

Housing in Ireland:  
Performance and Policy  
Background Analysis

# Approaches to Land Management, Value and Betterment

## 7.1 Introduction

An important issue in housing policy is the approach taken to the arrangements for bringing new land into development and the allocation of the increase in the value of such land. The overall process of zoning land for housing, servicing it, granting planning permission, connection to wider infrastructure and house construction gives rise to a very significant increase in the value of land. Across the world, the cause of that increase in land value, the just distribution of it and the legal ownership of it have long been a subject of analysis and debate. In Ireland, this is reflected in numerous actions by the Oireachtas and Government, including the creation of special capital gains taxes on land, granting powers of compulsory purchase to local authorities and the evolving planning legislation. It is also the subject of a debate that has recurred in the 1960s, 1970s, 1990s and is active once again.

This Background Paper considers approaches to public policy on land value and the operation of the land market. Section 7.2 begins by clarifying the concept of betterment and then identifies policy options in relation to the land market including further sharing of betterment. The four possible approaches identified are as follows:

- ◆ Public land banking, including compulsory purchase of land at agricultural value plus a premium;
- ◆ Site value taxation;
- ◆ A planning gain levy; and
- ◆ Increased capital gains tax.

These options were considered by the Council as part of the deliberative process. Analysis of these options is presented in Sections 7.3 to 7.6 below.

## 7.2 Assessing Land Policy Possibilities

### 7.2.1 Betterment

The term ‘betterment’ is widely used in discussion and analysis of land values and planning. It refers to the increase in the value of landed property owing to planning decisions taken by planning authorities. As pointed out in the Kenny Report, the term ‘betterment’ can be ambiguous, because it is sometimes used to describe the increase in the price caused by works undertaken by a local authority (such as sanitary services and roads) and sometimes to describe the increase in price brought about by all the economic and social forces, including planning decisions and actions (Kenny, 1973). The recent *Ninth Progress Report of the All Party Oireachtas Committee on the Constitution* (hereafter APOCC, 2004) says that the principal reasons for increasing property values are: (a) generally improving economic conditions; (b) the effects of formal land use planning; (c) the provision of infrastructure and general urban improvement; (d) transport

policies; and (e) taxes. It observes that 'Identifying the increase that could be securely attributed to planning decisions is more difficult than might be thought' (APOCC, 2004: 89). The All-Party Committee defines betterment as the increase in the value of land that proceeds from three sources: (1) zoning, (2) physical infrastructure and (3) social infrastructure.

### 7.2.2 Are Additional Land Policy Instruments Necessary and Desirable?

Opinions differ on whether a further sharing of betterment or land market reforms are desirable and possible in Ireland. It is argued by some that further measures to share betterment or other policy changes in relation to the land market would not be desirable. The following are considerations which would support this position. First, there is the view that it is wrong to treat the increases in the value of land differently from any other form of capital gain. On this view, the general tax and welfare system is the only instrument that should be used to achieve redistribution. Second, some point to the significant existing taxation of betterment. These existing measures consist of: the recently increased development contributions, Part V of the Planning and Development Act, stamp duty on land and houses, VAT on housing and capital gains tax on land'. It is argued that these constitute a fair and effective sharing of betterment. Any further sharing of betterment would be unfair and damaging to the housing system. A third, related, view acknowledges the very high level of land value betterment, especially in Dublin, reflected in extremely high land prices and the high share of land value in house prices, but argues that such betterment should not be *taxed* but *reduced*. This could be achieved, it is suggested, by greatly increasing the supply of zoned land. Fourth, there is a risk that the taxation of betterment could result in a reduction in land and housing supply. If this were to occur, house prices would increase by more than otherwise.

On the other hand, it is argued by others that reforms in relation to the land market would be supportive of the achievement of the Council's housing policy objectives. We outline here the reasons why policy changes in this area are considered by some to be desirable.

First, public policy decisions in planning and zoning and public investment in infrastructure and services are major sources of betterment. It is considered undesirable by some that such public actions should lead to major private windfalls. These windfall gains occur, for example, when land is rezoned, despite the measures that are already in place to share betterment such as development contributions.

Second, it is believed by some that reform is needed to support the objective of good planning. A key feature of land is that each plot of land has a unique location. Good development requires that sites be favourably located in relation to each other. However, as Evans (2004) notes:

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1. VAT on housing and stamp duty on houses are taxes on land to the extent that they get passed back to the landowner in the form of lower land prices. This can occur in that these taxes reduce the price that builders receive for houses which in turn will affect how much builders will be willing to pay for land.

*If the likelihood of a piece of land being put on the market depends solely on the owner's preferences, then the sites which are sold for development are unlikely to consist of sites adjacent to each other at a favourable location. Development is likely to sprawl in a quasi-random way across the landscape, sprawl which was seen in Britain between the wars and which continued to occur in countries like Australia and the United States after the Second World War (Evans, 2004: 181).*

Planning can be used to avoid an undesirable pattern of sprawling development. Planning typically operates as a control on new development and may cause house prices to be higher than otherwise. It reinforces the market power of the owners of particular plots of land. It is believed by some that the achievement of the objective of quality development requires more than the typical powers of planning which can prevent what are considered to be bad developments. It is almost universal for public authorities to have compulsory purchase powers for land, which they do not have for other resources; the public authorities in Ireland have such powers. In some countries, most notably Sweden and the Netherlands, there is wide ranging public management of land, including acquisition of undeveloped land and subsequent sale of land for development. Such intervention may be used to capture betterment, but an important motivation is also to promote integrated development.

Third, high land prices add significantly to the costs of social housing. Reforms that allowed social housing providers access to land at lower prices would help society in meeting social housing needs. Fourth, high land prices and the current compulsory purchase system add to the costs of infrastructure and the costs of providing public facilities such as schools.

### 7.2.3 Identifying Possible Reforms in Relation to the Land Market

Here we identify and analyse four broad approaches that are sometimes advocated:

- ◆ Public land banking supported by compulsorily purchase of land at agricultural value plus a premium;
- ◆ Site value taxation;
- ◆ A planning gain levy; and
- ◆ Increased capital gains tax.

Other proposals—such as a revised approach to development contributions—can be seen as versions of one of these four. The four possible approaches listed above are also the options canvassed in the recent APOCC report. The Council is anxious that its work inform the public discussion of the recommendations made by the All-Party Committee.

In discussing these possible approaches, it is necessary to consider their likely impact on a number of dimensions of the housing system. These include the effectiveness of the planning system, the provision of land for social and affordable housing, any effects on the market supply of land, how the sharing of

value is achieved and the likely effects on the housing market, including property prices. In the light of these considerations, it is possible to identify the main arguments for and against each approach, including key issues that arise.

Table 7.1 lists the four general approaches to a further sharing of land value (horizontally) and the various dimensions of the housing system that need to be considered (vertically). In discussing each of these four policy approaches we follow this procedure.

**Table 7.1 A Matrix for the Analysis of Further Betterment Sharing Possibilities**

|   | Public land banking<br>supported by compulsory<br>purchase of land | Site Value Tax | Planning<br>Gain Levy | Increased<br>Capital Gains Tax |
|---|--|----------------|-----------------------|--------------------------------|
| Effectiveness<br>of Planning                        |  |                |                       |                                |
| Impact on provision<br>of social/affordable housing |  |                |                       |                                |
| Impact on supply of land<br>to the market           |  |                |                       |                                |
| Impact on housing market                            |  |                |                       |                                |
| Incidence and Effectiveness<br>in Sharing Value     |  |                |                       |                                |
| Arguments + Issues                                  |  |                |                       |                                |

#### 7.2.4 A Central Consideration: the Impact on the Housing Market and House Prices

A central issue is the impact of these possible policy changes on the housing market. There is widespread public concern in relation to high house prices and the potential role that land supply and land prices play in relation to high house prices. A key question is what is the scope for policies such as those listed above to address these concerns. An understanding of the potential for policy in this area needs to be based on an analysis of how land and house prices are determined. An analysis of this issue is presented in Background Paper 2 above; we summarise the key points from that analysis here.

One perspective is that land prices are more the result than the cause of house prices. This perspective can be illustrated by considering how developers operate. Based on an expected level of house prices, developers compete for the land that becomes available for development. If house prices are expected to be high, developers will be willing to bid high prices for land.

Land prices will be bid up to the point where developers get a normal return on housing development, having regard to risks involved.

This perspective has a number of implications for the potential for policy instruments to affect land prices. It points to the limits of any policy to reduce land prices. If land prices were to be controlled, then in the absence of any other changes one would not expect any impact on house prices. House prices depend on the balance of supply and demand for housing which will not be changed by the control of land prices.

This perspective also suggests that there is potential for the taxation of betterment (such as capital gains tax) to raise revenue without causing distortions. Since the price of land for housing is far higher than its agricultural price, this price is higher than is needed to bring land forward for development. In this context, it can be argued that taxing some of this value will not prevent the transfer of land from agriculture to housing and the supply of housing will be unchanged. This would achieve a sharing of betterment but would not make housing more affordable.

This perspective is based on the supply of land being fixed. It is in the situation of a fixed supply of land that the price of this land will be determined by house prices and it is possible to tax the value associated with a fixed land supply without creating distortions.

Another perspective emphasises the variability and uncertainty of land supply. The implications of this variability and uncertainty have only recently been fully articulated, but they are an important part of a framework for understanding the role of land in the housing system (Evans, 2004).

The scope for owners to vary land supply points to the need for caution in relation to policies to tax betterment. By reducing the post-tax price received by landowners, the taxation of betterment may reduce the supply of land available for development and hence reduce housing supply. This would result in both higher land and house prices. The likelihood of this effect will depend on both the rate of tax and the land market context. The higher the rate, the greater is the likelihood of such a negative effect. On the other hand, in a land market where the development value of land is far higher than its agricultural value, there will be scope to tax betterment value without having a significant supply effect.

The fact that land supply can vary also raises the possibility of positive effects from two of the interventions, namely public land management and site value taxation. In the case of public land management, the acquisition of land by a public authority and the sale of cheaper land to builders could have the effect of increasing the supply of land for development. In particular, some land that would only be released if land prices reached some very high level might now be released without land prices having to reach this level. By increasing the supply of land for development it is possible to increase housing supply and hence moderate prices. If operated successfully, this policy also has the capacity to reduce risk for builders: if the public system can effectively ensure an ongoing supply of land, there is less need for private land banks. Of course housing supply

depends on factors other than land, in particular the capacity of the building industry. What this perspective implies is the possibility of increasing housing supply in a particular area, such as in the area around a city. Even if prices are not significantly affected this policy has the potential to achieve better planning: since the decision to develop land is no longer solely dependent on the owner's preferences, there is greater scope to ensure that development of contiguous sites takes place on a planned basis.

The view that land supply is variable also points to possible positive effects from an annual site value tax (as distinct from once-off betterment taxes). This would be a recurring tax on the land or site value of a property. A site value tax on land on which building was permitted would reflect this value and hence may encourage the development of land that would not otherwise be developed or may encourage earlier development of land.

#### 7.2.5 Incidence or Final Burden of Betterment Measures

An important issue is who would ultimately pay the burden of the various land policy measures listed above, what economists call the incidence of the measures. This is closely related to the impact on the housing market, as discussed above. The incidence of these measures depends critically on the supply responsiveness (elasticity) of land and housing. If the supply of land and housing remains the same as before, then one would not expect any change in house prices and the burden of a land tax measure (such as a special capital gains tax) will fall on the landowner. However, if there is a reduction in the supply of land and housing then the market price of housing will rise and at least some of the burden will fall on house buyers. If a measure were to lead to an increase in the supply of land and housing, then one would expect a reduction in land and house prices.

#### 7.2.6 Betterment-Sharing and Equity

Any mechanism to share betterment must be seen to be equitable. We can identify four dimensions of equity that are relevant:

- ◆ Between the rights of landowners and the rights of society;
- ◆ Between one landowner and another;
- ◆ Between new entrants to the property market and existing home owners; and
- ◆ Between dwellings that are built as part of a new development and those that are self-build or one-off.

The four approaches are likely to have different equity implications. The remaining sections of this Background Paper examine both the equity and efficiency implications of these options.



### 7.3 Public Land Banking supported by Compulsory Purchase of Land

Public policies to affect changes in ownership of land, or of the yield from land, have played a major role in Irish economic, social and political development in past centuries. In recent decades, the main focus of discussion has been on land for residential development. At a number of times, strong increase in land and house prices has given rise to public investigation of the problem. Within these investigations, the idea of compulsory purchase of development land has been one prominent proposal. It is back in public policy debate because it is the central recommendation in the recent report of the All Party Oireachtas Committee on the Constitution.

#### 7.3.1 General Description and Analysis of Public Land Banking Supported by Compulsory Purchase Approach

In 1971, Mr Justice Kenny was asked by the Minister for Local Government to chair the Committee on the Price of Building Land. The Committee reported in 1973.

The majority Kenny report recommended that local authorities be given the power to designate land required for development and the right to acquire this land at a price 25 per cent above its value in its existing use. The majority report recommended that on application by a local authority, the High Court would designate areas that in the opinion of the court met the following two conditions: (i) the land would probably be used during the following ten years for housing, industrial or other development; and (ii) the land either had been or would be increased in market price by works carried out by local authorities. All of the land within the designated area could be purchased by the local authority at agricultural value plus some percentage (25 per cent was proposed). Following the provision of services, some of the land acquired by local authorities would be used for their own purposes (including housing). Other land would be leased or sold to private interests. When leasing land for commercial development, the local authorities would seek the highest price or rent. However, for housing or other social purchases, land would be made available on terms that covered costs only. In making land available to private developers for building houses, the report envisaged that there would be a system of price control on the subsequent sale of such houses.

The proposals of the Kenny report were not implemented. Among the reasons was a belief that these measures might be unconstitutional. This is not something the NESC can comment on and is, in any case, the central question examined in the recent APOCC report. The All-Party Committee is unanimous in the view that ‘having regard to modern case-law, it is very likely that the major elements of the Kenny Report recommendations—namely that land required for development by local authorities should be compulsorily acquired at existing use values plus 25 per cent—would not be found to be unconstitutional’ (APOCC, 2004: 137).

The logic of price control on houses in the Kenny proposal is a reflection of one of the views on the underlying relationship between land prices and house prices (discussed above). The need for price control derives from the perspective that land prices are mainly determined by house prices: high house prices lead to a

bidding up by developers of land prices as they compete for the available land. From this perspective, if local authorities sell the land to developers below its full market price as envisaged by Kenny, there is nothing to stop the developers selling houses and apartments at the full market value. The proposal for price control is a mechanism for transferring the betterment value of land to the ultimate house buyer.

A separate issue is the feasibility of price control. There is a reason to doubt the feasibility of widespread control of house prices. If the underlying scarcity of land and housing remains, it is possible that better off buyers and builders will, together, find a way of making under-the-counter payments above the regulated price<sup>2</sup>.

While price control of houses on a widespread basis is problematic, some argue that there are potential benefits to the Kenny approach without price control. This is to a large extent the approach recommended by the All-Party Committee and we now examine its approach.

### 7.3.2 All Party Oireachtas Committee on the Constitution (APOCC)

The report by the All-Party Committee recommends the implementation of an approach similar to that advocated in the Kenny report. Its recommendation differs in two significant respects. Kenny believed that only areas where the state provided *physical* infrastructure could be ‘designated’, and excluded from designation areas where value had increased solely due to decisions of planning authorities in regard to zoning. APOCC emphasises that its own analysis of the dynamics of the market (summarised in Background Paper 2 of this report) shows that betterment proceeds from three sources: (1) zoning, (2) physical infrastructure and (3) social infrastructure. ‘The committee takes the view, in contrast to Kenny, that all these forms of betterment should be recovered for the benefit of the community’ (APOCC, 2004: 96). It believes that what it refers to as a ‘a Kenny-type mechanism’ modified in the light of current constitutional development and supplemented by the policy instruments that have since been developed to recover betterment—particularly under the influence of the Joint Committee on Building Land (1985)—would best achieve this. Secondly, as noted above, APOCC did not recommend that its land policy recommendations be accompanied by price control on new houses (the issue is not mentioned in the report).

A key statement in the report is: ‘The Committee see a modified Kenny-type mechanism operating (a) to control the price of development land coming to the market and (b) to recover betterment’ (APOCC, 2004: 97).

The APOCC report argues that its proposals would yield the following benefits. First, it would allow for the recovery of betterment, ‘efficiently and effectively’. Second, the state could acquire land for social housing on the basis of a fixed cost. Third, the state would be able to plan a range of other necessary services on the basis of a fixed price and accessible supply of development land. Fourth, it could supply the development land needs of private developers ‘which are based on the local area development plan, on the basis of open market competition’.

2. An element of price control already exists in Irish housing policy in the approach to affordable housing. This enables qualifying buyers to buy houses at less than the market value.

Fifth, as with the Kenny report, APOCC envisaged that the acquisition of land would operate in designated urban areas; however, it argued that there would be a spillover benefit so that land prices would fall in the areas in which the scheme was not in operation.

If the state were to sell land to developers on the basis of local area plans this should facilitate the objective of good planning. The report does not explicitly address whether or not this would have any effect on housing supply and house prices, although its analysis implicitly suggests that there may be some effect. This analysis was presented in Background Paper 2 above. To understand the potential impact on house prices, it is worth briefly summarising the key points of that analysis.

The APOCC analysis of the land market is that this market operates imperfectly. The system of land use planning leads to ‘a perceived shortage of development land’, a signal to entrepreneurs to involve themselves in the acquisition and holding of zoned development land and ‘an incentive to maintain the shortage and keep values up by not developing the land until it suits their interest’ (APOCC, 2004: 84-5). This implies that there may be artificial scarcities of land and land prices that may be higher than necessary. In this context, the analysis by Evans referred to above suggests that it is possible that the acquisition and resale of land by the public authorities could increase the supply of land available for housing and hence reduce land prices. While land would be sold on the basis of open market competition, the market price of land may be lower than otherwise as more land would be supplied to the market. An increase in the supply of land for housing would also have the potential to increase housing supply and hence moderate house prices.

A reading of the report suggests that APOCC’s first preference is that all development land in urban areas be subject to compulsory purchase at a premium over agricultural value. The Report argues that in non-designated areas, presumably rural areas, recoupment of betterment should be achieved by means of development charges, ‘planning gain’ (of which Part V is an example) and taxation<sup>3</sup>.

### 7.3.3 International Experience in Public Land Management

Active land management takes place in a small number of countries. There is a long tradition of public land banking in Sweden (Barlow and Duncan, 1994). The designation of land for development by local communes gives them the right to take it into public ownership. The price is regulated by special land tribunals. Most building is financed by State Housing Loans. Builders using these loans must meet various conditions, including limits on the price that can be paid for land and on the prices they can charge for housing. The Swedish system of land intervention is associated with a distinctive pattern of housing provision. The non-profit sector (public and private) is responsible for over 50 per cent of new completions. A large share of housing need is also met by ‘restricted-profit’ private provision and self-promotion, with speculative development only accounting for a small percentage of housing output.

3. The different treatment of designated and non-designated areas raises the question as to whether this difference in treatment would be in accordance with the constitution. This issue would not arise if there were a ban on development outside designated areas but this seems unlikely. It was the view of APOCC that the designation of lands that would be subject to a form of price control was consistent with the constitution (see APOCC, 2004: 43).

A comparison of the housing market in high-growth regions of Sweden, Britain and France revealed that the Swedish region had the highest level of productive efficiency, the least 'sticky' system, in that building land was readily available at fairly low prices, and the lowest level of uncertainty for builders. Despite some deregulation of the housing market in Sweden in the past decade, the practice of land banking continues (Needham and De Kam, 2000).

In the Netherlands, the development of land for new construction was traditionally undertaken mainly by local authorities. Local authorities are the dominant buyers in the land market. They prepare the land for building and then make plots available, either through sale or lease. They have compulsory purchase powers but these powers are rarely used (Needham and Verhage, 1998). Local authorities make land available to housing associations at low prices to enable the associations to provide social housing. This model worked very well for several decades. Changes in the process of land development mean that nowadays housing associations are finding it more difficult to acquire land. Despite the general rise in land prices, Needham and de Kam (2000) found that land prices for social housing were still at a modest level (€11,400 for a single rented family house).

#### 7.3.4 Summary of the Implications of Compulsory Purchase of Designated Development Land

Advocates of this approach point to the following potential benefits:

- ◆ Land can be acquired for social housing and other social purposes at a lower cost.
- ◆ The public body benefits from some of the appreciation in land values.
- ◆ The ownership of land would enhance the ability of local authorities to realise the vision of developing areas on the basis of an integrated plan. A key feature of land is that each plot has a unique location, as noted above. If the decision to develop depends only on the owners' preferences then it can be difficult to achieve integrated development of contiguous plots of land.
- ◆ In situations where active intervention in the land market led to more land being made available (or made available at an earlier stage) then there is a potential moderating influence on house prices. A more direct influence on house prices could be achieved if the resale of land to developers at a controlled price were combined with price control of the houses built on this land. This however is dependent on it being feasible to effectively implement price control.

There are also a number of challenges that this approach must address. Public land banking would impose considerable demands on the public system and the question arises as to what public agency would be capable of handling this in such a way as to guarantee either a strong supply of housing or integrated planning. If the process were cumbersome there is the risk of reducing housing supply. Another significant issue is whether this approach would be able to reduce house prices without price control; if price control is used, there is a separate concern with regard to the feasibility of price control.

There is successful experience from a small number of countries indicating that some systems are capable of overcoming the implementation obstacles with a system of this kind although as Evans (2004) notes, where it does occur it seems to have been a historical accident.

## 7.4 Site Value Taxation

If further sharing of betterment is considered desirable, another approach that might be considered is an annual site value or property tax. A standard annual property tax is charged on the value of both buildings and land; a site value tax applies only to the site or land value.

### 7.4.1 Impact on Land Use

It has been argued in the economic literature that a site value tax is neutral; i.e., it has no effect on land use decisions. This is on the basis that a site value tax is a tax on the surplus due to a location and there is no response by landowners that can improve the situation, assuming that the land was being used efficiently before the introduction of the tax (see for example, Oates and Schwab, 1997). This makes a site value tax ideal from the perspective of a key general principle of taxation which is that for efficiency reasons it is desirable to apply taxes to less mobile bases where possible.

There is also the possibility that, if for some reason that land was not being used efficiently, then a site value tax could lead to improved land use. A site value tax could possibly improve land use by encouraging infill development; i.e. the development of unused or underutilised land in existing urban areas. It also acts as a penalty on derelict sites since the owners are liable for the site value tax even if the site is not generating an income. If withholding of land were to occur, a site value tax could provide an incentive to avoid this. Taken together these potentially provide an incentive for improved land use and hence would potentially support better planning.

The possibility of affecting land use also raises potential negative effects from a site value tax. If it were levied on land that has been zoned and minimally serviced, it could encourage excessive early development that does not accord with planning policies. If it were levied on sites which have been granted planning permission, it might discourage landowners to seek planning permission and to rely, instead, on land value appreciation. Advocates argue that appropriate design and zoning can address these issues.

The effects of a site value tax on land use cannot be determined solely on the basis of theory. Some empirical evidence from the international experience is presented below.

### 7.4.2 Impact on housing and existing property

Because a site value tax applies to existing property (houses, commercial property and so on) it encourages the efficient use of this property. Advocates argue that it can moderate excess demand for housing. A site value tax would reduce the incentive to occupy housing in excess of one's current needs: there would be less incentive to buy property as early as possible in the life cycle, while at later stages there would be more incentive to trade down. Advocates of a site value tax argue that it would, therefore, improve the availability of properties and make them more affordable.

While the purchase price of housing would be moderated, buyers would then be liable for annual site value tax. While this might seem to leave them no better off, it could ease one of the most pressing problems of affordability. As noted in Background Paper 2, monthly mortgage payments have been strongly influenced by the fall in interest rates; it is the high purchase price, and the high associated deposit, that creates some of the affordability problem. Since a site value tax would moderate the purchase price of housing, rather than the ongoing cost, its advocates see it as particularly appropriate where prospective buyers face a hurdle in getting into owner occupation.

A site value tax can be expected to reduce land prices, since a buyer of land (or property) is acquiring an ongoing liability to pay the land tax as well as the asset. This would have the effect of reducing the cost of land for social and affordable housing.

### 7.4.3 Equity

The core equity argument for a site value tax is similar to the equity argument for compulsory purchase or a planning gain levy. Land values derive, in large measure, from public policy decisions and investments which support the economic and social activity of an area. The cost of these investments, and the value they create, should be shared by the whole community. But why might the fairness dimension of a site value tax be seen as superior to the other possibilities: compulsory purchase (discussed above), a new planning gain levy or higher capital gains tax (discussed below)? The main reason is that it achieves a sharing of betterment from the whole population of property owners, whereas the other measures seek improved sharing entirely from new build. A second, related, reason is that a site value tax would reflect the access to employment, services and other amenities provided by a given location. It could recoup some of the value created by particular transport investments, such as Luas or a Dublin metro.

There are also equity arguments against site value tax. A first argument is that it would be unfair to those who had recently paid the full price of property. They would face mortgage repayments on a high house price plus a duty to pay the annual site value tax. Indeed, the site value tax would tend to moderate the rate at which their house would subsequently increase in value. A second argument is that the site value tax could be a heavy burden on those who are asset rich but cash poor. The perceived inequity of this can create pressure to allow exemptions which could, ultimately, undermine the simplicity and effectiveness of a site value tax.

#### 7.4.4 Valuation

A final difficulty is in relation to valuation. A site value tax would ideally be based on the value of sites in their 'highest permitted use'. The determination of the market values of the site component of properties poses practical difficulties. It is argued by Evans that it is not feasible to determine the value of the highest permitted use, so that in practice a site value tax would reflect current use value. This would limit the ability of a site value tax to promote more efficient land use. Research of the experience in Pittsburgh (discussed in more detail below) found that current land use was an influence on valuation but the tax was still considered to work well (Oates and Schwab, 1997).

#### 7.4.5 Incidence

It is widely agreed that the ultimate burden or incidence of site value taxation falls on the landowner. Landowners in this context include homeowners, assuming that the site value tax applies to residential property. Initially a site value tax would be expected to lead to a reduction in land prices equal to the capitalised value of the site value tax. If there were a supply response then there would be an additional fall in land prices.

#### 7.4.6 International Experience

Annual property taxes are common across OECD countries. They are typically applied to both the value of land and buildings. In Denmark there is a specific tax on land or site values. In a submission to the recent Barker Review of housing policy in the UK, it is argued by Muellbauer (2003), a leading British economist, that the Danish land tax improves the functioning of the land use planning system, by increasing the costs of land hoarding when land prices are high, so increasing land supply counter-cyclically. Furthermore, he also argues that the land tax—as part of the Danish property tax system, which also includes a further property tax of 1 to 3 per cent on the market value of owner-occupied housing—plays a key role in stabilising the overall economy. The land value tax is equivalent to about 2 per cent of Danish tax revenue, while the residential property tax is equivalent to another 1 per cent. Muellbauer's analysis leads him to propose that a land tax be introduced in the UK, eventually including owner-occupied residential property.

In the US, Pittsburgh has made extensive use of land value taxation. For some years, it restructured its property taxes, so that land was taxed at more than five times the rate of structures. This coincided with a start of a construction boom in the city. Research suggests that this approach was indirectly supportive of the building boom; without the site value taxes, conventional taxes would have to have been raised, which would probably have constrained the recovery (Oates and Schwab, 1997). This reflects what many economists see as a key advantage of land value taxes; unlike taxes on labour and business, they do not inhibit economic activity. Notwithstanding this success, Pittsburgh has since moved from this dual rate structure to a conventional property tax.

#### 7.4.7 Conclusion

A site value tax would not facilitate the direct acquisition of land for social and affordable housing. But it has two indirect effects that could improve the provision of social and affordable housing: (i) it would reduce the market price of land; and (ii) yield revenue that could be used to fund social and affordable housing. It would achieve a sharing of value through two channels: (i) revenue and (ii) reduced land prices. It differs from other approaches in that it would share the value of land appreciation from both new and existing dwellings.

If it were considered desirable to achieve a further sharing of betterment, the main arguments for a site value tax are that it may (i) support the goals of planning policy; (ii) share value across the all asset holders rather than just new build; (iii) provide resources to fund increased social and affordable housing; (iv) moderate the entry cost to the market; and (v) improve the balance between supply and demand. The main arguments against a site value tax are that (i) it would be unfair to those who had recently paid the full price of property; (ii) it could place a burden on those who are asset rich but cash poor; (iii) it could encourage excessive early development of land; and (iv) the correct valuation of the site value component of properties would be difficult. There would be a significant challenge in designing a site value tax that could address these concerns in a satisfactory way.

### 7.5 A Planning Gain Levy

If a further sharing of betterment were considered desirable, a third possibility is the introduction of a new Planning Gain Levy (PGL). A PGL would involve payment of a new levy at the time that planning permission is granted. The levy would offer the opportunity for some additional sharing of betterment value. It would operate in addition to the existing regime of stamp duty, development contributions, land for social and affordable housing under Part V and could be a flat rate or percentage value.

The idea of a PGL can be seen to encompass a number of specific proposals advanced in recent years. One is Dunne's proposal that local authorities could acquire a greater share of betterment by basing development levies not on the direct costs of infrastructure, but on the value that is added to land by granting the right to develop and to connect to existing infrastructure (Dunne, 2004). A second is the proposal, such as that made by APOCC, to expand the provisions of Section 48 of the Planning and Development Act, 2000, so that development contributions would also cover social housing as part of public infrastructure and facilities.

The recently published Barker report in the UK, which examined housing supply, advocated the introduction of a special additional levy on new development. Barker considered it superior to two other possible measures, reintroduction of a development gains tax and imposition of VAT on new housing.



### 7.5.1 Impact on Land, Housing and Planning

Those who favour a planning gain levy argue that it could be supportive of the planning system. It could be tailored to local conditions to support sustainable densities, consolidated urban areas, compact urban settlements and development around transport corridors.

The effect of a PGL on housing supply and prices will depend on the responses of both landowners and builders. If a PGL were introduced, builders would be willing to bid less for land. It is possible that lower land prices would reduce the supply of land made available for development, hence reducing housing output. It could also reduce housing output by creating a disincentive to apply for planning permission. These risks might be overcome if a PGL were to be tapered as to incentivise early release of land. As a backup, local authorities might retain the right to compulsorily acquire land for designated purposes but at full market value. Advocates of a PGL argue that it can be supportive of housing supply. If the levy were payable by the landowner once planning permission was granted it would provide an incentive to proceed with development.

The planning gain levy would be expected to reduce land prices (see discussion of incidence below). This would reduce the cost of land required for social and affordable housing.

### 7.5.2 Incidence

There are three possible groups on whom the ultimate burden of paying or the incidence of the PGL can fall:

- ◆ Landowners, in the form of lower land prices – this could arise from developers taking account of development levies and bidding less for land;
- ◆ Builders, in the form of lower profits – to the extent that builders cannot pass the levy back to landowners in the form of lower land prices or forward to house buyers in the form of higher prices, the incidence would be borne in the form of lower profits;
- ◆ House buyers, in the form of higher house prices – this could arise from a fall in housing supply, either because landowners are less willing to supply land at lower prices or the PGL creates a disincentive to apply for planning permission.

The recently published housing policy review in the UK (Barker report) argued that the incidence of a PGL would fall mainly on landowners. This was on the basis that developers would know the rate and level of the tax in advance and that they would then pass this cost back to landowners through lower bid prices for land. It was also argued that competition from second-hand houses would limit the scope to pass on the levy to new house buyers.

Consideration of recent trends in the Irish housing market can help in predicting the possible incidence of the possible introduction of a planning gain levy or similar mechanism. A planning gain levy and development contributions are analogous to building costs. Over the past decade there has been a very weak relationship between building costs (excluding land) and house prices. Between

1994 and 2003 building costs have increased in total by less than 60 per cent while new house prices have more than tripled. House prices have been driven by the strong demand for housing rather than building costs, and the strong growth in house prices was reflected in increased land prices as developers bid more for land. In this context, if there were certainty as regards the future of the levy, and transitional measures to take account of the fact that developers buy land in advance of their building requirements, then one could expect the levy to be largely passed back to landowners in the form of lower land prices.

### 7.5.3 Conclusion

The main argument for this approach is that it could yield significant betterment and reduce the cost of land for social and affordable housing somewhat. The main challenge it must address is how it would work in those contexts where the supply of land to the market or seeking planning permission could be reduced.

## 7.6 Increase in Capital Gains Tax on Land

If a further sharing of betterment were considered desirable, the final approach considered is the introduction of the higher rate of capital gains tax (CGT) for the sale of development land.

The current rate of CGT on all assets including development land is 20 per cent. This is a low rate by historic standards. It is not unprecedented to have differential rates of CGT on development land from other assets: for much of the 1980s gains on development land were taxed at rates of 50 or 60 per cent, which were higher than the rate applying to other assets. In 1998 it was announced that a rate of 60 per cent would apply to land for residential development from 2002 although this was not subsequently implemented.

### 7.6.1 Impact on Land, Housing and Planning

The impact of CGT on the supply of development land is not clear cut and will depend upon the willingness to supply land. It is argued by Evans that some owners for lifestyle reasons, will be willing to sell their land at agricultural value but most owners 'would be unwilling to sell at this price but would require a higher price, sometimes a much higher price' (Evans, 2004: 226). This willingness to sell will vary among owners so that higher prices result in a greater supply of land for development. A capital gains tax, by reducing the price received by owners, could reduce the supply of land and hence increase land prices. If this were the case, then the attempt to share betterment might have a negative effect on housing supply and frustrate the achievement of one of the core goals of housing policy. One way of addressing this would be to graduate the tax in such a way as to encourage the timely development of land. For example, the level of tax payable could increase in each year following the zoning or servicing of the land, although it would only be payable when the land was actually sold and would differ from a standard capital gains taxation regime.

In some situations, the scarcity of development land means that its value for development is far higher than its agricultural value. Evans refers to the situation, in the South East of England in which the price of agricultural land is about £5000 per hectare while housing land is worth around £1 million per hectare. In situations like this, it is argued by Evans that ‘it is evident that while tax rates near to or at 100 per cent would inhibit development, rates of 40 per cent or even 60 or 70 per cent would not’ (Evans, 2004: 231). In these situations, Evans argues that the preferences of landowners are more likely to relate to the timing of development than to whether the price is high enough to persuade them to sell and compensate them for moving.

Some argue that the reduced level of CGT in place in Ireland since 1998 has facilitated the strong supply of land and housing since that time. However, it is worth noting that the strong growth of housing output started some years before 1998 and a strong recovery in Irish housing in the late 1980s was associated with much higher rates.

Higher capital gains tax would not provide any direct assistance to planning nor would it help in providing social housing, except insofar as any tax measure can provide revenue that can be used for social housing.

### 7.6.2 Incidence

The ultimate burden or incidence of a higher CGT will depend critically on the impact on supply, as discussed above in the case of the PGL. If the expectations of landowners adjust and they are willing to accept a lower post-tax price for their land, then one would not expect any impact on land or housing supply and hence no impact on house prices. In this scenario, the incidence falls on landowners. On the other hand, if landowners are unwilling to accept lower land prices, they will supply less land; this will lead to a reduction in housing supply and higher house prices. This would lead to at least some of the incidence falling on house buyers in the form of higher house prices.

### 7.6.3 International Experience

In the past in the UK, efforts were made to tax gains on development land at 100 per cent. In her review of UK housing supply, Barker notes that there are a number of reasons why previous taxes on development value in the UK were not as successful as they might have been. These include credibility, complexity, poor targeting and very high effective tax rates. As Barker notes:

*These are important lessons for policy makers. Any tax on the uplift in land values must have credibility, relative simplicity and be perceived as reasonable, or landowners may withhold land in the expectation of policy change, or engage in elaborate strategies to avoid paying (Barker, 2004: 78).*

Apart from the expectation of policy change, very high effective rates may have failed in the UK for economic reasons: as noted by Evans, the very high effective rates eliminated the incentive for landowners to sell land for development.

These are important considerations if any similar mechanism to capture increased betterment were under consideration in Ireland.

#### 7.6.4 Issues and Arguments

If further sharing of betterment were considered desirable, increased CGT has a number of attractions:

- ◆ The right to use the tax system to appropriate the gain in capital value is widely accepted;
- ◆ The tax only becomes liable when the actual gain is realised; and
- ◆ CGT is already in existence and is widely understood.

There are, however, a number of challenges to the use of CGT to share betterment. A first challenge is how the tax would work in those contexts in where the supply of land could be reduced

Second, a liability for CGT and, therefore, increased sharing of betterment, only arises if the land is sold. Where development land is bought in anticipation of future zoning decisions, the developers would make no additional contribution from the betterment value conveyed on the land through the planning system. Barker observes that 'for a number of reasons CGT does not always capture the full extent of windfall gains associated with the selling of agricultural land for residential use' (Barker, 2004: 74).

## 7.7 Conclusions

While there are several potential benefits to the measures discussed in this chapter, there are also a number of challenges that each measure needs to address:

- ◆ The case for public land management supported by widespread compulsory purchase must explain what agency would be capable of handling this and must consider contexts in which the policy can work with and without price control;
- ◆ Those who argue that additional betterment capturing measures (such as a higher CGT or a new Planning Gain Levy) must address how it would work in those contexts where the supply of land could be reduced; and
- ◆ The case for a site value tax must clarify a number of features of its design, including how it would apply to those who are asset rich but cash poor.

The conclusion reached by the Council in its main report, based on its analysis of the operation of the land and housing market, is the adoption of a combination of approaches:

- ◆ A land-use strategy over a long horizon, including zoning and servicing of land;
- ◆ Land for enhanced social and affordable housing programmes;
- ◆ Sufficient active land management to ensure delivery of housing; and
- ◆ Betterment sharing measures, designed in a way that does not damage supply.

The content of each of the above and the basis for their adoption is outlined in Chapter 7 of the main report. In devising the appropriate combination of policy, it is necessary for local and national authorities to identify what is the main constraint on achieving the goals of housing policy. This task can be assisted by the increased capacity and capability for analysis of spatial development and property markets proposed in Chapter 5 of the main report.