

How much does it take to get a landowner to release land?

Planning Authorities are trying to increase planning contributions while still ensuring that land is released for development and houses built. The question is, how far can you increase contributions without endangering development? Or, to put it another way, how much of the value generated by development should be left to provide the level of inducement required for landowners and developers to bring land forward.

This issue surfaces in appraisals in two contexts. Firstly, if you are going to do a viability assessment for policy purposes you need to start off with a notional 'price' that will need to be paid for the land to be developed. Secondly, when dealing with individual applications there is the issue of the level of land value that should be assumed. Note that I am not dealing with developer's profits here - just the land price. Profits are discussed in my guide to Development, Viability and Planning which can be found on my website, where you found this!

The first part of this note comprises a general discussion of the issues involved. The second part summarises my own review of the 'hard evidence'. There isn't much beyond anecdote so this mainly covers the available literature on landowner behaviour and land supply in the context of the various efforts to impose a tax on development profits since 1947, and more recent research commissioned by the GLA to establish the thresholds of viability for developer contributions to affordable housing.

Part One

A land owner will want more for land for development than it is worth in its current use...

The main distinction must be between land that has significant value in its current use and land that does not. Agricultural land might typically be worth between £15,000 and £25,000 per hectare, a sum that is not really significant when compared to development values in most places. In contrast land that is in use usually has significant value. For instance, an old but occupied industrial estate might be worth over £3m per ha in economically successful areas of the UK and over £1m ha nearly everywhere.

Usually quite a bit more!

The size of the incentive that a landowner will need over and above the current use value of the land before he/she will release it varies. As far as agricultural land is concerned, some farmers have an attachment to their land. Others will be heavily taxed on the proceeds of any sale. In some places there is good reason to suppose that the planning authority will be keen to see the land developed so the landowner will not want to sell until he or she believes that the price offered is unlikely to be bettered in the future. Major landowners such as the Church Commissioners are often prepared to be very patient in

this respect. In contrast many industrial landowners do not want to retain land or property that is no longer needed for their business and will simply aim to dispose of it on the best basis they can. The trick here is to know who your key landowners are and to try and understand their motivation and constraints. Then you can tailor your analysis to local realities or start agitating for CPO powers to be used!

Don't confuse your land price in your appraisal with the amount that the landowner actually gets

Bear in mind that the net amount that a landowner receives will not usually be the price used as a starting point in your appraisal. Selling the land involves costs and as I have already mentioned there are taxes on any gains. Perhaps more significantly in this context most viability studies undertaken for policy purposes include broad assessments of typical development costs but make no allowance for additional costs such as site assembly, access works, remediation and abnormal groundworks. And if the site is in use then occupants might have to be bought out and this can give rise to compensation payments that exceed the market value of the property concerned. The land price that is assumed for the purpose of a viability study for policy purposes must allow for these costs to be met in enough instances to ensure that the requisite amount of land is released. This judgement requires some general knowledge of the constraints on development of the sites involved. Once again, there is no substitute for local knowledge and homework.

The relationship between land values and planning use is not straightforward

The price at which land is sold can anticipate planning permission, or at least countenance the possibility, whether or not the wider planning framework explicitly endorses it or a specific permission exists. The premium paid is sometimes referred to as 'hope value' and is effectively the price of a wager on a beneficial planning permission being forthcoming at some point in the future.

The planning system is the author of its own misfortunes in this respect. By allocating only enough for development to meet demonstrable needs, it strengthens the hand of the landowners. Karl Marx would be giggling in his grave.

Are there any evidence based standards or benchmarks to guide an estimate of the level of incentive that landowners require to release enough land?

To the best of my knowledge, no. I have tried to summarise what is known in Part Two of this note. DCLG informally acknowledged in the context of a discussion with them about the basis for CIL, that the lack of any research into landowner behaviour was regrettable.

A way forward.

An approach that I have adopted in recent years is based on the housebuilders practice of securing large strategic development sites through option agreements. Until the recent fall in house prices these typically gave the housebuilder the obligation to seek planning permission and then the right to draw down land for development as and when required at a price based on market value but with a minimum price. That varied widely but sums of around £200,000 per gross hectare were typical in many areas. The highest I have seen in the last five years is £500,000 per hectare and the lowest was nil. You would expect the

option price to reflect the strength of the local market but the pattern is actually quite varied.

I sometimes use this £200,000 hectare figure and add:

- A premium to 'lubricate' the local market - perhaps an extra £100,000 hectare*
- In policy studies based on wide ranging assessments and where it was clear that some of the additional costs of development referred to above were not fully reflected in the appraisal, I might add an extra £200,000 hectare or more to cover these costs, bringing the overall estimate to £500,000 per hectare.*

The lowest figure I have used is £300,000 hectare. The highest was £1,000,000 per ha in a County-wide study in a high value area where I knew nothing about the individual sites.

When a site has significant value in its current use I would take current use value and add between 25% and 50% depending on my perception of the landowners position. Were they likely to be keen and impatient to sell?

When values fall...losses, write off's and intransigent financiers.

This mainly affects land held by developers rather than landowners and has become an issue recently when they have sought planning permission using a viability study based on the assumption that they should achieve the price that they paid for their site even though it would have fallen in value since. In some cases this ignores the fact that they have 'recognised'; a loss on what they paid for the site in the form of a reduction or 'write down' of the value attributed to it in their accounts. And in others they hide behind their bankers skirts and claim that finance will not be available unless the full price paid for the land can be realised.

I can see no reason why the planning system should as a matter of course insulate developers against the possibility of loss. After all, the risk of loss is part of the justification for their profit margin. The issue of whether or not the value of the land has been 'written down' is irrelevant here because the resulting value is to a large extent subjective and arbitrary. And the bank's views are similarly irrelevant because they will hinge on the risk of loss and that will depend on how much of its own money the developer is investing. It doesn't really matter whether that money comes directly as cash towards meet project costs or indirectly by writing off some of the money paid for the site. Or rather, it might matter to that particular developer, but it shouldn't matter to anyone else!

This is the nub of the issue. These issues are irrelevant in the context of the economics of the development business as a whole but might well be a constraint on the plans of any individual developer, busy juggling threats and opportunities. In some situations a Planning Authority might want to compromise in order to expedite a scheme failing which the logical outcome would be for the developer to abandon his plans or to sell the site. The latter might solve your problem but delay the eventual scheme. If you are desperate then you don't really have a negotiating position and can only haggle. And, of course, the grant of permission is no guarantee that the site won't be sold or the development stalled in any event.....

Part Two

The History of Levies on Development Land

In gauging what level of diminution of value from taxes and tariffs landowners might bear while still releasing land onto the market it would be foolish both to ignore past experience and to assume that attitudes couldn't have changed with new market and fiscal realities. the commentary that follows assumes that the dynamics of the land market is - to some extent at least - blind to the intrinsic distinctions between planning contributions and land taxes. po

Increases in the value of land arising from causes other than the owner's investment, have been seen as a theoretically attractive target for attempts to raise government revenues for some time. There have been several attempts to establish a tax since 1945. The salient features of each are described in summary form below.

The 1947 Town and Country Planning Act introduced a Development Charge payable by a developer on commencement of a development. The sum payable was equivalent to the full increase in value. This formed part of a wider framework aimed, in effect, at transferring into the public sector the benefit of the rights to exploit development opportunities. It appears that the supply of land to the market was significantly reduced following the introduction of the legislation and the Development Charge was abolished by the Town & Country Planning Act 1953.

A second attempt was made in 1967 with the introduction of a Betterment Levy in conjunction with the establishment of a Land Commission. The Levy was assessed at an initial rate of 40% (with a stated eventual target of 50%) of the difference between:

- 1. The sale price or value of a site with the benefit of any planning permissions and*
- 2. The current use value of the site plus 10%, or the purchase price, in both cases including the cost of any development works.*

This legislation was also a failure and in 1970 was repealed by the Labour Government who introduced it. Some of the reasons were administrative. It was very complex, and it took two years for the Government to recognise the need for relief for small schemes. The Land Commission was swamped with assessments.

A DoE Research Report in 1976 concluded from a study of house prices between 1963 and 1973 that land prices were a function of present and past house prices, while the volume of land sold was a function of house prices and the presence or absence of the Betterment Levy. The researchers estimated that while the levy was in operation the supply of land reduced by 30% but that the Betterment Levy did not itself affect land prices which in fact rose significantly during the period and even more quickly thereafter. There are clearly difficulties in distinguishing between various causes of movements in land value, but in both cases rises in house prices seem to have been the motor behind land value increases.

In 1973, a Conservative Government initiated and a subsequent Labour Government introduced the Development Gains Tax. For the latter, this was an interim measure and it was followed with the Community Land Act in 1975 and the Development Land Tax Act in 1976. This was carefully drafted legislation which married a determination to allow the State to share in gains from changing the use of land, with an attempt to learn from past

experience. The Community Land Act allowed Local Authorities to intervene in the land market in order to secure the supply of development land that was deemed to be needed. The Development Land Tax (DLT) was levied on the difference between the sale, or the market value of land (at a point referred to as a 'deemed disposal') and one of three deductions. These were key to the application of the legislation and are summarised below. The taxpayer could decide which to opt for.

- Cost of acquiring the land plus expenditure on improvements plus the difference between the Current Use value (CUV) at disposal and the CUV at acquisition, plus some special additions which in practice might be substantial since they related to interest rates which were high then.
- 110% of CUV plus expenditure on improvements which increased the development value.
- 115% of acquisition cost plus expenditure on any improvements.

If the owner had purchased the property recently the first and third approaches tended to give the best result. Where land had been in one ownership for some time, the second approach was usually the best for the owner.

DLT was originally set at the high tiered rates of 66% - 80% depending on the size of the liability. Responding to the experience of the unsuccessful Land Commission legislation, small transactions were excluded through an annual exemption of £10,000. The subsequent Conservative Government repealed the Community Land Act but initially announced that it had no intention of repealing the Development Land Tax Act although it increased the annual exemption to £50,000. (The eventual abolition of the Tax, sometime after the abolition of the Community Land Act, appears to have been relatively unexpected).

There are two key factors here which suggest that, if it had been left in place, the DLT might have worked. Firstly, what originally appeared to be cross party support for the principle of taxing development gains should have reduced the tendency for larger landowners to withhold land from the market in the hope of a more relaxed tax regime. Secondly, the combination of the calculation of the 'Three Bases' and the annual exemptions meant that landowners and in particular greenfield site owners, rather than developers, were most heavily affected by the tax. This was politically important at the time since land speculation and over development were popular political issues.

Received wisdom is that the Acts caused a major reduction in the supply of development land. An RICS / FT poll in 1978 suggested this. It is also suggested that it was not very successful in raising revenue. The reality seems to be rather more complicated.

As far as revenue is concerned, a total of £244 million was raised through 8,623 DLT assessments between 1977 and 1982. Receipts tended to lag due to the nature of the regime itself, and the amount raised in early years was indeed very low. This is partly a reflection of the way in which the tax was constructed. Although elegant in theory and carefully drafted, the macro economic conditions it operated within were unhelpful, with high inflation and interest rates. Furthermore, somewhat opaque key concepts such as the Current Use value of the land were often difficult to calculate in practice. This provided rich pickings for valuers.

As far as land supply is concerned, it is difficult to distinguish the DLT effect on land supply from the effect of wider market conditions during economically turbulent times.

Research carried out in Leicester in 1977 suggested that a quarter of landowners would

not sell their land while DLT was at 80 per cent. This equated to 60 per cent of development capacity, primarily because those affected were the owners of large greenfield sites. Oddly, the researchers also concluded that many landowners were prepared to pay DLT simply because they did not believe that it would be reduced or removed, and that the relationship between tax levels and land sales was not straightforward. This is clearly the case. For instance, the number of transactions in housing land was much higher in 1978 when DLT was levied at 80 per cent, than in 1975 when DGT was levied at 52 per cent.

With each of the taxes referred to, there was accompanying legislation aimed at ensuring an adequate supply of development land. In each case these arrangements did not work. From 1947, the Central Land Board used its Compulsory Purchase powers sparingly. The Land Commission was intended to be a central land assembly agency but simply failed in this role. Partly as a result of that, the implementation of the land supply and site assembly provisions in the 1975 Community Land Act was entrusted to Local Authorities. They did not have the capacity to undertake the novel role given to them and were not given enough financial incentives to pursue opportunities aggressively. The Community Land Act was also fated by being launched in very unhelpful market conditions. After repeal, its single legacy was the Land Authority for Wales, later merged with the Welsh Development Agency, which seems to have been judged to be a general success.

In conclusion, the limited amount of research suggests that the previous levels of tax did have an affect on the supply of land, but that landowners also take into account the prospects of the tax regime tightening or relaxing. Part of the reason that the various tax regimes eventually failed was their complexity, and partly the inauspicious circumstances in which they sometimes had to operate. There was also a general view that since its introduction in 1965, the Capital Gains Tax regime overlapped with DLT and muddied the waters of fiscal equity. But a key factor was that the potential effect on the land supply was recognised in the legislation, but the means of addressing this danger were ineffectual. In all, the failure of the attempts to tax gains in value of development land cannot be clearly attributed in their entirety to the rate of tax itself.

We conclude from this that any arrangement to secure contributions from developers towards infrastructure requirements needs to be based on a relatively simple and objective calculation, and should not seek an impact on development values as high as those sought through the various tax regimes.

The Three Dragons / Nottingham Trent Study and Atis Real Weatheralls Report (ARW)
Three Dragons and Nottingham Trent University were commissioned by the Greater London Authority to quantify the impact of various levels of social housing obligations in Section 106 Agreements, on the value of development across London. Subsequently, ARW were commissioned to evaluate the potential commercial impact of the implications of the Study.

Three Dragons / Nottingham Trent suggested a threshold of £2m per hectare below which they implied that land values would be too low for the market to operate and an adequate supply of housing land achieved. They further implied that competition for land from competing commercial uses would be a key factor.

It is also useful to note some of their subsidiary conclusions in the context of the affordable

housing proposals here. On the sensitivity of land values to changing assumptions the Three Dragons / NTU Study says:

"Residual values are very sensitive to changes in house price and density. Change in the mix of affordable housing tenures have far less impact, whilst the costs of dealing with special site development costs (e.g. decontamination) and other planning obligations can make a big difference to the residual values; The variation in residual values which arose from the sensitivity testing highlights the importance of taking into account site-specific considerations in assessing the amount of affordable housing which a site can deliver - at least from the viewpoint of its development economics. (Page 27)"

Regarding then £2 million threshold, the ARW indicates that: there is not a single theoretical threshold at which landowners will choose to release land for residential development.....Instead, we believe that the model should ideally reflect a threshold value surface, with a substantially higher base value (we would suggest £3.7m per ha based upon our experience of housing markets in London and the South East), except perhaps in east London boroughs, which would peak in Central London. In addition, we believe that landowners' consideration of thresholds is primarily related to the existing use value of their land rather than unconstrained alternative development value.

The £3.7 million per hectare figure appears to be the level which they believe is 'average' for housing land in the South East although, as previously noted at the beginning of this Section, the Barker Report identifies an average South East residential "bulk" land value of £2.76 million per hectare. They appear to think that market behaviour will create resistance to land sales below that point and while this might not apply to any specific transaction, the effect would be noticeable if the volume of land sales was aggregated on a regional basis. In the absence of any underlying research, both threshold figures are effectively based on a guess.

Thresholds in London partly reflect the need to attain better land values in alternative uses that in some circumstances (offices and retail) are far higher than might be obtainable in Cambridgeshire, or to deal with the higher costs of dealing with constrained inner city brownfield sites with attendant demolition problems.