The Role of Property in Financing Infrastructure

Edited by Tom Startup and Ann Rossiter

SOCIAL MARKET FOUNDATION

PREFACE

This paper is based on a roundtable seminar which was held at the Social Market Foundation (SMF) on 29th July 2003. The seminar was designed to examine the question of the role of property in financing infrastructure projects. The paper includes a restatement of the presentations given and also a summary of some of the main points that emerged from the discussion. An attempt has also been made to draw together some of the main strands of the discussion in the form of tentative conclusions.

Our thanks go to all who attended the event and particularly to our Chair and the four speakers.

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FOREWORD

If you ask anybody connected with development and regeneration what is the single most significant barrier to major progress, infrastructure will almost certainly be the first item to be mentioned, often then qualified further as transport infrastructure. Of course, we Brits like to think we invented infrastructure with the major provision of transport and other utilities in the Victorian and Edwardian eras, so it seems all the more ironic that we should now have fallen far behind other parts of the world in building the major public projects that are needed to move millions of people on a daily basis in a relative degree of comfort.

The problem is that we now have so much ground to make up and the building of roads, railways and airports is so hugely costly that it is difficult to see how a government committed to reducing its Public Sector Borrowing Requirement and to spending what extra cash it can raise on health and education can bridge the gap. So it is probably not surprising that government eyes are turning increasingly towards the property and development industry as a potential source of funds to make good the deficit between aspiration and means.

Contrary to popular belief, the property and development industry is not unwilling to make a reasonable contribution to infrastructure. Indeed we already put a huge amount of money into funding local projects through the existing Section 106 mechanism which is being stretched to cover an ever broadening range of needs by the more enterprising local planning authorities. But so far the debate has been relatively muted and indeed we have seen no firm proposal from government that could be publicly debated by both the supporters and detractors of either developer – or broader business – contributions. That may, of course, be about to change with the publication of Kate Barker's report on housing supply in which she suggests a planning gain supplement to be paid out of the enhanced value of land that is given planning permission for development.

The publication of this pamphlet could not, therefore, have come at a more timely moment, offering, as it does, a range of different views on whether and how the property industry might contribute to infrastructure projects. The

pamphlet does not offer a particular way forward nor indeed a definitive view on the best way of bridging the infrastructure gap. What it does show, however, is that all those connected with the property industry are more than willing to engage in a serious and sensible debate about how this barrier to successful development and regeneration can be surmounted and quality of life improved.

Liz Peace
Chief Executive, British Property Federation

OVERVIEW FROM THE SMF

Tom Startup, Research Fellow, SMF

How should we pay for transport infrastructure? Everyone wants high quality infrastructure because it is of great value to individuals, business and government. But everyone – including the government – would ideally have someone else pay for it. It's a classic free-rider problem in a modern policy context.

Often – although not always – the property industry is a major beneficiary of new transport infrastructure, with local businesses benefiting in the form of higher revenues, and developers and property owners in the form of higher rents and capital values. Intuitively then, the idea of attempting to 'capture' some of these raised values in order to help finance the infrastructure is an appealing one.

However in this context it is essential to remember certain abiding truths about the property market. First, although economic growth will tend to drive property values up in the long term, capital and rental values do not always rise. There can be significant periods of falling prices and values even following the introduction of much-improved infrastructure. So any mechanism for raising money from 'increased values' must be sensitive to the risk that the increased values will not in fact materialise as expected.

Second, property values are disproportionately influenced by macroeconomic forces such as changes in interest rates and wider economic forces. What this means is that it is very hard – probably impossible – to detach value uplifts that are the result of say, a fall in interest rates, from value uplifts that result from a new train station. Any mechanism that relied on being able to draw such a distinction would be flawed for this reason.

Lastly, the impact of the introduction of infrastructure on a given set of property values is sometimes positive, sometimes negative and, at best, uncertain – something our speakers all highlighted in one way or another. It is actually very hard to predict which properties will benefit and which will not from a given development because the consequences of new infrastructure for e.g. noise levels, and traffic flows in certain areas are so hard to calculate.

So these are some reasons to be cautious about the feasibility of mechanisms which attempt to 'capture' projected increases in property values.

The fact remains that the most obvious and easily definable class of beneficiaries from new infrastructure are the people who use that infrastructure. Imposing fares which more realistically capture the cost of using the infrastructure should therefore be a major priority. The case for fares to be held artificially low or subsidised by government expenditure is weak. A greater use of the fare box and premium pricing will be a necessary aspect of the future financing of major transport infrastructure projects.

And of course it must be remembered that the property industry already *does* provide funding, both directly and indirectly, for various infrastructure projects: through voluntary contributions, Section 106 charges, business rates, corporation taxes and other more indirect[1] forms of taxation.

By and large the use of voluntary contributions, joint ventures, and particularly Section 106 charges works reasonably well for small projects, where there are a limited number of beneficiaries, and where the project can be managed principally by a single local authority. However, problems emerge when much bigger projects, which may span multiple authorities or perhaps even many regions are on the table. Then things become more difficult.

So what of the options for bigger projects such as Crossrail?

Voluntary contributions could play some role in the financing of Crossrail but it cannot be a large one. The incentives for individual property owners and developers to free-ride – in the hope that others will contribute but they will still benefit from the new infrastructure – are simply too great, and the complexities involved in securing voluntary agreements too onerous. This is something Robert John's contribution highlights.

Section 106 charges are problematic too because they are determined at the level of individual local authorities, and Crossrail would span numerous authorities, as Richard Shaw points out in his contribution. Central government would have to have the means to impose a common charging structure across the affected authorities – something it is unable to do under the current framework.

A levy on the uplift in freeholder value or, even more ambitiously, the use of Site Value Taxation have also been mooted as possible mechanisms for financing infrastructure (or, for some, the whole business of government). One of the problems here is that the 'value' of the property is somewhat unreal – it is not unlocked until it is sold. So value may be hard to convert into cashflow. And measurements of 'uplift' are notoriously difficult to establish. Nonetheless freeholder value – although problematic – is something that businesses have

to account for in the balance sheet and so can be measured. But 'site value' is something even more abstract – the value of 'land' independently of any buildings that may be located upon it. Whatever merit there is to the arguments in favour of taxing property values, and there is some merit, it does not lie in an untenable distinction between 'land' and 'property'. Pragmatically, it is better to consider adaptations of the existing system of property rates rather than a complete overhaul.

So a levy on business rates is perhaps the most promising option. Businesses – whether as owner-occupiers, or merely occupiers – are one of the principal beneficiaries of new infrastructure in an area. Business rates are part of an existing system of property taxation which is widely understood and accepted (if not exactly appreciated). A levy on business rates would also, indirectly, be a way of charging owners and developers who would face correspondingly lower rents or prices.[2] Some preliminary analyses in this area, for instance that of Andrew Smith, suggest that some of the big businesses could manage a supplementary levy of 1-2% on existing business rates to help finance a project such as Crossrail.

However if such a levy is to work and, perhaps more importantly, secure acceptance, it is important that it is a) time-limited, b) limited to a specific area and c) tied to a specific project. More contentiously, it may need to be voted for by a majority of those affected. Here the key to an effective system lies in designing a procedure for defining who can vote and what is necessary to secure a go-ahead. In any case, such a levy would certainly require controversial primary legislation.

Whether this last option can be made to work will largely be determined by whether a scheme which is equitable, implementable and comprehensible can actually be formulated within the current system of property taxation and capital expenditure – and that remains uncertain. In any case it is clear that the solution will not lie in the 'discovery' of an ideal mechanism, for it does not exist, but rather in a greater capacity by central and local government to develop and adapt existing and new financing mechanisms to meet the individual needs of infrastructure projects.

[1] Indirect, that is, in the sense of being taxes which are essentially unrelated to property or infrastructure.

[2] This is not to say that rents would be lower than they are without the infrastructure. But they would be likely to be lower than they would be if the same infrastructure development went ahead but without any additional levy.

ATTENDEES

Chair

Tony Travers,	*London School of Economics*

Presentations

Michael Gunston,	*British Land*
Robert John,	*Canary Wharf Group*
Richard Shaw,	*FPD Savills*
Andrew Smith,	*Tesco*

Participants

Jeremy Edge,	*ATIS Real Weatheralls*
George Hazel,	*McLean Hazel*
Liz Peace,	*British Property Federation*
Chris Carter,	*British Property Federation*
Nigel Hugill,	*Chelsfield*
Justin Funnel,	*Sainsburys*
David Joy,	*London and Continental Property*
Paul McNamara,	*Prudential Property Investment Managers*
Roger Squire,	*Consultant*
Tom Startup,	*Social Market Foundation*
Tim Wacher,	*Royal Institute of Chartered Surveyors*

CHAIR'S INTRODUCTION

TONY TRAVERS, LONDON SCHOOL OF ECONOMICS

The funding of infrastructure through property is highly relevant both to the country's economic competitiveness and to the needs of urban areas, although by no means only urban areas, for renewal and regeneration. It is also enormously germane to the present government's capacity to deliver on a wide range of policy objectives

We live in a country with a very high degree of centralisation of public spending and of the public expenditure process, with over 95% of all taxation paid in this country being paid to national government[3] – the remaining five percent or so being council tax. These numbers are clearly indicative of the degree and balance of control between local and national government in Britain. For many years, indeed for the whole of the twentieth century, in effect one hundred percent of all capital expenditure by the public sector has been in the hands of central government.

Obviously the only real constraints operating on the private sector are those of shareholder acceptability. But the public sector, when it invests in larger projects, is very heavily constrained by this extremely centralised public finance system. This has meant increasingly that all major projects – and particularly major transport projects – are in effect not sanctioned by the Department for Transport but are rather sanctioned by the Treasury. This places the Treasury at the centre of the debate about public sector infrastructure.

The present government has faced significant demands for revenue expenditure – many of them generated by its own commitments, of course, towards education and health.[4] Given the demands for day-to-day revenue spending, particularly in health and education, inevitably these commitments have left little for capital expenditure, particularly capital for transport projects. So although there has been a slight increase in capital expenditure, even for transport, it is from an entirely derisory level.[5]

The Treasury's own records of public sector capital expenditure over a long period show that in the early years of the present government, capital expenditure was at a lower level than virtually any year under the last

Conservative government.[6] Since then, the amount of capital spending by the government has increased only marginally from a very low level. This has been one of the motivations for the government push towards mechanisms such as public/private partnerships, Private Finance Initiative, Section 106[7], and the recent development of the latest great panacea – the not-for-profit company. It is also one of the driving forces behind the search by many fertile minds for new ways of financing projects: tax incremental finance, sophisticated methods for deriving extra money from the business rate, and many others.

It is worth remembering that the effort expended developing new funding mechanisms for public infrastructure projects is spent in order to find clever ways for the government to overcome hurdles the government has set for itself. Even if successful models can be developed, the task will remain of convincing government, particularly the Treasury, that the measures can be put into practice without risk to the government's fiscal reputation.

[3] HM Treasury: total tax receipts 2002-3 £396.2 billion, of which: Council Tax £16.7 billion (4.22%), and business rates £18.5 billion (4.67%).

[4] HM Treasury: total managed expenditure in 2002/3 (est.) on education: £53.3 billion (12.7% of total managed expenditure); health: £65.9 billion (15.7% of total managed expenditure).

[5] HM Treasury: Capital expenditure on transport by central government, local government and public corporations: 97-98: £3797 million; 98-99: £3178 million; 99-00: £2978 million; 00-01: £3110 million; 01-02: £4940 million; 02-03 (est.): £5975 million.

[6] HM Treasury: public sector net investment: 97-98: £5.6 billion; 98-99: £6.4 billion; 99-00: £4.1 billion; depreciation: 97-98: £11.9 billion; 98-99: £12.3 billion; 99-00: £12.9 billion. Therefore, capital expenditure: 97-98: £17.5 billion; 98-99: £18.7 billion; 99-00: £17 billion.

[7] Section 106 of the Town and Country Planning Act 1990 states that local planning authorities may enter into agreements with those interested in land in their area to restrict or regulate the development or use of the land, permanently or over a period specified within the agreement, with the local authority free to include such provisions as it sees fit, including financial arrangements.

PRESENTATIONS:

Robert John, Canary Wharf Group

The underlying assumption throughout the debate on financing large-scale public infrastructure projects is that property must make a greater contribution to the cost. Yet which properties should be included? The inclusion of residential properties within any scope of properties earmarked for 'value capture' would certainly lead to an interesting debate, yet realistically no politician could countenance targeting home-owners and so it will be businesses which will be asked to carry the burden. Being pragmatic, if business really wants to see these major transport schemes delivered, then whether it is equitable or not, we will have to raise a contribution.

Canary Wharf invested around £110 million into the Docklands Light Railway, and further monies into the Jubilee Line. And since then we have invested another £94 million into the Jubilee Line which will increase its capacity by 45%. In each case we identified benefits and made a commercial decision that those benefits fully justified any expenditure. Yet in both cases we were not the only beneficiaries: many others benefited without any mechanism existing to capture their added value. Any new scheme should be more systematic – capturing value from all who benefit, ensuring equity and an evenly distributed burden.

Any proposed system must be transparent, understandable and capable of practical implementation. We have seen a number of tax regimes introduced which failed one of those tests and so ultimately failed[8]. Furthermore, when developing new schemes for value capture, we must be careful to pay close attention to specifics. Canary Wharf has been lobbying hard for Crossrail and we have concerned ourselves with all the policy facets of this project from the alignment, the supporting business case, procurement and, critically, financing. The greatest risk is if we were to allow government to impose another general tax. Any new imposition must be project-related and hypothecated to a specific new investment. It should not be used as a substitute for mainstream public investment.

The major options

In April 2002 we commissioned what was then CB Hillier Parker[9] to look at various approaches to infrastructure funding with the objective of examining what role property might have in contributing to the cost of Crossrail. The criteria cited above were noted: any system must be equitable, understandable, and practical. We also sought a structure for the levy that, as far as possible, would not deter employment or development. We focused on three main areas: Section 106 planning obligations, incremental rates and a levy on the uplift in freeholder value[10].

The work concluded that the first two approaches of Section 106 charges and an incremental business rate could largely meet the criteria of being understandable and practical and, I would argue, they are broadly equitable. However, Section 106 is a well from which everybody wants to draw and, like all wells, there are limitations on what you can draw from it. It is certainly no panacea for the financing of major transport projects.

The third option is a freeholder levy. There are clearly issues around the timing, area and scale of a levy, but these are not insurmountable. However, according to the CB Hillier report, this approach would create significantly more problems and, in fact, would struggle to meet any of the tests, and would be welcomed only by lawyers and agents mindful of the riches they could harvest.

Cash flow

The issues of infrastructure financing are not only related to securing investment but also to its flow. Politicians may understand value but they seem to find cash flow and its nature a little more puzzling. In this area, cash flow is complicated by the cyclical nature of the property business and the problems the industry has at different points in that cycle to raise cash.

Infrastructure gain can often lead to value gain, but not always[11]. Investment in infrastructure does not in itself create extra cash flow. This fact also points us towards rates and Section 106 payments as a way forward.

Canary Wharf has taken its work to the next stage to see how monies raised from these sources could be applied to help finance a project like Crossrail[12]. We are looking for a practical solution to a practical problem. The nature of cash flows from the two different models is different: from rates it is more certain, from Section 106 it is less certain both as to quantum and timing. In relation to the amount of income or its timing, this may not be an

insurmountable problem but it does demand that the two models are treated differently in terms of financing structures.

Since we have done this work, we have been working closely with Transport for London (TfL) on their ideas on tax incremental financing (TIF)[13]. There is much to commend the work that TfL has done, but the one thing TIFs do not achieve from the rather hard Treasury perspective is to give any certainty of extra cash. It is a process which seeks to utilise the extra tax revenues which result from new developments. However, the TfL work does indicate a way forward, possibly by combining this approach with incremental rates.

Conclusion

It is our belief that property can make a contribution, but its impact is limited and this contribution cannot solve the totality of infrastructure funding problems by itself. However, the ability to capture increased property value will be an important determinant of whether Crossrail proceeds. The critical criteria for any new financing scheme must be that it is structured in a way that is broadly equitable, implementable and understandable. Furthermore, it must be tied back to the project, be time-limited and hypothecated.

Discussion

- A potential problem with 106 agreements is that the authority collecting the charge would not be the authority in charge of financing the project. So, for typical infrastructure projects which span many local authorities, 106 charges are unlikely to work. For a project as large as Crossrail, there would need to be something like a regional (or national) 106 levy.

- It was also suggested that there would be great difficulties in trying to secure cooperation from several local authorities over a single project because they operate in such different ways and sometimes have conflicting priorities.

- It was suggested that even when 106 contributions are used, transport needs are a relatively low priority for local authorities.

- In terms of Crossrail, it was suggested that the benefits are roughly one-third nationally, and two-thirds to London, so charging should roughly reflect that division.

[8] An example is the poll tax – transparent and understandable, but not capable of practical implementation.

[9] Hillier Parker (2002) 'Crossrail: Property Value Enhancement'. Prepared for Canary Wharf Group Plc.

[10] This scheme would require, following the introduction of new transport infrastructure in the area, freeholders in a defined area to pay a tax on any incremental increase in the market value of their properties, as part of a contribution to the cost of the infrastructure.

[11] The CB Hillier Parker Study for Canary Wharf estimated the current value of stock in the Crossrail study area as being £107 billion and anticipated that its value would rise by between 5-10% after Crossrail – £5-10 billion. A 2% tax on the post-Crossrail value could secure £2.2 billion , or 37.5% of the value uplift.

[12] Hillier Parker (2002) 'Crossrail: Property Value Enhancement'. Prepared for Canary Wharf Group Plc.

[13] TIF proposals by TfL are mentioned in report number 8 of the Greater London Authority, by the Director of Secretariat to the Economic and Social Development Committee, 2 December 2003, which agreed the terms of reference and suggested an outline programme for the Committee's scrutiny into Alternative Funding of Regeneration. No report has been published.

PRESENTATIONS:

Andrew Smith, Tesco

The situation on business rates is already rather involved (they are subject to a fairly complex system of revaluation and transition) and a number of factors are complicating the picture further, including the small business rates relief and the Growth Incentive Programme. In addition, the Government's 2005 revaluation is approaching rapidly[14].

BIDs

A further complicating factor is the question of funding mechanisms for infrastructure. There are a variety of policy options here. On the service side, there are Business Improvement Districts (BIDs). These are pre-defined areas, in which local businesses vote for or against a particular levy on their business rates. There is a high degree of uncertainty as to whether BIDs will come into being, yet even if they did so they would only be appropriate for relatively small-scale, local projects, not for major infrastructure.

TIFs

In contrast, tax incremental financing (TIF), upon which Transport for London has been doing detailed work[15], promises to provide capital on a scale large enough to help fund the largest transport schemes of our generation. The fundamental premise is that if you can predict that investment infrastructure will lead to a rise in property values, then you should be able to capture some of that increasing value. This increased value, in the form of a revenue stream, can then be used to borrow up front to pay for the infrastructure.

Transport for London have been looking at two models of incremental tax. The first they describe as a 'modest proposal'. Under this scheme selected Infrastructure Development Areas (IDAs) are excluded from the rate calculation at revaluation, then the new rate is determined by applying an RPI cap on like-for-like growth outside the IDA. The new rate is then applied to all rateable values across the UK. Between revaluations the rate grows at RPI.

TIF model one

Using Crossrail as a case study helps to illustrate how the mechanism might work in practice. The particular area is specified and then excluded from the rate calculation at the next revaluation. In this case that could be either 2005 or 2010, depending on how quickly Crossrail is developed. The rate of growth should be different between the infrastructure zone and the rest of the country. Non-domestic rates would gain a share of the growth in the property values within the infrastructure area, in this case, in the region of Crossrail. The contribution of individual properties through the rates system would rise in real terms only if the increase in property values in the infrastructure zone was higher than that outside the zone.

The key risk lies in the assumption that the construction of Crossrail would lead to a greater increase in property values inside the infrastructure zone than beyond it, and that, in itself, is uncertain. Some infrastructure projects have had that result. The Helsinki Metro had an effect on house prices within a one kilometre radius of around 6%, although this was reduced in the immediate vicinity of stations, counterbalanced by negative environmental factors. Apartment prices within a similar ten minute walk from Hong Kong light rail stations experienced increases of 3%.[16] Yet this pattern has not been echoed in either Manchester or Birmingham with their supertrams. The Manchester Metrolink was judged to have had a very marginal negative effect on house prices[17], most probably due to mild adverse environmental considerations. The Sheffield scheme resulted in a 'modest' increase in house prices near the route before work began but it had a slight negative of around 3% in 1993 before flattening out again in 1996[18]. If the value uplift does not materialise then neither will the contribution that has been planned for.

In terms of fairness and equity, if this model of financing was used the majority of funding would come from within the infrastructure development zone itself, which would ensure that the rest of the country was not burdened with subsidising what could be perceived as a local project.

Under this proposal, premises that failed to benefit from the infrastructure development might be at least partially insulated from additional contributions, which, in the case of a simple supplementary rate, might not be the case. Using the latest transfer funds and estimates, a 20-year bond could raise £1.4 billion on the back of future tax increments over 20 years which would then be used to fund the Crossrail development.

TIF model two

The second model, a supplementary rate, is also relatively simple to understand. An additional levy is imposed on business rates within a certain radius from, in this example, Crossrail stations or proposed Crossrail stations, with that money hypothecated forward and used to securitise borrowing.

One problem with this approach would lie in setting the rate at the right level. But the main issue would probably concern equity at the local level. All properties would see their rates go up provided they are within a specified distance from the station, yet those just outside the boundary could see a drop and arguably a lot of them could still benefit from the new transport. Both models would require the enactment of primary legislation.

The main unintended consequence of this scheme is that the boundary question has the potential to create major market distortions and an impact on investment decisions. In terms of administration, the re-calculation procedure would be fairly similar as with the first model although some ring-fencing might be required.

Impact on Tesco

At Tesco, we estimated the approximate cost of a 1% or 2% supplementary rate levied on all of our commercial property within two kilometres of where we think the Crossrail station might be. The total cost would be around £150,000 per annum for us. This is a sizeable sum and could, other things being equal, undermine the profitability of certain outlets. Admittedly this is a rough calculation, but it is indicative of what this proposal would mean for a large business, but perhaps not one that is an intensive user of commercial property in central London.

Conclusion

The infrastructure development area for Crossrail would include around 10% of the UK's commercial property. The incremental impact on the rates bill of a 2% supplementary rate on all properties within a 2km radius of the proposed stations would amount to around 8% of the existing tax bill. For some companies that might not be manageable and could have perverse consequences.

The key questions which need to be addressed in relation to the financing of large scale transport projects such as Crossrail are:

- to what degree do the private and public sectors share responsibility for the scheme's financing?

- what principles should guide the nature of private sector contribution, both nationally and in relation to specific projects and localities?
- should value-capture methods be based on transactions, rises in property values, or both?
- to what extent should the private sector assist the government in developing the tools and mechanisms necessary for complicated financing?
- who should assess and bear the risks inherent within tax incremental financing?
- what should 'value capture' mechanisms capture – rises in property values, capital gains or both?
- what impact would different value capture methods have upon inward investment, business location decisions, regional and wider economic growth?

Finally, behind all of this discussion lies the assumption that there is additional property value to capture. This is far from certain and cannot necessarily be accurately predicted.

Discussion

- There was some discussion about Andrew's estimates of the impact of a supplementary rate of 2% on the rates bill for businesses. Largely, it was implied that the impact of a 2% supplementary charge was 'manageable' for many London businesses.

[14] The Rating Revaluation 2005 will be undertaken by the Valuation Office Agency (www.voa.gov.uk), to come into effect in April 2005. The valuation date for properties is 1st April 2003, though any physical changes in the subsequent two years will be reflected in the valuation, and therefore the rateable value.

[15] TIF proposals by TfL are mentioned in report number 8 of the Greater London Authority, by the Director of Secretariat to the Economic and Social Development Committee, 2 December 2003, which agreed the terms of reference and suggested an outline programme for the Committee's scrutiny into Alternative Funding of Regeneration. But no report has been published.

[16] S. Laakso, 'Public Transportation Investment and Residential Property Values in Helsinki,' *Scandinavian Housing and Planning Research* , 9, 217-229 (1992) and H So, R Tse and S Ganaesan, 'Estimating the Influence of transport on House Prices: Evidence from Hong Kong,' *Journal of Property Valuation and Investment*, 16, 397-410.

[17] F. Forest, J. Glen and R. Ward, 'The impact of a Light Rail System on the Structure of House prices,' *Journal of Transport Economics and Policy* 30, 15-29 (1996).

[18] F. Forest, J. Glen and R. Ward, 'The impact of a Light Rail System on the Structure of House prices,' *Journal of Transport Ecopnomics and Policy* 30, 15-29 (1996).

PRESENTATIONS:

Richard Shaw, FPD Savills

Section 106s

From a planner's perspective, there are a number of major problems for Londoners and developers with the current system of Section 106s. All too often local authorities are inequitable and inconsistent in their approach, which brings considerable uncertainty into the development and planning application processes. Furthermore, there is a great deal of time-consuming argument involved in the process of negotiating 106 charges, with the basis for 106 contributions continually changing[19], affected by both local and national politics. All this adds up to substantial planning delay.

There are a number of checks available in the present system: negotiation, legal challenge and the right of appeal. But all these avenues simply serve to inject further uncertainty into the process. This uncertainty quite often leads to an unhelpful tension between the land-owner and developer, particularly when a developer is acquiring a site right at the beginning of the overall process, when it is so very difficult to pin down what the range of issues are going to be, never mind the cost of resolving those issues.

The length of option agreements has also become quite a significant problem in light of developments increasingly becoming part of a comprehensive package, rather than an individual one-off development. The comparison between greenfield and urban regeneration is illustrative because greenfield sites provide a major difference in land value. With urban regeneration however, the margin may be much smaller, with site remediation and other costs being involved.

Issues for consideration

There are a number of issues worth considering when looking at Section 106s as a potential source of funding for major infrastructure projects.

First, a long-term project may take ten to twenty years to implement, during which time there may be two or more property cycles. At different stages in a developer's cash flow, values may need to be adjusted down to

compensate for falls in land prices. Section 106 contributions may no longer be feasible at previously agreed rates.

Despite this there are section 106 success stories, like the South West District expansion of Northampton which has been underway since the late 1980s. It's gone through the traditional 106 approach and it has worked, mainly because it is a greenfield site and there has been a substantial increase in property values. It has also been helped by the fact that English Partnerships and the NHS are two of the landowners, working effectively in partnership with private sector landowners and developers. Inspite of planning delays, the scheme has progressed because all parties approached the project as a consortium. Undoubtedly the results would have been very different if this co-operation had been absent – it shows that there is an incentive for major landowners to join forces. This project is producing 4 million square feet of employment and major infrastructure, including a 45 acre lake, about 4,000 houses, increasing to potentially 8,000 with higher densities.

Second, we are soon likely to have a new Planning Act which will bolster the regional approach to planning and infrastructural issues by cutting across local planning authority boundaries. The government is putting out a clear message to local authorities that it is going to be the regional branches of central government that will take the lead in defining new spatial strategies. Local authorities will have to conform to these strategies. If they do not, Central Government will intervene. This regionalisation of planning could potentially help overcome the problems inherent in a system of localised contributions where the developer would have to go through each individual planning authority and agreement would never be found. For example, as Milton Keynes grows, it expands into another county and spans four different planning authority areas.

Third, we need to consider whether it would be possible to impose a tariff of some sort for development contributions, with a standardised contribution towards infrastructure and other costs. This would potentially replace Section 106 contributions. Hypothecation of funds, specifically towards transport or other infrastructure would be essentiual for such a process to surplant Section 106 agreements. Is there the legal framework in place to achieve that or are we entering into an even deeper, murkier minefield of legal challenge? Consider Temple Quay in Bristol. The local Regional Development Agency (RDA), in collaboration with Bristol City Council, is beginning to finance and bring forward major infrastructure at the Temple Quay development.

A final question is whether it will be possible to levy access charges for roads and infrastructure in the future. At the moment this is not possible because roads are adopted by the highway authority and then become publicly accessible. However, there is a strong argument for looking at a mechanism for relating infrastructure delivery to land release.

If tariffs are going to be imposed, the plan-led approach needs more certainty and the appeal process needs to be reviewed because there must be a guard against developers evading the process. Hypothecation is also an important issue, with very clear terms required to define the way in which money gets channelled into projects.

There is also a tension arising between local and regional or other strategic requirements: local authorities will be more concerned about their local facilites and ambitions than they will about projects like Crossrail.

Discussion

- The issue of the level at which government operates (local, central, regional) came up again in the context of 106 charges only working at a local authority (not regional or national) level.

- It was mentioned that some developments, e.g. in Milton Keynes, cross three *regional* boundaries so even a regional spatial strategy may be hard to coordinate in such a situation.

[19] A report commissioned by the Office of the Deputy Prime Minister, entitled 'Delivering affordable housing through planning policy', and based on a postal survey of July and August 2000 found the average time taken to negotiate a Section 106 agreement to be around 6 months, and 7.3 months for Greater London.

PRESENTATIONS:

MICHAEL GUNSTON, BRITISH LAND

Infrastructure covers a range of matters essential to modern existence, but arguably the most important is transport. The quality of our transport infrastructure is critical to the success of British business. This is particularly true of London, a city which serves not only as the nation's capital but as a global hub, and also applies to other cities and towns. The upgrades in infrastructure necessary to preserve this competitive position will require tens of billions of pounds.

Limits on contributions from developers

British Land's overriding concern is the increasingly fashionable trend of local government, as well as central government, to consider that each development project has bottomless pockets. This is not the case. The existence of every scheme is predicated upon its ability to generate profit. The more schemes there are, then the greater the fight to secure tenants. The more demands there are for contributions to local infrastructure, the less likely that the development project will make a profit.

In such a climate there will be less willingness to put forward capital sums for infrastructure, particularly where the developer has no say in the management of those infrastructure schemes. It is crucial for the industry to persuade the government agencies involved that development projects cannot *automatically* fund affordable or social housing, new schools, road improvements and tunnels and lines for trains. There will undoubtedly be justifiable exceptions, where developments can withstand social contributions. These might include road widenings and roundabouts, for example. This is the case particularly where the properties are for owner occupation. Very often such works are essential for safe access to such sites and may, therefore, be regarded as relevant to the scheme. Frequently such properties as supermarkets which are cash generative in the hands of their owners may be likely to withstand social contributions. Other examples might include a new school or a library which are frequently dealt with by way of Section 106 contributions.

More difficult are the city centre schemes, particularly those in central London, where the rail and road networks appear to be under the greatest strain. Ambitious schemes such as Crossrail, which have been stalled for far too long – sometimes in excess of 10 years – are critical to the whole of central London, not simply the areas next to the primary stations. There is a real difficulty with any possible payment of capital sums in respect of existing buildings let alone future buildings. The rental market, and thus capital values, are extremely volatile, as we have seen in recent years. The beneficiaries will be London as a whole, or any other city receiving those improved facilities, in the shape of occupiers of those buildings, whether they be for business or residential use and, of course, visitors to the areas in question.

Funding from HMT

Major transport schemes should be undertaken by well-managed, non-governmental concerns but funded largely by the Treasury. This may require bonds to be issued and taxation to be redirected to specific projects. These funds should not be drawn from central taxation, but an overhaul of the local taxation system may well be appropriate. Further revenue will come from fares but an additional tourist tax on hotels, as used in Florida could also be considered[20]. Occupiers of the buildings will benefit from world-class infrastructure and businesses should be able to measure the benefits against any increased local taxation. This would suggest a general overhaul of the local taxation system, which may include more regular rating revaluations, a much more effective way of capturing the benefits of any infrastructure enhancements than the present inflexible system. It should be remembered that rating assessments relate to the rentals that might, or are, achieved in any particular commercial scheme. Residential rating now works on a slightly different basis, reflecting the capital rather than rental values.

Better infrastructure should, with all things being equal, point to higher rentals for commercial properties and capital values for residential, all flowing through to the rating assessments[21]. Critics of this revenue approach will inevitably say that this will merely impact upon the occupier rather than the owner or the developer. Prima facie, this is correct subject to the fact that occupiers tend to look at their total property outgoing, which will, after the calculation of overheads, indicate the amount that is available for rent, leading to indirect contributions from the property owner or developer. Second, from the property owner's point of view, better service schemes should generate higher

rentals without the likelihood of greater corporation tax and VAT, whether they stay in the same ownership or are sold as investments. The closer a commercial property is to transport links, the higher the demand from potential occupiers. This in turn should lead to higher rentals being achieved. If the position becomes competitive then a rent higher than that originally envisaged may be well be achieved. This is likely to lead to a higher profit which should in turn produce higher taxes – the higher the rent then the higher the stamp duty paid by the occupier. Additionally, VAT may be payable. The property industry as a whole should not be shy about the fact that it contributes some 15% of the UK's GDP[22].

Financing the capital's infrastructure

London exports £20 billion of taxes each year to the rest of the country[23], this should not be overlooked when considering the capital's transport requirements and may well be worthy of adjustment.

The topic of infrastructure, in particular rail schemes, should be taken as far as possible outside the political arena and into something akin to a development corporation empowered to raise revenue by way of a ratings surcharge and the ability to securitise the projected income stream. Such a corporation may or may not be so equipped to invite private equity. It is hoped that such a structure will enable projects to be tightly managed and free from government intervention.

Government has already indicated the possibility of local authorities being able to retain rating revenues, generated from increased commercial activity. Whilst this would be helpful under the present system, its utility may well alter under any reformed system of local taxation. The debate surrounding the funding of London's necessary transport investment must be wide-ranging, looking at the wider local tax framework, rather than simply focusing on a predefined and limited remit.

[20] A Tourist Development tax was introduced into Florida in 1989 and was contributing $109 million, to the state economy according to the 'Florida Visitor Study', Florida Department of Commerce (1995). The option to levy a 1-5% tax on lease and rental charges for holiday accommodation has been taken up by over 40 of the state's counties.

[21] see Andrew Smith above.

[22] Total property-related GDP – which comprises construction, letting of dwellings plus imputed rent of owner occupiers, the real estate sector, architectural and engineering consultancies, property-related value added in the banking sector and in other financial institutions accounted for 15.3% of total GDP in 2001. 'Commercial Property Quarterly Review: June 2002', British Property Federation.

[23] London exports £20 billion of taxes each year to the rest of the country GLA Economics Working Paper No. 6: *Calculating London's Tax Export*, March 2004.

GENERAL DISCUSSION

- It was pointed out that not all transport infrastructure is likely to result in increased property values and so any mechanism which was based on this would only be of limited application.

- There was some disagreement about whether the Treasury was failing to understand that new infrastructure already does provide increased tax revenues or whether it was simply choosing not to appreciate that fact in negotiations with private sector partners.

- Some frustration was expressed as to the plethora of bodies with competing interests involved in the development of transport infrastructure, all governed by short-term politics.

- It was suggested that a major public utility such as Crossrail should be entirely funded by central government.

- One problem mentioned was that the impact of Crossrail is very diffuse and spread across an area which is not governed by any single government authority.

- It was suggested that this whole debate about new funding mechanisms is simply part of a negotiation between the Treasury and the private sector as to their relevant contributions towards Crossrail.

- It was mentioned that the main problem with TIF from the perspective of the Treasury was that there was no certainty on day one as to the money being available.

- The timing (relative to the economic cycle) of any decision on infrastructure projects was important.

- In terms of the cost of financing, it was pointed out that by far the most important consideration was the rate of interest payable – something that could change considerably in a short period of time.

- It was argued that the government should simply raise tax – any tax – in order to pay for the infrastructure. However, almost all attendees believe that additional funds or tax revenues should be hypothecated.

- It was discussed whether putting new tax proposals to a business vote was important and there was considerable scepticism about whether businesses would agree.

- There was some discussion about whether regional governments, with their own 106 powers, could help ensure that infrastructure was built, with general agreement that it would. But one participant argued that some of the major projects would cross more than one region so the problem would reappear in a different form.

- General scepticism was expressed about the potential of using council tax to raise revenue. It was felt that it would be both unpopular and ineffective.

- Professor George Hazel explained at length how his company works as a middle-man between the developer, the government and the landowners to get around the problem. They assess the potential impact on property values of the development. Then they seek to secure voluntary agreements from landowners to make a contribution towards the cost. Once they have agreement from the landowners to pay a fee, and from the developer (and authorities) that it is acceptable, the money is paid into a Deed of Trust.

- The idea of a Development Corporation with limited powers to impose levies and raise debt was raised as a potential model. It could have some powers to negotiate 106 agreements, use TIF or impose a levy on business rates. However, it was suggested that there could be a problem with the democratic legitimacy of such a model if it did not include a strong element of voting.

- It was generally agreed that there was a lot of distrust and incomprehension between the private sector and local authorities which hampered the ability to form successful partnerships.

- The idea of a tax on the increasing capital value of commercial properties was was considered to be too much of a departure from the existing system to be worth pursuing.

- Site Value Taxation was mentioned briefly only to be roundly dismissed.

- Premium pricing – pricing new infrastructure higher due to its greater convenience – was discussed. Most attendees thought that for particular projects where there were other inferior alternative means of transportation, premium pricing could be an important potential source of revenue.

- There was discussion about the merits of regionalising payment for transport infrastructure, given that most transport projects are of much more benefit to those who live close to them than those that live in another part of the UK. Broadly it was felt that a greater regional focus would be fairer and easier to justify to both businesses and voters.

- The merits of securitisation against future revenues were discussed and it was felt that part of the Treasury's hostility was to do with the fact that it could be deemed a contingent liability and therefore have to be accounted for as part of the PSBR. An additional objection was thought to be that it might raise the costs of borrowing above what is normally available through issuing government debt.

CONCLUSIONS

1. The seminar concluded that the industry continues to be frustrated by the way in which government bodies operate in relation to infrastructure projects. In particular, chronic short-termism, a failure to understand commercial priorities, and an unwillingness/inability to provide up-front capital funding continue to present obstacles to effective public-private partnerships.

2. However, the seminar recognised that transport infrastructure must compete with a number of other government priorities and that the restrictions imposed, on government borrowing for instance, are here to stay.

3. In this context, the seminar accepted that the industry is a major beneficiary of some, although not all, infrastructure projects and is not inherently opposed to new forms of property-related taxation or charging to raise money for such projects.

4. However seminar attendees believed that private individuals are also a major beneficiary of infrastructure projects and that they should also contribute towards the cost of infrastructure, probably through the fare box, or pricing structures, in most instances.

5. While the property industry will continue to play an active role in financing new infrastructure the seminar believed that for many projects – particularly very expensive ones that span great areas – government must continue to play a crucial and leading role.

6. The seminar found that new forms of funding mechanism should meet the criteria of being equitable, understandable and implementable.

7. What counts as an equitable mechanism is principally one that raises money from those that benefit from the infrastructure, and to the extent that they benefit.

8. The seminar believed that the industry is likely to be positive about new forms of financing infrastructure to the extent that they:
   - constitute methods of raising *additional* finance and are not used merely as a substitute for existing commitments from government
   - are tied to specific projects (hypothecated)
   - are time-limited
   - raise money from those who directly benefit from new projects and to the extent that they benefit from them
   - have a public sector partner at the appropriate geographical level
   - allow the industry to have influence over the development and delivery of the infrastructure
   - are not overly punitive.

9. The seminar felt that a single mechanism is not likely to provide the 'answer' to how to fund new transport infrastructure. Instead a number of different tools are appropriate, each with their own advantages and disadvantages. New infrastructure is likely to be funded by a package of these mechanisms rather than by any particular mechanism.

10. The following mechanisms are all considered appropriate mechanisms for raising money for new infrastructure:
    - voluntary contributions
    - Section 106 charges
    - Business Improvement Districts (BIDs)
    - a levy on business rates (TIF)
    - premium pricing / fare box.

    Voluntary Contributions:
    - may work well where there are a relatively small number of beneficiaries each of which benefits substantially
    - work less well where there are a large number of beneficiaries and where each beneficiary only benefits to a small extent
    - will not work where there is a strong expectation that the development will go ahead eventually even if there are no contributions
    - can be facilitated by the use of a third party mediator or negotiator who can forge contractual agreements and help encourage all beneficiaries to contribute.

Section 106 charges:

- work well for relatively small projects that do not span more than one local authority boundary and where the overall cost of the infrastructure is small relative to the value of the development
- are already being used for a very great number of purposes by local authorities
- become unwieldy for large projects that span many local authorities or regions.

Business Improvement Districts:

- are likely to work best when the development is driven by the business community in a relatively small area
- won't work for projects it is believed the government will finance
- are not suitable for large projects.

Levy on Business Rates: the 'Modest Proposal':

- presents a relatively high risk that the expected incremental revenue will not materialise
- entails a lack of clarity about who will take the risk and whether such borrowing would be on the government's balance sheet
- would mean borrowing against such revenues would be more expensive than ordinary government borrowing
- has the potential for market distortions around the 'border' of the IDA.

Levy on Business Rate: Supplementary Rate:

- entails relatively less risk than the modest proposal that expected incremental revenue will not materialise
- involves a relatively higher risk that the rate will be perceived as 'unfair' by those who do not directly benefit and could constitute an unacceptable burden on businesses
- also involves a lack of clarity about who will assume the borrowing and burden of risk.