

Land value capture

Final report
Executive Summary
February 2017



'Then, as the millennium was dawning, a miracle happened. The government returned every penny that I had paid in taxes over the previous 40 years. So for four decades I had lived tax free – and I had not dodged the taxman! How was this possible?

I 'confessed' in 'Taken for a Ride'. Taxpayers generously funded the extension to the Jubilee Line, one of London's Underground lines. Two of the stations were located close to office properties that I own. Those two stations raised the value of my properties by more than all the taxes that I had paid into the public's coffers over the previous 40 years.'

— Don Riley in Harrison, F (2006) *Wheels of Fortune*

In the March 2016 Budget, the Government invited Transport for London (TfL) to submit detailed proposals for funding transport projects in the city using land value capture. Additionally, in July 2016 the Mayor of London reconvened the London Finance Commission, to help the Mayor and London's local authorities improve the tax and public spending arrangements for London to promote jobs, growth and greater equality. This technical report and supporting annexes are the result of a joint study by TfL and the Greater London Authority (GLA). Their purpose is to support policy discussions with Government, the Commission and wider stakeholders. They do not represent TfL or Mayoral policy.

Final Version – 20 February 2017

Executive summary

London has achieved remarkable success as a world city, attracting people and business from across the world. This success brings challenges, with increasing pressure on transport and housing supply and affordability. Solving these issues is necessary if London is to continue to function as a globally leading city. In particular, improving and expanding transport provision is central to driving economic growth, jobs and housing. At the same time we need to make London fairer, healthier and more sustainable, and continue to make life in the city better. Substantial investment over a sustained period is needed to enable this and the question of how this is to be funded is now a pressing one.

Since public transport generates significant positive externalities, it is not efficient for fare payers to cover all capital expenditure. In the past, general taxation has funded the gap (including business rates and government grants). But as the funding requirement grows, without alternative funding sources, there is no obvious way of paying for major network upgrades and extensions, other than increasing the burden on general taxation. Land value capture (LVC) is one such alternative funding source. This report investigates ways in which the Government could work together with the Mayor of London and ourselves at Transport for London (TfL) to improve the ability to capture land value uplift to fund transport investments in the Capital.

Land value capture refers to a set of mechanisms used to monetise the increase in land values that arise in the catchment area of public infrastructure projects. Our focus in this study is on transport (and related placemaking interventions), but land value capture has wider applications.

Users of public transport schemes typically value the benefits of such schemes well in excess of the fares charged for them. This 'consumer surplus' is capitalised into the value of land around the access points to the transport network, in the form of a 'transport premium' that is freely paid for property by transport users as they compete with each other to locate as close as they can to new transport facilities. In addition, transport projects often catalyse new development opportunities in their catchment area, which generates planning gain for landowners. These are both windfall gains for those fortunate enough to own land or property in the catchment area of proposed transport schemes. LVC mechanisms seek to capture a proportion of such gains to fund the investment that gives rise to them.



London is not alone in exploring land value capture approaches. Hong Kong has long practised a uniquely successful model of land value capture, through the Mass Transit Railway's (MTR's) 'rail plus property' model, and other Asian cities such as Beijing are following a similar approach. Infrastructure Victoria (in Australia) has recently published a policy paper for consultation on expanding the use of land value capture, setting out options for reform including betterment levies and charges on development, while the Gold Coast Light Rail line in Queensland is partly funded through a tax on property owners along the line of route. Atlanta, San Francisco and Kansas City in the United States have all experimented recently with land value capture levies focused on development and real estate.

There is a vast theoretical and empirical literature that supports the idea that the benefits of transport schemes (alongside placemaking interventions) get capitalised into higher land values. There is clear evidence from Nationwide (using mortgage data) of the existence of a 'transport premium' of up to 10.5 per cent around Tube and rail stations in London.

KPMG and Savills' research for this study (using transactions data from Land Registry and local controls for background price inflation and local place effects) indicates that past projects such as the Jubilee line extension (JLE), the Docklands Light Railway (DLR) extension to Woolwich and the upgrade and incorporation of the North London line into the Overground network have produced significant land value uplifts, of 52 per cent, 23 per cent and six per cent respectively, relative to controls. While there is no clear evidence so far of Crossrail (still in construction) lifting the values of existing residential stock¹, there is evidence that it has produced uplifts on commercial property (around 1-2.5 per cent per annum relative to controls), and in enabling new residential development (with a 50 per cent increase in density of new housing within 500 metres of a Crossrail station compared to areas further away).

'Eight prospective TfL projects that cost around £36bn (including Crossrail 2...) could produce land value uplifts of about £87bn'

Looking ahead, KPMG and Savills estimate that future transport schemes in London are also likely to produce large land value uplifts, both in increasing the value of existing properties and by inducing new development. For instance, a sample of eight prospective TfL projects that cost around **£36bn** (including Crossrail 2, the Bakerloo line extension and the DLR extension to Thamesmead) could produce land value uplifts of about **£87bn**.²

The problem is that existing value capture mechanisms extract only a small fraction of land value gains from transport investment, in an ad hoc and poorly targeted manner. These mechanisms include: business rates on commercial premises; Stamp Duty Land Tax (SDLT) on the transfer of land or property (although this accrues to central rather than local government); over-station development; and development taxes such as the Community Infrastructure Levy (CIL) and

¹ Previous reports such as those from CBRE (2016) and GVA (2012) have forecast that Crossrail will produce significant land value uplifts. However, Savills' research for this study indicates that there is little evidence from actual property market data of such uplifts on existing residential stock during the construction period of Crossrail. This does not mean such uplifts will not materialise once the line is operational; it merely indicates that no uplift effects have been *anticipated* in the residential property market thus far.

² Costs and total value uplift over 30-year period from FY19 to FY48. Unless specified otherwise, all costs, uplift and funding figures in this report are expressed in present value terms.

negotiated developer contributions. Governments in the past have attempted to improve the ability to capture land value uplifts, but mainly by targeting new development, and arguably using relatively blunt approaches and high tax rates. Improvements in data, technology and research methods now enable cities to isolate the transport-induced value uplift in a more intelligent, targeted and potentially more proportionate manner.

While business rates retention offers a potential model for extracting user benefits to fund transport improvements that service large new commercial developments, there is no equivalent for residential development. This makes it difficult to fund transport-led housing expansion in London. Projects such as Barking Riverside extension and the Northern line extension (NLE) demonstrate that land value capture can provide significant funding for extending transport connectivity to areas that could support large expansions of housing. But such efforts have been episodic and opportunistic, relying on special circumstances (such as a single 'anchor' developer or the pre-existing Greater London Authority, GLA, ownership of land) that are unlikely to be replicable across the city. That is a major lost opportunity in a city like London, where residential property prices are among the highest anywhere in the world.

This study suggests ways to improve the ability to capture land value uplift systematically from major transport investments. If implemented, they should materially improve the Mayor's ability to fund our capital expenditure programme in response to local demand, and to fund transport connectivity to poorly served areas to unlock new housing supply in London. They should also materially improve the ability to support higher levels of affordable housing associated with new development around new transport investment in the Capital.

The Mayor's clear preference is that control over the major property taxes (Council Tax, business rates and Stamp Duty Land Tax) and powers to introduce new charges and levies should be devolved to London, which will make the sorts of changes described below straightforward to implement within London. For this reason, this report should be considered alongside the final report of the London Finance Commission (LFC).



To improve the extraction of land value uplifts on new and existing stock:

- One* The Government should explore with the Mayor a framework for assigning zonal value growth in **Stamp Duty Land Tax** receipts relative to a London-wide or local control, either as part of a wider devolution of SDLT receipts, or through a zonal SDLT assignment scheme.
- Two* As part of business rates reform, the Government should consider regular revaluations and full **zonal retention of revaluation growth from business rates**, either as part of the wider devolution settlement for London or through an enhanced Enterprise Zones (EZs) policy.
- Three* The feasibility, effectiveness and acceptability of creating a **new land value capture charge** – such as a transport premium charge as discussed in this report – should be explored further. Such a charge could capture a proportion of the premium paid to landowners by new purchasers or tenants of residential property for access to new transport facilities. This would create a mechanism to capture transport-induced value uplift that cannot currently be captured within the existing property tax system, and has the potential to be very effective in funding new infrastructure (particularly schemes that could expand the supply of housing). The introduction of such a charge is likely to be difficult, and we therefore suggest the Government works with the Mayor and ourselves to consider producing a paper for wide consultation.

This study suggests the key principles of such a charge should be that it:

- Applies in defined zones of influence around new or significantly upgraded transport facilities (such as Tube stations)
- Be based on regular transparent market-based measurement of the premium freely and willingly paid to landowners by new purchasers or renters of residential property for access to transport within such zones of influence
- Be proportionate to the measured premium paid for access to transport in each location
- Be designed so that
 - New purchasers and tenants can be given a free choice to opt in to paying the charge through their decision to locate within the zones of influence, and are given the opportunity to pay the same overall premium for access to transport with the charge that they would have been freely willing to pay without it
 - Existing residents can be entirely exempted from paying the charge

The consultation paper should set out the overall objective of land value capture, describe the need for and the basic principles of the new charge and set out the advantages and disadvantages of various design options, as discussed in the main report.

To improve the extraction of planning gain from new development:

- Four* For zones with low to medium development potential with multiple landowners, the Government should maintain the Mayor's powers to levy a **Community Infrastructure Levy (MCIL)** as a general development tax that makes a contribution to strategic transport infrastructure.
- Five* Bespoke **section 106** developer contributions should continue to be negotiated on transport-dependent developments where there is a clear, single 'anchor' landowner or developer.
- Six* For zones with high development potential (particularly for housing) with multiple landowners, the Government, TfL and the GLA should consider the **development rights auction model (DRAM)**, a new land value capture mechanism.

The key features of the development rights auction model are:

- The integrated planning and consenting of land use and density in a defined zone around a major new transport facility, in parallel with the planning of the transport scheme
- The introduction of a periodic development rights auction, in which development rights over land put forward (voluntarily) by landowners are auctioned in assembled packages to a competitive field of developers. Gains above a reserve price are shared between the participating landowners and the planning/auctioning authority. No development taxes (such as CILs or s106 payments) are payable under this scheme. All non-operational but developable public sector-owned land within the zone is entered into the auction as part of a standard public sector land pooling arrangement
- The introduction of a high zonal CIL for those landowners who wish to self-develop rather than participate in the auction
- The use of reformed compulsory purchase order (CPO) powers (following successful passage of the Neighbourhood Planning Bill 2016) to deal with holdout problems that threaten to stall development, together with further consideration of other options as discussed in the report

- Seven* The Government should consider making the process of acquiring land through **compulsory acquisition** more transparent by:
- Introducing an independent valuation panel to determine the market value of the land based on the 'no scheme' principle set out in the Neighbourhood Planning Bill 2016
 - Establishing (early in the land acquisition process) an objective and transparent evidence base on alternative development potential in the absence of the scheme, for such a panel to determine 'no scheme' market values, for instance through the use of a modified section 17³ certificate

³ Land Compensation Act 1961

To manage the property market risks and cash flow timing mismatches likely to be associated with LVC instruments:

- Eight* Individual transport projects should not be significantly exposed to property market risks that they are not well placed to manage. Instead, land value capture should be **managed as a programme** run at a corporate rather than project level, so that property market risks are diversified across projects. While the programme is in trial or demonstration mode (with a small number of pilot projects), the exposure of individual projects to property market risks should be limited through appropriate contingency arrangements. This could include the deployment of the UK Guarantees scheme.
- Nine* Cash flow timing mismatches (between capital expenditure and LVC revenues) should be addressed by borrowing in accordance with the Prudential Code.

Finally, to test how these measures would work in practice:

- Ten* Following further work on detailed design and implementation issues, the land value capture instruments proposed in this study could be tested on a selection of forthcoming transport schemes in London.

These measures could release significant resources to fund transport investment.

As part of a package of reforms, our modelling indicates that a transport premium charge could potentially generate between **£13bn-£28bn** of funding across eight sample TfL projects investigated in this study, particularly from projects such as Crossrail 2 and the Bakerloo line extension (BLE). The zonal retention of SDLT value growth (relative to controls) could potentially raise **circa £6bn** while full zonal retention of revaluation growth in business rates could raise another **circa £7bn**. Revenues from a systematic implementation of the DRAM are likely to be more modest (since new development is typically a fraction of total land and property stock), but our modelling indicates it could potentially raise **circa £3bn** across the sample projects, compared to expected revenues from the existing CIL regime of **£1.5bn**. In total, the model illustrates that these mechanisms could potentially raise **circa £29bn-£44bn** across the eight sample projects, which have a capital cost of circa **£36bn**.

Although the proposals presented in this study have been developed in the context of transport investment in London, they are of more general applicability to other UK cities and other types of public investment that creates land value uplifts. Significant land value uplifts will in general arise wherever public investment generates large consumer surpluses, access to the benefits of such projects depends on location and land markets are relatively inelastic.





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