A screenshot of the front page of a hypothetical residual valuation spreadsheet

Land value capture - Hypothetical site development appraisal											
Red = adjustable inputs		Site Area m2	30,000								
RESIDUAL LAND VALUATION				DEVELOPMENT MIX							
Gross Development Value	£40,443,375			Unit Type	Size (m2)	Quantity	Price (£/m2)	Sales Price	Capital Value	Area m2	Cost
Construction Costs	£13,743,988			2 bed Semi Mews	55.74	35	3500	£195,090	£6,828,150	1950.9	£1,853,355
Finance on Construction Costs (to completion)	£1,171,723			3 bed Semi Mews	76.65	75	3500	£268,275	£20,120,625	5748.75	£5,461,313
Professional Fees	£1,099,519			3 bed Detached w/ garage	85.94	20	3500	£300,790	£6,015,800	1718.8	£1,632,660
Finance on Professional Fees (to completion)	£140,607			4 bed Detached w/ garage	106.84	20	3500	£373,840	£7,478,800	2136.8	£2,029,960
Costs at physical completion	£16,155,836					150			£40,443,375	11555.25	£10,977,488
Holding Costs	£1,600,520			CONSTRUCTION COSTS		Cost	£/m2	Notes			
Sales & Marketing Fees	£1,415,518			Build Costs £/m2		£10,977,488	£950	Strip footing and basic external			
Contingency	£687,199	5.00%		Abnormal Costs & Site Prep £/m2		£2,250,000	£75	For site area @ 30,000m2			
Total Development Costs	£19,859,074			Garages (per unit)		£280,000	£7,000				
Profit	£8,088,675	20.00%		Roads and Footpaths £/m2		£49,500	£49.50	1000	m2		
Gross Land Value	£12,495,626			Landscaping (trees / grass)		£7,000	£10	700	m2		
Land Acquisition Fees	£656,020			Car parking		£180,000	£50	3600	m2 for 300 spaces (2.5m x 4.8m)		
Land Cost Finance (to completion)	£2,734,880			Other							
Net Residual Land Value	£9,104,726			LVC mechanism 1							
				LVC mechanism 2							
				LVC mechanism 3							
						£13,743,988					
				FEES AND FINANCE RATES							
				Finance rate (% p.a.)			6.5%				
				Professional fees (% building costs)			8%				
				Land acquisition fees (% land costs)			5.25%				
				Sales & Marketing fees (% CV)			4%				
				DEVELOPMENT PERIOD (YEARS)*							
				Pre-contract Period (years)			0.50				
				Building Contract Period (years)			2.50				
				Period to Physical Completion (years)			3.00				
				Disposal Period (years)			1.50				
				Development Period (years)			4.50				
Author: S.Payne, University of Sheffield											
Date: 17th Jun 2019											

'It's actually the landowner who pays for it [...] but the houses are more expensive as a consequence aren't they. In theory if you didn't have to provide affordable housing, land should be cheaper because you are not substituting market houses for affordable. It's an interesting point who is actually paying for it, is it the landowner who is taking a knock on the value he is getting, or it is the house builder?' (Land promoter, nationwide England)

This raises a question about whether different actors within the development industry assume the same impact of alternative LVC mechanisms on land values, developer's profit and house prices.

In the roundtable discussion it was broadly agreed that although it is clear that in theory LVC should be passed on to the landowner (whether directly or through a lower price for their land), in practice the cost of LVC may be shared between multiple actors, including the landowner, developer and home buyer.

A further problem with the hypothetical scenario and residual valuation became apparent in some interviewees' observations, in that it was more complex than their own decision-making calculations.

'We don't actually do a valuation process per se; we have an idea, but it's very broad-brush' (Land promoter, nationwide England)

There is an assumption in the method used in this research and in many arguments regarding LVC that land values are always available. This is technically possible and can be calculated using assumptions about the possibility of planning permission and unit sale value etc. However, it is also clear that development activity takes place without accurate knowledge of land values by multiple stakeholders in the development process. A landowner may have an idea of the price that they could achieve for their land if sold for housing development, but this does not mean it is accurate.

A land promoter may have an idea about the number of units that could be developed on a site (which would create a certain land value), but it is also clear that for some parcels of land multiple permissions have been granted with subsequent changes (often increases) to the number of units permitted, resulting in possible imprecision in the initial land valuation.

A local planning authority may have an alternative view of the land value for a planning application than the applicant. It is evident from these examples that a form of activity or stage in the development process may take place without accurate knowledge of land values.

'Because we are working on a site which takes so long to delivery... we try not to get into the business of forecasting land values for landowners. It's just a minefield, because we don't know how much things can change... So, we'll have a rough idea ourselves because we'll do our own fag packet calculation at the point where

we are negotiating terms with the landowner, so we know the percentage we are taking is going to give us adequate return. But we take that with a pinch of salt at that stage.' (Land promoter, nationwide England)

Interviewer: *'How does Section 106 get into the residual valuation?'*

Interviewee: *'So that's an ongoing process really, the valuation gets updated regularly, sales prices increase, we carry out market research and we find a different mix [of development] would be more profitable, our valuations are continually evolving. The closer we get to planning consent and the 106 being done, more information will go into it on the legal agreements. There's also all the infrastructure: how much does a roundabout cost? how much does diverting some media cables cost? Can we get Virgin out there to look at it and get a quote?; and all those types of things. As we move on those type of things, they are a little bit more crystallised, sometimes they aren't and it's a risk factor.'* (Land assembly firm, south of England)

Where there is some uncertainty in the cost of planning obligations, it does not necessarily mean that developers will not be proactive, but that their actions may be based on heuristic calculations or risk averse actions through seeking estimated higher returns and offering lower land values.

'If we're in a shortlist of three and been asked to come forward with what our interpretation of what the gross land value, we'll all just put our best foot forward and wing it' (Medium-sized house builder, nationwide Scotland)

'Until you get detailed designs there is uncertainty, so when a developer is negotiating to buy the site they will include some sort of contingency: 'we will give you X amount of money because we don't know exactly how much the junction might cost'. But it could be higher. So, they cover themselves by giving them a reduced land offer for the site' (Planning consultant, nationwide England)

In principle the completion of a residual valuation is possible at any point in the house-building process. The interviews, however, revealed that in practice residual valuation is not uniformly undertaken by all actors responsible for developing houses, or at all stages of the development process. Heuristic short cuts to assess the land value and development value were more prevalent among interviewees than full residual valuations.

'We take rules of thumb If it's an early fag packet appraisal we put in you know £15,000 or £20,000 per unit, or whatever as a figure, just to put something in there till things start firming up' (Land assembly organisation, south of England)

As such, interviewees routinely considered it unnecessary to use the residual valuation to assess alternative LVC mechanisms.



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4.2 Implications of political change

From 2016 to late 2019, England and Scotland experienced a period of unprecedented uncertainty. Calls for changes to LVC occurred at a time of political re-configuration with the threat of various permutations of Brexit hanging over business, house building and political decision-making generally. One of the most common arguments made regarding house building is that the industry requires certainty, and that risk requires greater returns.

'Generally, the house-building industry, if there is uncertainty, they just put the margin up, and then figure out what the uncertainty is, figure out how to deal with it, and then deal with the margin accordingly.' (Medium-sized house builder, nationwide England)

The extent of the impact of the decision in 2016 to leave the EU covers issues from the trade of goods and services, to the availability of skilled labour and changes to the structure of housing demand. There is, however, agreement across the political spectrum relating to the need for between 200,000 and 300,000 new homes per annum in England and strong support for an increase in affordable housing in England and Scotland.

'Brexit is just one of those side issues. I think in Scotland we've been having elections, more referendums, more uncertainty, and I think in Scotland people are fed up of it, and just say what happens, happens.' (Medium-sized house builder, nationwide Scotland)

The specific incentives for homeowners, the affordable housing sector and house builders have fluctuated since 2008, to the point where there has been uncertainty in whether incentives will still be relevant on completion of complex larger sites. One interviewee highlighted the uncertainty around the future of the Help to Buy scheme being problematic back in early 2019 for a decision they were making on a site.

Uncertainty in planning permission was raised by interviewees as being a significant issue, attributed to less well-resourced local planning authority departments. This included uncertainty in receiving the final planning decision and delays in agreeing negotiated contributions (s106).

'We need more certainty in terms of the financial elements required for planning obligations. The more certainty we have, the more accurate we can make our appraisal and bid.' (Medium-sized house builder, nationwide Scotland)

4.3 The residential house-building industry

The house-building industry is frequently portrayed as being comprised of homogeneous actors with identical systems and processes. While a small number of house builders may be responsible for the delivery of a large proportion of dwellings in England and Scotland, they do not all have the same approach or represent the full picture of the development process.

'Private house builders have been the largest contributor to supply of housing in the UK since the 1960s and dominated the market since 1980s with almost 90% market share of new homes built in the country. However, they are not a small homogeneous group, but a very large and diverse collection of companies' (Goodier and Pan, 2010, p.9)

This research does not distinguish between organisational motivations, yet there are likely to be distinctions between privately owned companies, publicly limited companies and charitable or third sector organisations, such as housing associations.

The report highlights some of the key distinctions in attitudes and motivations in development according to three categories: landowners, land promoters and house builders. Several interviewees worked for companies involved in more than one of these categories, and there may be distinctions in motivations and attitudes towards LVC between different arms of the same organisation.

4.3.1 Landowners

There are a large number of landowners in England and Scotland, if we include residential plots owned by individual households and brownfield sites in cities. In contrast, beyond urban areas there are fewer landowners and much larger amounts of land. It is worth noting that HM Land Registry does not know who owns at least 20% of the UK, so a representative analysis of landowners' views is impossible.

Interviewees and roundtable participants emphasised the proactive role that many landowners take in the development process, supporting the argument that they can expect a reward for their action. One participant said:

'Landowners should not be characterised as passive; some are active in bringing land forward for development and as such should not be considered as not earning the increment'.

Therefore, the economic rent arising from the uplift in land values arising from development can occur as a result of landowner behaviour, rather than simply the granting of planning permission. This highlights a polarisation in the view that land values rise from either landowner or government activity, when in practice both combine to create the value uplift.

When considering landowners' motivations to develop housing on their land there needs to be recognition of the motivation not to develop at a specific point in time. How existing use values are evaluated has been a contentious issue in England and Scotland. Yet, it is not contentious to say that many landowners are not forced into a sale, but under the current planning paradigm and limited operation of compulsory purchase in England and Scotland, are required to voluntarily or willingly bring land forward for development.

'You have got to think about what these historic landowners want. They don't have to sell the land, so unless there is a pretty significant incentive to make a profit for their estate, they won't sell it.' (Planning consultant, nationwide England)

'Land is not just sitting there waiting for development, it has a value for landowners: a farming value. I have a client in Dorset that owns thousands of hectares of land, his family has always farmed it, and it is fairly marginal whether he sells his land for development or carries on farming it.' (Planning consultant, nationwide England)

The principle that private landowners will require a financial motivation to willingly bring land forward for development is clear, however, the price that motivates landowners will vary.

'One landowner might be happy with a certain price for their land, another might not... every landowner is different in their expectation of what their land is worth... landowners act in different ways and they often do not get on.' (Planning consultant, nationwide England)

In addition to private landowners, much of the land in England and Scotland is owned by the public sector or by quasi-public organisations, such as the Crown Estate. The motivation to bring forward land for housing for these organisations may also be diverse, from aiming to earning profit from the land to meeting public benefits, such as the provision of affordable housing.

Some private landowners, however, will be willing to act out of either paternalism or self-interest to improve the local infrastructure through accepting a lower price for their land. This may be particularly evident where there is a local emotional connection between the landowner and the site.

'Most of our landowners are prepared to give something away through the Section 106 system, but over and above that quite a lot live locally to the site, so they are quite content to say 'it would be a nice idea to provide a new roof on the village hall, or provide a new village hall'. So, there's quite a lot of that legacy stuff that landowners actually want to do, which doesn't usually get translated well, as it's usually seen as trying to buy planning permission, but landowners are actually quite willing to do that.' (Land promoter, nationwide England)

4.3.2 Land promoters

Land promoters, it is claimed, are responsible for around 50% of pre-application sites being explored with local planning authorities (Lichfields, 2018). They now play a significant part in identifying land and gaining outline planning permission in England and Scotland. Land promoters agree with landowners (via option or promotion agreements) to pursue outline planning permission on a site and then, once accepted, to sell the land to a house builder. In return the landowner shares a proportion of the price achieved from the sale to a house builder with the promoter. Both the landowner and the land promoter have a motivation to increase the value of land and are often viewed as having synonymous motivations and views of LVC (Jones and Comfort, 2019).

‘For a land promoter, because we take a percentage share of what the landowner receives, we want to argue that [LVC] contribution should be as low as can be. Well, as low as is appropriate; it’s not as low as possible, it’s what is an appropriate level that can be justified by the council.’ (Land promoter, nationwide England)

There are two key ways in which land promoter and landowner attitudes towards LVC might differ.

- It is often the land promoter that puts capital speculatively into the pursuit of outline planning consent, while the landowner commits only a limited investment into securing advice and legal support in creating the option or promotion agreement with the land promoter. There may also be discrepancies between landowners and land promoters in the trade-off between the cost of securing permission and the uplift in land value from securing that permission (i.e. landowners may seek a higher value where the cost of securing that higher value falls upon the land promoter).
- In contrast to the extensive time periods over which many landowners consider whether to bring land to the market, land promoters operate over a shorter – but still significant – time period.

‘Even with a very positive planning process it can take about seven or eight years before you first secure an interest in land and the first houses are built, so the market in that period can do all sorts of things, but generally our clients on the strategic side will still want to secure land and get planning consent on it. The issue is that when they sell it onto a house builder then the market sensitivity is a bit more unknown, because, during a recession house builders will not buy a site with planning consent to build houses, because they are not building houses.’ (Planning consultant, nationwide England)

4.3.3 House builders

Private house builders are responsible for building more than 70% of the total housing output in England during most years (MHCLG, 2020). The relationship between house builders and land acquisition (and therefore land

prices) has not been systematically researched, but there is a distinction made in most of the profession between strategic land acquisition (normally taking an option to purchase land that has not currently received planning permission) and short-term land acquisition (the purchase of land with planning permission, normally to be built within a two to five-year time frame). How this land is accessed may be through the open market, or through closed negotiation, as Payne et al. (2019) write:

‘House builders’ land acquisition methods will usually involve the use of options and conditional contracts to reduce risk, uncertainty and initial capital outlay; that they utilise the land use planning process to target options and contracts on land likely to be released. House builders rely more on networks than markets to source land for residential development.’ (Payne et al., 2019, p.18)

In practice, there are distinct types of house builders operating in England and Scotland that fulfil different tasks in the development process, from developing on long-term land ownership (e.g. land owned through historic activities, such as ports or coal-mining sites) through to builders that only undertake the actual construction work and are contracted to deliver a specified number, type and standard of units.

Where there is separation between the landownership and construction activity there is likely to be a distinction between the house builder and landowners’ perspectives of LVC.

‘From the house builder perspective, it’s actually a zero-sum game. Because that money either goes to the council or the landowner, it doesn’t accrue to the developer. If they think there’s a million pounds of planning gain and we can reduce it, but we think it should only be half a million pound, so they put half a million on the land value and try and argue it with the council; it doesn’t go to them on the surplus to their profit. It’s one of the reasons why the land promotion industry has grown up, because for a house builder arguing to the council, it’s often easier for them just to pay the money, it comes off the land value, not off their profit.’ (Land promoter, nationwide England)

In the same way that different landowners are willing to accept different prices for their land, different developers are willing to accept different margins for building houses. Interviewees indicated that some house builders were currently seeking around 30% profit, while others were willing to consider a 15% profit margin. This variation is likely to have an impact on perceptions of LVC.

4.3.4 Summary

The heterogeneity in the house-building industry and process of development means there is a range of motivations, perceptions of LVC and resulting behaviours. However, we should also consider the overall picture and outcomes in addition to the individual micro behaviour.

Where there is competition between house builders for sites then their activities, or those of their competitors, have adapted to historic changes in LVC mechanisms. There is evidence from the interviews that the structure of the land development industry has changed, with the growth in intermediaries acquiring options for land and obtaining planning permission, and interviewees were optimistic that businesses would adapt to alternative LVC mechanisms. There was also the feeling that where competitors had in the past been too bullish and their businesses suffered, in the long run new businesses would emerge as long as entry costs were not prohibitively high.

In contrast to land promoters and house builders, where there is competition, landowners have a monopoly or oligopoly over the development potential for particular sites. While a house builder's involvement in a specific site is temporary, even if it lasts for 20 years, many landowners have had a connection to the land for much longer periods. House builders are dependent on landowners for making land available, but there is a clear distinction in the motivation between landowners and other actors (such as land promoters and house builders) in relation to specific sites and, correspondingly, a tendency towards alternative views on LVC. Landowners, therefore, can be seen to have a greater control over the market than competitive businesses and their response to alternative LVC mechanisms may have a greater impact than the response of land promoters or developers.

4.4 The need for change

A common theme from interviewees was confusion in terms of the calls for change and understanding what the current situation actually is. Interviewees argued that the current mechanism of CIL with planning obligations meant there was a lack of clarity over the purpose of different mechanisms and whether they could be defined as LVC.

'I think we have got ourselves in a bit of a pickle, because I think there are too many things going on at once, and, I think it's quite hard to handle for everybody [local authorities as well as private house builders]' (Planning consultant, nationwide England)

'If we want to have a system of land value capture, an explicit system of land value capture then, great, let's do it. But let's be explicit about it, let's not sneak it in through the backdoor through creeping minor amendments to the practice guidance' (Land promoter, nationwide England)

As a result of the lack of clarity on the purpose and extent of current mechanisms to extract planning gain or LVC there are competing demands in the current system.

'People have got to ask themselves what priorities they want. Do they want housing or money for infrastructure delivery? The answer is probably both but, if there is both, it's about acknowledging there is only so much value in land.' (Developer, south of England)



Image source: Flyby Photography / Shutterstock.com

There is evidence that in some local planning authorities CIL has ‘crowded out’ affordable housing provision (Lord et al., 2018). Where developer’s profit is protected in viability assessments in markets with lower levels of land value uplift through granting planning permission, then there may be mutually unachievable public goals.

The double mechanisms of CIL and planning obligations were also raised in relation to wider taxation. Indeed, perhaps the most consistent argument made by interviewees was that the representations of LVC in the media underestimates the amount of income in addition to s106, s278 and CIL is being captured in other forms of taxation through development.

‘I think the way they [the media] report planning obligations, it ignores how much in ‘uplift’ is actually captured by the state. More generally, through other mechanisms like stamp duty, land tax or capital gains tax when the landowner sells it. They also get corporation tax on the profit the house builder gets when they build homes.’ (Land promoter, nationwide England)

Several interviewees argued that given the range of current mechanisms for local and national authorities to extract monetary or in-kind contributions through taxes and planning gain that there should be no fundamental change to the current situation. Two arguments were raised to support this, it was argued that it is already possible for local planning authorities and government agencies to extract land value uplift.

‘There is no real need for major reform, there are plenty of tools in there at the moment, that are adaptable and flexible for different circumstances, if you have got a garden city or a piece of national infrastructure, they are different animals, they need particular tools that go with them. If you have got smaller scale housing development in a local area, that’s a more traditional route.’ (Landowner and developer, north of England)

Also, historic examples of an increase in taxation or LVC that resulted in a decrease in land supply were raised as warnings against increasing LVC.

‘In reality we already do land value capture, and, the whole sort of debate needs to be very careful. If it is reformed and pushed too far it will just stop development; we have seen this historically.’ (Landowner and developer, north of England)

One planning consultant put forward the argument that planning policy already obscured the ‘correct’ value of land, and any changes to LVC would further complicate this.

‘If you’re starting from our spreadsheet scenario with the developer, ultimately all of the changes impact on land value. You are changing the land value constantly, every policy tweak. The big beef at the moment is: what is the correct value of land? If you keep changing the policy, we will never get to a steady state on what the land is worth.’ (Planning consultant, nationwide England)



Image source: Flyby Photography / Shutterstock.com



Image source: Flyby Photography / Shutterstock.com

This viewpoint does question the mechanics of LVC, chiefly in determining a value when there are complex market influences. However, it is less clear whether this is a problem for the development industry. Despite revisions to planning obligations and CIL over the last decade, land transactions and housing delivery has continued, and the house-building industry appears to have managed to create units and profit under these conditions. So, would further changes to these mechanisms make the valuation of land so complex that development slows down?

Risk is evidently a component of development, and there was some restraint from interviewees on even broaching a discussion on LVC. One interview commented, when asked if they had a preference for a different mechanism.

'It depends what 'different' is – that's the problem. You could end up with 'different' and it ends up worse' (Medium-sized house builder, nationwide Scotland)

Most interviewees agreed that planning applications should be policy compliant and some even made reference to the large profits made by some businesses in the house-building industry as a moral argument for LVC. One interviewee stated that the only change they would endorse would be the removal of affordable housing being provided through private development.

'Affordable housing is the largest single benefit in society. It's a benefit, pure and simple. There is no other form of development where you are required to give part of your land away to subsidise someone else's housing. You don't go to Tesco and there are two lines of aisles: one for people who can afford to buy baked beans at normal price, or a discounted line for those who can't.' (Land promoter, nationwide England)

4.5 Alternative LVC mechanisms

Interviewees were asked for their views on three alternative LVC mechanisms.

1. Fixed flat tariff based on local infrastructure requirement induced by the scheme
2. Fixed flat tariff based on local infrastructure requirement regardless of scheme impact
3. Negotiated fee based on local infrastructure requirements.

4.5.1 Fixed flat tariff based on local infrastructure requirements induced by the scheme

This mechanism is a project-based standard charge. It is designed to offer simplicity to the development industry and the local planning authority responsible for setting the tariff, without incurring a region/authority-wide charge for every development. If, for example, the development could be shown to increase the need for education in the area through an increase in the number of school-aged children arising from new housing delivery, then the development could be charged at a fixed tariff across the authority. Some interviewees were in favour of the simplicity of this tariff, and the fact that it was only on infrastructure induced by the scheme avoided concerns that the tariff would be used as a generic revenue-raising mechanism.

'If I could look at a 100-unit site and know we have got to pay £15,000 per plot, that would be fantastic, it would give everyone certainty. The landowner would know how much land is worth, the developer would know how much it is worth; that would be beneficial.' (Developer, south of England)

'This was what I called the Milton Keynes roof tax, sort of, way of doing it, and in fairness to Milton Keynes, it seems to work, well. Milton Keynes is a high demand housing area with growth aspirations, they seem to have justified to me, it's saying you pay £11,000 per dwelling, or whatever you pay for these various items, and then you don't need to think about your impact on highways or that kind of infrastructure.' (Land promoter, nationwide England)

Flat tariffs would remove any time for negotiation and could therefore speed up the development process.

'C' takes time and if you go with 'a' or 'b' then they're fixed figures, and you might be able to sort it in four or eight weeks after resolution to permit. Negotiation takes time and, at the end of the day, the approach to the valuation would be the same, because you would take out whatever the calculation of whatever 'a', 'b' or 'c' was from your residual valuation. But in terms of speeding things up, probably 'a' or 'b' would speed things up.' (Land promoter, south of England)

A flat tariff was viewed as the simplest mechanism for LVC to be passed on to the original landowner, as it would clearly indicate the costs for every type of development. Most interviewees believed that these costs would be passed on to the landowner, rather than being absorbed by the house builder or end occupier.

'A flat tariff, if it has been through a public examination, and is viable, it doesn't kill the land value, but it also ensures the community are seeing the right, necessary levels of planning obligations, we don't have a particular problem with that. We will buy land on that basis. Planning sets the price of land, whether it is, through planning policy that seems more sensible than a flat tariff that central government set as a rate or leaving the whole thing up to a negotiation.' (Large house builder, nationwide England)

Although this LVC mechanism was designed for simplicity, some interviewees cast doubts on whether the local planning authorities have the resources to deliver such a scheme effectively, given the costs of assessing what infrastructure is required and how much it would cost.

'It would be interesting to see how option a) would come about based on local infrastructure requirements. That's a flat fixed fee; it would be down to the local authority looking at each of the constituent settlements in the area, and deciding that area A needs a new junction, new schoolroom, new nursery, it all adds up to this, so every single house coming out of area 'A' needs to contribute to that. I can't ever see any local authority doing that, that's too much work for them, they are already underpaid ...' (Medium-sized house builder, nationwide Scotland)

A further concern was whether local planning authorities may lack the capacity to update the plan and tariff regularly, and the tariff becoming out of date with the current stage in the market cycle.

'I do like the idea of a completely flat rate which all developments meet. That would be the simplest and fastest way of doing it. The problem with that is it would have to be based upon local authority information. That takes so long to produce it's out of date by the time it is written.' (Medium-sized house builder, South East England)

4.5.2 Fixed flat tariff based on local infrastructure requirements regardless of scheme impact

In this tariff, the requirement for the scheme to have an impact that needs mitigating is removed, instead the contribution is based simply on all infrastructure requirements required locally, including existing need. It is entirely predictable for developers, as the authority publishes the tariff costs. This tariff is much closer to a revenue-raising mechanism rather than a planning instrument.

One interviewee argued that this mechanism was more practical than the one based on infrastructure requirements arising from the development, because of the reduced burden for local planning authorities to assess the impact of the scheme.

'I'm just a bit concerned on how a) would work in terms of value wise, how a local authority would provide all this information, how would it be checked and verified, I can just see it becoming a bit of a headache. Whereas if a local authority says we know within our whole local authority area this is what we need, this is what we have as housing and land supply, we know if we are going to deliver all these houses in the next five years, this is what you need to pay per unit. That's easier than a), because it's in a local authority wide context, not a settlement by settlement.' (Medium-sized house builder, nationwide Scotland)

The clarity for house builders to pass the known cost on to the landowner through the price that they would be prepared to pay was seen as a benefit of the mechanism. This clarity was not only easier for doing business, but also reduced uncertainty and therefore would cost less across businesses.

'That one is dead easy, that's how we work at the moment, they would all have an impact on the landowner, because they would all be taken off our land value and paid as an abnormal cost. The one I can see as bringing benefit in certainty to a landowner is that one there, because if they know exactly what that local authority is demanding from them, it will give them certainty... So the obvious benefit of that is reduced risk for them, and gives us a reduced risk... we know exactly what we are putting into our appraisal, everyone should be working off the same platform.' (Medium-sized house builder, nationwide Scotland)

The objection was raised however that this LVC mechanism moved away from specific site requirements and into general taxation.

'As soon as you get into a fixed-rate tariff, that's actually providing infrastructure over and above what you are required to do, that's when it's starting to get a bit inequitable. Just as with affordable housing, the need for affordable housing is not derived from providing housing, you know, they pre-exist, I'm meeting that pre-existing need. When you have deficiencies in roads and junctions nearby, and you start providing over the above that to mitigate that, it's starts getting, you know [...] a bit difficult.' (Land promoter, nationwide England)

This is an argument against LVC in principle and not the precise mechanism. The argument is that the house builder should only contribute to the direct costs incurred as a result of their scheme, and not be taxed on the uplift in value derived from the granting of planning permission. This highlights the ingrained opposition to sharing the uplift in land value created through state action from re-classifying land for development. Evidently, while this view is not shared across all organisations within the development industry, for some the very concept of LVC is contentious.

Interviewees were critical of the ability of local planning authorities to update their tariffs in line with the changing infrastructure requirements in the area.

'I think the potential problems with mechanisms a) and b) are that they work in a plan led system. But beyond a plan led system, if there is a response needed in terms of a lack of a five-year land supply, or something is failing, something is falling short, then I'd question whether those two mechanisms would be able to respond to that. That is relatively problematic and that is a situation that we are in fairly often. So, in a perfect world b) in particular would be great, but plans don't work like that, plans fail all the time, you would probably need a combination of b) and c) in that regard.' (Land promoter, nationwide England)

There was concern that including local infrastructure could result in costs being too high, and not justified by the development impact.

'The problem is, where the local authority is trying to identify the infrastructure requirements, they put a tariff on everything. That stifles the delivery. I'll give you an example, I work with a local authority in Essex, and they have their draft CIL tariff, charging schedule, they wanted something like £20,000 per plot on top of the Section 106 requirements. We looked at the charging schedule; they have things like a new public swimming pool in a nearby town. So we asked the question: "is there a demonstrated need for this?" They say "no, we just want it". I asked "do you have a site for this?" They said "no, we just want it". So, then I said "well

when is this going to happen?" They just said "I don't know, we just want it". This is the type of mindset you are up against. So, if it is for wider infrastructure there needs to be a demonstrated need – It just needs to be reasonable and sensible.' (Developer, south of England)

There was repeated concern raised that local planning authorities lack the capacity to maintain a regularly updated infrastructure requirement, costed at a rate that did not stifle development. Developers argued that a flat tariff would need to be regularly updated, and potentially reduced if was restricting development.

4.5.3 Negotiated fee based on local infrastructure requirements

The negotiation of a fee based on local infrastructure requirements was often considered to be close to the existing situation of negotiating Sections 106/278/75. How negotiation occurs in the setting of planning obligations is under researched. While evidence by Lord et al. (2018) suggests that conditions are rarely accepted initially, necessitating some form of negotiation in the agreement of planning obligations. Less clear are the timescales for negotiation and how frequently these negotiations include contested assessments on issues such as viability and the need for affordable housing.

'Nine times out of ten I've been able to deal with on an email exchange, showing the viability of the site using their own internal viabilities, but this is the first time I've actually had to go into the local authority saying inputs are wrong, and your assumptions are then incorrect in terms of land value.' (Medium-sized house builder, nationwide Scotland)

Interviewees regularly raised the concern that negotiated planning obligations (or the potential for any other form of negotiated value capture) makes it very hard to value land accurately. With flat tariffs, charges, or even known policy requirements (such as fixed proportion of affordable housing), all house builders, land promoters and landowners can factor the same figures into their calculations.

'If the policy says A and B, the rest is negotiated then you know it's more difficult for the landowner for the house builder, or for the land promoter [to value land accurately].' (Large house builder, nationwide England)

'It's all well and good [the local authority] saying to the land market you should price these contributions in, but if you don't know what the local authority shopping list is, and the price of the shopping list, how are you supposed to price it into your land bid?' (Planning consultant, nationwide England)

Some interviewees argued that there would be distinction between actors, with some arguing for and some against negotiation.

'If you've got contributions certainty then I think the market generally likes that certainty and it can adapt to it, you know through design or other things, so I think – the more certainty the better. Having said that, a lot of people might go for a negotiated one, because in a sense it gives you the maximum flexibility. But the reality – is the risk – of that, on both sides is kind of more like a blank piece of paper, it will probably take a long time to fill in the gaps, as it were.'

The obligations in a planning agreement are negotiated against the development proposal but not all obligation types are treated equitably in the negotiation. For example, road infrastructure might be the most important obligation and therefore be relatively fixed, while a contribution to policing, the environment or affordable housing may be considered less important and be more flexibly negotiated.

'The national planning policy framework makes it very clear. A bit like affordable housing is very much subject to viability, if a developer can argue that a scheme is not viable as it needs to provide 35% affordable housing and X, Y, Z in terms of highway work, then the key flexible element of Section 106 negotiation is affordable housing. If you have 3,500 homes, you will need a school, that is fixed, you will need the roads in place to support the vehicles, you will need the off-site junction, the only element which is not fixed is the affordable housing. That affordable housing is negotiated down in this situation.' (Planning consultant, nationwide England)

4.6 Other issues

In addition to responding to the core alternative mechanisms, interviewees also volunteered perspectives on interconnected issues.

4.6.1 Market adaptability

Interviewees routinely argued that blanket charges on LVC across a region or nationwide would have a significant impact on many slower markets. They argued that if the development was to be viable in every market context, then any LVC policy needs to be able to be adapted or removed to support viability.

'In general, if you go to a town, there are usually some good areas, some bad areas. Really what we have got is a system that applies a generic solution to situations that are not generic, that are not uniform. You can even go one street to the next, you get expensive houses, and cheap houses.' (Small house builder, South West England)

The evidence from the last ten years of developer contributions in England is that while the combination of s106 and CIL does not work in some markets, the relationship between the value of developer contributions and the value of land is not linear (Dunning et al., 2019).



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4.6.2 Local community requirements

The argument made by interviewees was that LVC should be linked to the needs of the local community and that any expenditure should be evidenced locally. This was primarily supported by house builders, in that local communities were likely to consider the development more positively if they could see benefits from the wider infrastructure. However, while this may make the role of development easier for house builders, no interviewees articulated why LVC should not be redistributed geographically to the same extent as general taxation or spent elsewhere in the local planning authority or region.

'It's better that whatever contributions or obligations are being made for those to be directly related to the local area in which the development is taking place.' (Landowner and developer, north of England)

4.6.3 Timing between charges and delivery of infrastructure

The timing of a charge or cost has a significant impact upon a residual valuation. The earlier on in a development that the cost occurs the greater its cost as a result of borrowing or opportunity costs. However, if these costs are passed on to the landowner through the residual valuation then it may not affect the developer's profit but will limit competition for land at a higher price.

There was universal agreement that where the costs of LVC could be shifted later in the process, the more viable the development was likely to be and the greater the potential uplift in land values from the granting of planning permission. Developers preferred when costs, charges or payments were negotiated later in the process; when the timing was early and fixed was less popular.

'Part of the issue is that local authorities have to be more flexible in how they ask for some of this contribution. Staged payments will help schemes come forward quicker, rather than being bogged down in saying, well if I'm paying £2 million pounds for a roundabout and £3 million for CIL on day one, then I can't afford the costs of the development. Then I'll need the affordable housing to come down and that doesn't help anyone.' (Land promoter, nationwide England)

The timing of payments, however, was only usefully delayed where it did not prevent necessary infrastructure from being delivered for development to successfully take place. The Housing Infrastructure Fund (a government capital grant programme to help fund new housing) is one option available to local authorities, enabling up-front infrastructure construction prior to housing delivery. The impact of this on the delivery of housing is not yet clear but is an alternative opportunity for infrastructure delivery.

One interviewee stated that, whether funded (initially) by the developer or government, developers were content to see investment take place earlier in the development

process because it was good for public relations and helped potential home purchasers see the development in a positive light. If this increased the sale price, it was considered to compensate for the cost of early capital expense.

'I'm happy to make the payment early because if it's for a school, for example, you want that work to have commenced and completed in time to mitigate the effects of your development, so I think it's right to make that payment early or else you are going to have a problem.' (Medium-sized house builder, South East England)

4.6.4 Provision of up-front infrastructure

Perhaps the most popular change for house builders (but not landowners or promoters) was for the local authority or government agency to provide infrastructure before the development process and then seek to recoup the cost of the infrastructure through planning permissions at a later date.

This strategy suggests that local authorities' proactive allocation of sites for development and the associated infrastructure to develop these sites would re-configure the order of development and risk. LVC would occur after local authority expenditure, rather than after developer expenditure. Local authorities would be able to stipulate where development occurs, inducing an alternative economic growth trajectory (see e.g. Lord et al., 2019).

While this scenario was not formally presented to interviewees, several developers described their preferred LVC mechanism as one which aimed to recoup the value uplift after the provision of infrastructure. Two arguments were made for this. The first was to lessen the risk factor of the development by providing infrastructure prior to seeking planning permission.

'Do away with the commitment at the start of the development for a developer. It is also taking away risk, so the margins can drop, so where we are faced with building a big road, you know somebody else has done it, that risk has been taken out of the project, so rather than building a big road, we are building a footpath. And there is less risk associated with doing those infrastructure works, now I know, in places like Hong Kong and development industry in Dubai, they seem to put all the infrastructure in and then development follows, but then again they are awash with money.' (Medium-sized house-building company, north of England)

An issue with this approach would be house builders competing over land with ready development opportunities, rather than trying to weigh up the risks of being the first to bear the cost of producing new infrastructure that developers would benefit from subsequently. Some interviewees added to this with a call for the provision of public sector-created serviced plots.

‘The public sector selling serviced parcels of land? I see that as an attractive proposition because we are not exposed to all those infrastructure works; the roads, the sewage works etc., and the timings associated with those improvements. We are concentrating on building houses, rather than worrying about a multi-million-pound road junction.’ (Small house builder, South West England)

However, the same house builder made clear that there may be issues in the competition to purchase homes that are developed too rapidly. Serviced plots may, therefore, be easier for the house builder but not necessarily speed up delivery as they are still built to facilitate a release rate that the market will accept, and at a price the house builder is content with.

‘There is the issue of understanding where the demand to buy the house is coming from, and I don’t think the government have correctly understood market forces. So, they might decide on 2,000 units on a specific site, and then put the infrastructure in; then sell half a dozen parcels off to house builders, with potentially 300 units each. The question is, will that site have enough demand from six outlets selling three or four houses a month? Probably not. So, within the house-building industry we have a measure called return on capital, where we are looking at how much money is going out – and, importantly, how quickly it comes back.’ (Small house builder, South West England)

4.6.5 Profit sharing

Some interviewees suggested a larger deviation from current LVC practice in England and Scotland. Specifically, this would mean formalising the relationship between landowner and the public sector to create a combined impact on land values. Profit sharing between private house builders and local planning authorities was considered as an alternative to serviced plots. Joint ventures and similar organisational structures are already operating in England and Scotland, which means that there is already an element of sharing land value uplift between the public sector and private sector house builders.

‘If we were buying from Homes England or a council where we had an arrangement whereby the value of their land and the value of our build was the same, then we could create a joint venture. If land was valued at a certain point in time and there was a mechanism to revalue then we could work out the profit and losses for the scheme and decide how they should be shared.’ (Large house builder, nationwide England)



5.0 Conclusions

This research explored the motivations, attitudes and behaviours of interviewees from across the development industry towards LVC in England (and Scotland in some cases). Between 2018 and 2019, 20 interviewees explained that there was a high degree of uncertainty in the future of LVC but there was a continuous and high level of demand for housing, which was unlikely to diminish in the medium term.

The development industry is not homogeneous. While it may not be the most heterogeneous business sector, there is variation in the motivations, attitudes and behaviours of all actors. This means there is no singular view from the housing development industry on LVC and that prevailing attitudes and behaviours may be widely divergent between those directly involved in land acquisition and the granting of planning permission and some house builders.

Although landowners and land promoters are frequently considered to have synonymous goals in the development process, interviewees hinted that under some circumstances there were discrepancies in how they approached LVC. There were clear differences between the attitudes of landowners and land promoters, and house builders that were able to pass on the costs of planning obligations and CIL to landowners and other actors.

Representatives from across the industry routinely argued that public discussion about LVC needs to be clear on the range of charges and taxes that apply to the development industry. They also argued that there should be moral clarity around any proposed changes to LVC. For example, are the changes designed to redistribute wealth from landowners to other members of the public, or to mitigate the impact of a development for the local community, or both?

The current system and each of the three alternative LVC mechanisms were selected by at least two interviewees as their preference, suggesting that the choice of LVC mechanism is unlikely to hinder the entire development industry. Furthermore, examples of further alternative LVC mechanisms were offered up by interviewees, suggesting that there is scope to consider more radical alternatives.

Many interviewees' comments suggested there was friction between aspirations for clarity and certainty and a desire for flexibility. Further work is needed to ascertain whether this friction is inherent, or whether it occurs as a result of the current LVC mechanism. If it is not possible to design out friction in the land market arising from LVC then some development may not take place, particularly on marginal and more complex sites (for example, some brownfield sites in lower priced housing market areas). Despite this, the levels of recent development suggest that housing development has both created large numbers of housing units and been profitable for house builders.

Development activity, such as negotiation between landowners and land promoters or the creation of an outline planning application, often takes place without a transparent and accurate land value. The difficulty of employing a residual valuation research method for this report was because some interviewees put forward the argument that a residual valuation was unnecessary for a precise land value, as their practices arise through awareness of market behaviour (prices) rather than residual valuation. This raises two questions.

- If the land value is unknown by private development actors until the point of sale, how does a public body assess land values to value the uplift through granting planning permission?
- How can public bodies identify a reasonable return to the landowner if there is little clarity on what the value is that has been created?



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6.0 Recommendations

1. Clarity in the purpose of any LVC mechanism is necessary. There is a moral obligation on the state to explain the broad remit of any form of taxation and public accountability in its expenditure, and the same should apply to LVC. Clarity would also support the need for the residential development industry to demonstrate to the public how it contributes towards public needs.
2. An LVC mechanism, if it is to be locally adjustable to respond to local market dynamics, requires the local planning authority to have the resources and expertise to understand the mechanism and be able to apply it. Therefore, changes to LVC should not be introduced without consideration of the skills training and support required for local planning authorities to implement the mechanism appropriately.
3. An LVC mechanism, if it is to be a fixed flat tariff, should only be introduced if there is a mechanism to ensure an ongoing supply of land in different market conditions.
4. Further research is needed to:
 - identify which components of planning obligations, CIL and wider taxation are captured from the uplift in land values from the granting of planning permission and to what extent they are captured from other sources, such as constructor's profit and house prices
 - ascertain whether a new LVC mechanism can be designed to provide both clarity and flexibility.

The results provide a platform towards an informed discussion on attitudes in the house-building industry relating to alternative LVC mechanisms and the impact on development viability and the delivery of developer contribution-funded infrastructure in England and Scotland.

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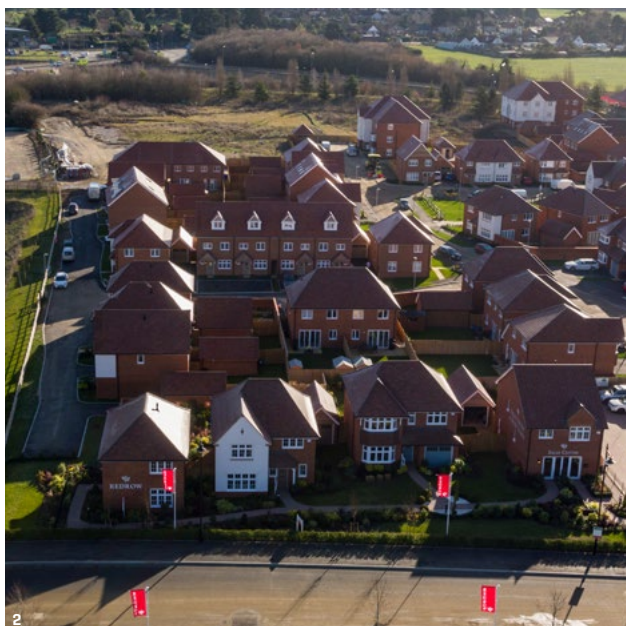


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