

HMT/ODPM CONSULTATION PAPER: PLANNING GAIN SUPPLEMENT

1. Scottish Ministers welcome the opportunity to comment on the consultation paper. We strongly share the proposal's stated objective of promoting investment to support regeneration, affordable housing and development more generally. This is critical to the Executive's goals of encouraging safer stronger communities and securing economic growth.

2. We have, however, found it difficult to come to a firm view on the potential for these particular proposals to succeed, in the absence of many of the key details which will define the workability and impact of the proposed supplement. It is clear that the effect of these measures will vary across the UK, according to the political, institutional, economic and commercial context of the areas in which the measures are applied. In particular, there are distinct implications for Scotland which need to be tackled in the specific context of the devolution arrangements. With this in mind, we have identified a number of issues which do require to be addressed before a final decision to proceed is taken.

3. There are three main areas of concern: that a misconceived final design of the planning gain supplement might constrain rather than support development and regeneration; the tensions that arise from divergent planning systems and other differences in approach in devolved policies; and the need for transparency and equity in the distribution of the revenue. These concerns are summarised below, and Annex A provides a more detailed and technical commentary on the proposals.

4. We understand that this consultation is only the beginning of the process of refining a workable measure. As the development of this policy enters the next and critical phase, it is essential that our respective administrations work closely together, to ensure an outcome suitable to us both.

Impact on Development and Regeneration

5. First, we believe that, if the details of the proposal are misconceived, the planning gain supplement (PGS) might act as a disincentive to development. We support the strategic principle that additional funding for infrastructure should facilitate investment in development. But at the level of individual decisions, there is a significant risk that deterrents to development would prevail. The marginal effects of PGS might either encourage landowners not to release land for development, or might render otherwise sustainable developments economically unviable. Our development industry has expressed considerable concern both over the effect of the proposed timing of the tax liability on cashflow and eventual profitability, and over the potential threat to the up-front delivery of essential enabling infrastructure.

6. The potential disincentives to development are most likely to apply outwith areas of high economic growth or high land values. This would affect development across much of Scotland, with its large remote rural areas, and its areas of high regeneration needs. The Barker report on housing supply, which was the origin of the current proposal, was predicated primarily on the housing market conditions in England. As recent Scottish reviews have shown, Scotland's housing and wider development economy is very diverse and differs significantly from that in England in several respects. This means that it is likely to react differently to the introduction of a land development tax. These effects are likely to be particularly significant in smaller-scale developments, which form a greater proportion of

activity in Scotland compared to England, and in the re-use of brownfield sites which are important in the wider regeneration effort. If the net effect is to act as a brake on development in most areas of the UK, it will be particularly acutely felt in Scotland, given the different nature of the market and prevailing land values.

7. Some of the negative effects are likely to be most marked during the transitional phase of the policy, as the market adjusts to the new conditions prevailing. The way in which land deals are made, at times with options over fifteen years or more, means that it will take a very long time before transitional effects fully unwind. There needs to be a better understanding of how transitional issues might affect the viability of the measure immediately preceding and following its introduction..

Interaction with Devolved Decision-Making

8. We must also ensure that the full implications of the devolved settlement are acknowledged and accounted for under any new arrangements. Although the proposal is for the planning gain supplement to be a UK-wide measure, it would be predicated on the operation of our respective planning systems, which are devolved, separate and increasingly divergent. Officials have already identified areas where technical differences in the two systems may affect the workability of the supplement.

9. Perhaps more importantly, the direct impact of the supplement would be on policies of devolved responsibility – planning modernisation, housing supply and affordable housing provision, local government finance and responsibilities, and the provision of local and national infrastructure. Our planning modernisation proposals, for which a Bill is currently in the Scottish Parliament, are strongly based on the principle that the effects of planning applications are considered and mitigated through local engagement. The disconnection of infrastructure provision from individual applications implied by the PGS and accompanying restriction on planning obligations would appear to militate against that principle.

10. As you might be aware, the Executive has recently introduced new measures to promote the supply of housing, and affordable housing in particular. These are key to supporting our objectives of creating stronger and safer communities. Under the terms of Planning Advice Note 74, the principal means of securing affordable housing provision will be through planning agreements under section 75 of the Town and Country Planning (Scotland) Act 1997 – equivalent to English section 106 agreements. Experience of s75 agreements has not, however, mirrored that of s106 agreements in England, where their expanding use appears to require greater control. We see section 75 agreements as a key tool in bringing improvements to accompany development at a local level and at the right time. This is, as you know, an area of devolved responsibility, and we would be keen to preserve the full flexibility to design our policies on these agreements as we see fit.

11. We would also be very concerned if the effect of the PGS would be to place extra burdens on those central to the delivery of our key policy objectives of affordable housing provision and regeneration. We rely heavily on registered social landlords, the agency Communities Scotland and Local Authorities for the delivery of our housing investment programme. It would not be desirable for the achievement of investment objectives to be compromised by the imposition of a greater burden on those public bodies. Indeed, we feel there is a strong case to remove public bodies and registered social landlords from liability for PGS, particularly where the land in question is to be developed solely for the provision of

affordable housing. We would also appreciate a greater understanding of the burdens that are to be placed on local authorities in supporting HMRC's administration, collection and enforcement of the PGS regime. As you are aware, additional burdens on local authorities will require additional resourcing.

The Recycling of Revenues Raised

12. It will be essential to understand and be transparent about the basis on which any revenues raised would be recycled to Scotland. At present, the proposals have caused considerable confusion and concern over how the resources to be allocated would be calculated, and the mechanisms for implementing those allocations. Clear public understanding of these issues would help address concerns over the breakage of the link between infrastructure provision and development. The basic justification for the planning gain supplement is to support the provision of infrastructure through the revenues raised, and this will need to be seen to be done.

13. It would be helpful to know whether it is the intention that 100% of planning gain supplement revenues would be recycled. As we currently understand it, the amount to be distributed would be split into two portions, with the larger of these directed to local authorities and the smaller directed to "strategic" infrastructure. We note the consultation paper's statements that "PGS revenues will be dedicated to financing additional investment in the local and strategic infrastructure necessary to support growth" and that "The Government anticipates that an overwhelming majority of PGS funds will be recycled within the region from which they derived". We strongly urge you to ensure that the principles on which distribution will be made are fair and transparent, with the revenue allocated in proportion to the sums raised.

14. As you are aware, the arrangements for distribution to Scottish authorities are different to those in England. Final distribution decisions for both elements of the recycled revenues will be a matter for Scottish Ministers. We do, therefore, need to know the parameters within which we will be working when making decisions on these distributions.

Seeking Solutions

15. As stated in the introduction, it is difficult to come to a firm view on the workability of the proposals without further detail on some of the key points. We would wish to seek a solution that would be practical in Scotland as well as the rest of the UK. Given the differences that exist, it may be difficult, but any solution would need to address the following issues:

16. First, there needs to be appropriate flexibility in the application of the proposed supplement. The variability in market conditions, and greater susceptibility of certain areas to the marginal effects of PGS should allow for different rates to be applied to different areas. At the very least, there must be a lower rate applied to brownfield sites. We consider that there is also a case for lower rates in other areas where the conditions supporting development are already weaker – in particular, remote rural areas. Lower rates may also be appropriate as part of a transitional phase when the supplement is introduced.

17. Thought also needs to be given to the scope of the supplement. In addition to the necessary exemption for householder improvements, we would not welcome a tax that acted

as a disincentive to small and medium sized enterprises to upgrade their premises, in particular where it is important to maintain the vitality of our town and city centres.

18. Second, thought needs to be given to the micro-economic effect of the supplement – in other words, how to ensure that investment and development would not be deterred by the supplement’s impact on cash-flow, viability and profitability of individual projects. It is rare for a tax to be levied on gains that are not yet realised, and there may be a case for phased payment of the supplement. If this tax is combined with the continuing need for developers to provide infrastructure up-front to allow developments to take place, the effect could be to stifle active development. Development interests here have suggested that expenditure that is certified as necessary infrastructure provision could be offset as some form of tax credit against liability for PGS. Alternatively, local authorities could pay the developer on site to carry out the infrastructure work pre-commencement, and then recoup costs from the PGS budget. We consider that both suggestions merit serious consideration, not least because they would address the fact that local authorities are not well placed to procure work of this kind.

19. Third, there needs to be a commitment that the PGS will take into account the present system and not frustrate existing policies or enforce the introduction of differing policies in areas of devolved responsibility. It will be essential for the further development of this measure to take full cognisance of the divergence in planning systems, on which the proposal depends so heavily. Officials have already identified areas for further exploration, and we would be very happy to work more closely in order to ensure the full implications are understood. This includes common work on the issues relating to “start notices”, a concept we have introduced in our Planning Bill, which inspired the parallel proposal for PGS.

20. Fourth, the most critical element of these proposals is that relating to the redistribution of the revenues raised. It is here that uncertainty and confusion over the basis for deciding how allocations would be made could be most damaging if allowed to continue. We would of course welcome and support a transparent and equitable distribution of the monies raised through this proposed measure. We would welcome a clear indication that the revenues are to be distributed as additional funding recycled in proportion to the amounts raised.

21. Finally, we would like to reiterate that we will be keen to work with your officials in gaining a greater understanding of the full implications of potential costs of this proposal in the devolved context – its practical workability, the costs to be incurred, the effect of differing planning systems and other policies, and ensuring the effectiveness of the investment funded throughout the UK.

Appendix I: Detailed Commentary

Valuation Issues

1. In general, we are concerned that “self assessment” of both current use value and planning value would, in practice, be highly difficult and complex. It will almost certainly be necessary for developers to contract professional valuers in cases of any complexity. Valuations will be costly to obtain, and may be subject to challenge, adding to the cost, bureaucracy and delay of the system.

2. It may be more difficult to assess **Current Use Value** than the consultation paper suggests. For example, it would be hard to establish the existing use value for a contaminated site incorporating a disused warehouse, where planning permission has been granted for it to be demolished and the site reused for flats.

3. The proposed method also does not take into account potential disparities in current use value and the sums developers will actually pay to purchase land. Developers actively manage their land banks, acquiring sites that they can promote through the planning system. Where they consider that a site has a good chance of being allocated for development, they may pay more than existing use value – often referred to as ‘hope value’ when acquiring land. . This will in practice diminish the actual uplift in value available to them. It may be more equitable and practical to apply accounting type historic values with existing use taken as a revalued input cost in the CGT style with allowance for ‘hope value’.

4. To prevent this happening, it would not be sufficient merely to assume that the CUV is as if no permission has been granted, as this would penalise those who genuinely bought a site with extant permission at market value. There is also an associated issue with development plan allocations – an allocated site, if subject to valuation may well be considered to be worth substantially more than an unallocated site, given that we operate under a plan-led system.

5. **Planning value** is also difficult to determine, particularly if the calculation is retrospective. The valuer would need to know the state of any contamination at the time, the state of the infrastructure, local demand for that kind of property, any legal burdens or other obligations that might affect the value. There would need to be absolute clarity on prior charges against liability, in particular in relation to planning obligations, and how they are to be calculated. Officials have already indicated their willingness to work with HMRC to develop valuation methods that are practical and sensible.

Potential Disincentives for a) Release of Land and b) Development

6. There is, of course, the general risk that the imposition of planning gain supplement would depress land values to the extent that landowners change their willingness to release land for development, instead waiting in anticipation of a change in policy. As a general rule, the imposition of a tax tends to constrain supply. It is important in this regard to understand the likely differential effects in different areas of the UK. We expect that landowners would be less willing to release land for development in Scotland and other areas where the marginal effects of planning gain supplement are likely to be highest.

7. Where land is made available for development, the introduction of PGS might also act as a disincentive to develop. The payment of the charge prior to the commencement of development, when a developer is most financially committed, would significantly affect the economics of a development. At the start of the development process, there will be payments due for the land, infrastructure, materials and wages, but this would be prior to the point where a development may have generated a revenue stream. This would increase borrowing costs, and consequently affect the developer's cashflow, with the achievement of profitability pushed back further into the future. This could render the development uneconomic, or at the very least, increase the risk associated with development. This would make it harder for developers to secure funding from investors or banks.

8. This disincentive to develop could particularly apply in areas of regeneration, with a high preponderance of contaminated sites. The current use value of an old warehouse that nobody wants in a neglected industrial area with disused factory on a contaminated site may be nil or even a negative sum. As a residential site it could be very valuable. A requirement to pay tax levied on the uplift between nil and residential value is unlikely to be an incentive to bring such sites forward, especially as the costs of remediating the site to realise the value will be substantial.

9. The property development industry here in Scotland has highlighted the difficulties if the direct relationship was to be broken between a development and the provision of the infrastructure it requires. The circumstances of an individual development could mean that a essential infrastructure is required in the early stages of a development to enable that development to take place. Combined with PGS this, in effect, would create a 'double hit' on the developer, again making the economics of development less attractive. In the event that PGS does not provide a sufficiently flexible mechanism to deliver the necessary infrastructure at the right time, a developer would be likely to have to undertake the essential enabling works in order to be able to proceed with the development as well as paying PGS..

10. There is a risk that the proposed broad scope of the supplement would act to suppress growth and regeneration. The consultation paper proposes applying PGS beyond housing development, to all commercial development. This means that liability would extend to small businesses when they intend to upgrade or extend their premises. Again, the marginal effect of the proposed supplement could well be to stifle the revitalisation and regeneration of our town centres. We would therefore strongly support an exemption for small-scale commercial applications.

Relationship to Devolved Policy Areas

11. There are 2 principal areas to consider:

- (a) How planning gain supplement would interact with the differing planning systems; and
- (b) The implications of the proposed supplement for broader areas of devolved policy.

A. Interaction of PGS with the Planning System

12. There are a number of ways in which the operation of the proposed supplement, which is predicated upon the respective planning systems of the devolved administrations, could give rise to inconsistencies and anomalies. Depending on the scope of the supplement, variations in the systems' permitted development rights could create inconsistencies in the applicability of the supplement. Developments which require planning permission in the one system could be subject to permitted development rights in another. This would lead to a situation where identical developments either side of the border may differ in their liability for the supplement. We need to consider whether the extent to which this may happen would be so marginal as to be acceptable.

13. Officials have also identified other differences in the respective planning systems, relating to the point at which planning permission becomes active, which may also have a significant effect on the workability of the supplement. These need to be explored further, jointly with HMRC and ODPM officials.

14. A further complication arising from changes to the planning system in Scotland is that we are proposing the introduction of development start notices for planning purposes; an idea which was the inspiration for the start notices in relation to planning gain supplement proposed in the consultation paper. It would be important to ensure that the requirement for 2 start notices, one for planning purposes and one for tax purposes, did not lead to unnecessary duplication and a burden on developers which penalised development north of the border. There is of course the much wider question of the role local authorities would be expected to play in helping HMRC monitor and enforce the proposed planning gain supplement system. Further clarity is required on the extent to which local authorities will be expected to monitor and enforce the provisions of the scheme.

B. Implications for Broader Areas of Devolved Policy

15. This paper has already referred to the potential constraints on regeneration; particularly if the supplement rendered development on brownfield sites unattractive. But the most direct and significant impact of the proposed planning gain supplement on devolved policy would be the effect it has on the current means by which planning gain is captured and then spent. In Scotland this is regulated by Section 75 of the Town and Country Planning (Scotland) Act 1997 which allows for a system of planning agreements similar to that in relation to planning obligations under Section 106 of the English legislation. The interrelationship between PGS and s75 planning agreements and obligations will have very significant implications for other devolved policies such as affordable housing, health, transport, environmental protection and education.

16. In relation to the provision of affordable housing, Scottish planning advice in March 2005 set a benchmark that serviced land to accommodate 25% of the units on any site should be made available for affordable housing contribution and this recent advice is beginning to have a significant impact on expected to make a real and growing difference to the delivery of land for affordable housing across Scotland. It should be noted that the definition of affordable housing differs North and South of the Border, with low cost housing for sale included within the terms of our planning guidance. There could also be adverse impacts for health and education portfolios, both in the constraints on their ability to dispose of redundant assets for development in lower receipts available to reinvestment directly in services, and in

the potential loss of the provision of new facilities through the negotiation of planning agreements

17. We note that the consultation paper proposes that Section 106 obligations will be subject to tighter legislative controls in order to restrict the scope of such obligations to the provision of affordable housing and to matters directly related to the development on site. We would have to consider carefully the implications for the Scottish provisions in relation to planning agreements. The current Planning Bill seeks to expand and reinforce the role of planning agreements as a tool for securing local improvements at the right time, in a transparent and locally understood system. The legislation does not currently include provision for the scope of agreements to be curtailed. Until now, they have satisfactorily been regulated by means of administrative action, and it is current policy for this to continue.

Allocation of Resources

18. This will be the key to public understanding and acceptance of any proposal. It needs to be absolutely clear how much of the total PGS collected would be recycled as infrastructure expenditure and the mechanisms for doing so. The absence of detail has made it hard to come to any conclusions on the viability and implications of the proposed measure. The impact of PGS will of course depend on the amount raised, itself a function of the rate or rates at which it is levied. With no indication of what that rate might be, other than it will be “modest”, it will be hard to determine its potential significance in supporting additional investment. There needs to be a reconciliation of the apparently conflicting lines that PGS will fund genuinely additional infrastructure on the one hand and that it will be funding infrastructure that was previously provided through s.75/s.106 agreements.

19. There are specific issues in relation to funding in Scotland. The questions that need to be answered include:

- ◆ In relation to the proposed split between sums to go direct to local authorities and sums for regional infrastructure works, what would the split be applied to? Would it be the total tax taken or would the total distributable amount (at a UK level) be some other (lower) amount?
- ◆ How will the split between the resources for local and strategic infrastructure be determined?
- ◆ In any application of the Barnett formula to determine devolved administrations' share of the Departmental Expenditure Limits element, will there be applied a 100% comparability factor?
- ◆ What arrangements would be made to ensure transparency of allocation under a Barnett formula process?
- ◆ Are we also to assume that we will be unable to use the approved budgets until some payment approval mechanism is triggered by the receipt of PGS by HMRC? If so, this will exacerbate the disconnection between local development and local infrastructure provision.
- ◆ If the receipt of PGS is the only trigger for the release of recyclable funds then there will need to be a clear mechanism for the relevant data to flow back from

HMRC to ODPM and Devolved Administrations. What will this be, and how will it be resourced?

- ◆ The recycling of PGS to the Devolved Administrations would take the form of appropriate budget approval in the Scottish Parliament. Will that not give rise to difficulties in timing for budget setting? The Scottish Spring Budget Revision will be the last opportunity to provide cover for expected PGS recycling in any year.