

funding affordable homes and new infrastructure – improving section 106 or moving to an infrastructure levy?

Tony Crook, John Henneberry and Christine Whitehead look at how the Infrastructure Levy proposed in the Planning White Paper is intended to work and how much it might be expected to raise; whether modifications might be needed if it is to meet the government's stated aims; and whether these aims could be achieved by simplifications to the current Section 106 and CIL arrangements

The proposed new Infrastructure Levy (hereafter the IL) aims to provide a much simpler way of capturing development value to help fund new affordable homes and the additional infrastructure required to support development. It does this by avoiding many of the complexities of the current Section 106 developer contributions and Community Infrastructure Levy (CIL) arrangements while including more types of new development – such as change of use and some permitted development (PD) – in the tax base as well as limiting exemptions to custom- and self-build homes.

In the debates and responses to the government's White Paper on planning reform in England¹ two main issues regarding the IL have been discussed:

- Will the IL raise more revenue than Section 106 and CIL, and will the money be available at the right times in the right places?
- Will it be possible to achieve the IL's objectives while maintaining its simplicity, or might it be easier to meet the same objectives by simplifying the current system?²

In the light of these debates, this article examines:

- how the IL is intended to work, how much it might be expected to raise, and where;
- what modifications to the IL might be necessary to meet its own objectives of simplicity and certainty in securing the funds required for infrastructure and new affordable housing and in addressing the regional 'levelling-up' agenda; and
- whether significant simplifications to the current Section 106 and CIL arrangements might achieve similar goals.

What sums might the IL raise?

How will the IL work?

The IL rate will be set nationally (although the White Paper recognises the possibility of central government setting different rates for each region and/or types of development), but the revenue will be collected and used locally. Mayoral/strategic



CIL in London and the combined authorities will become elements within the IL.

There is to be a threshold to the IL, based on average build costs per square metre and a small allowance for land value. Below the threshold, all developments will benefit from a zero tax. Importantly, unlike Section 106 and CIL, there will be no other exemptions from the IL, except for custom- and self-build homes.

The amount to be paid, while agreed in principle at the time of permission, will be charged on actual gross development value (GDV) at the point of occupation. This is the opposite of the position under Section 106/CIL, where the value of the obligation (based on costs, not value) is fixed at the date that planning permission is granted. The change results in the risks posed by market volatility during the development period being shifted from the developer to the local authority. The local planning authority may borrow against the expected levy income in order to get the infrastructure in place – although this could be relatively expensive because of uncertainties about the value and timing of such income.

Subject to the requirements stated in the revised/simplified Local Plans, developers will be expected to provide on-site affordable homes, including the new 25% First Homes element of the affordable homes total. The net cost of the new affordable homes (defined as their market prices less the price

paid for them by affordable providers) will be taken off the IL payment upon completion of the whole development.

How much will it raise?

Our understanding is that the government is not expecting the IL to raise vastly more than the existing system of Section 106 and CIL (although many commentators see that possibility as a major reason for change). Rather, it has promised that it will raise at least as much, including in terms of affordable housing numbers.

To address this issue we have used a residual cash flow model (examining all the income and costs of completing new development) to project the funds that the IL could yield if it were set at a fixed rate across the country. We have done this for a typical, 3 hectare greenfield residential development of 105 dwellings in each region of England.³ The various assumptions that underpin the model are shown in Box 1 on the following page, but the core assumptions are that:

- average house prices and building costs for new dwellings are realised in each region;
- the IL is set at 20%;
- there is a requirement for 20% affordable housing provision (including First Homes); and
- the IL threshold is set at average construction costs plus a site value allowance of 10 times agricultural value.

Box 1

Core assumptions – prices, costs, thresholds, IL rates, and affordable housing requirements

Our assumptions use the most recent available data on new house prices, costs of construction, financing, and industry profits (for example, the Valuation Office Agency's land value estimates^A). We have used a cash flow residual valuation model^B to arrive at our estimates. Our core assumptions are:

- 105 new homes on a 3 hectare greenfield site – each home at 90 square metres with construction costs including the building of the homes plus fees, site development costs (assuming no abnormal ground conditions), marketing of the private homes, financing costs at 3.5% per annum (estimated over a 13-quarter development period), and profits at 15% of GDV.
- A sales price of £306,000 for the national estimate (approximate national average for newly built homes) with regional variations.
- An IL rate of 20%.
- No IL to be paid on sites with GDV below the threshold. For developments with values above the threshold there will be a zero rate on the amount up to the threshold. The White Paper suggests that the threshold will be related to construction costs and some contribution to land costs. We have assumed a threshold of national average construction costs and an allowance for land costs assumed to be ten times agricultural land value. Neither construction costs nor agricultural land values vary greatly by region, but house prices do.
- Other than as a result of the threshold there are no exemptions.
- An affordable housing requirement of 20% of the development, including 25% of this housing as First Homes, with the balance split between affordable rent and shared ownership.
- Housing associations pay 66% of market values for shared-ownership homes and 50% for affordable rented homes – these were the national average prices as estimated in our 2018-19 study of Section 106 and CIL for the Ministry of Housing, Communities and Local Government.^C
- Developers sell First Homes at the required 30% discount on market price.

A *Land Value Estimates for Policy Appraisal 2019: Guidelines for Use*. Valuation Office Agency, Aug. 2020.

www.gov.uk/government/publications/land-value-estimates-for-policy-appraisal-2019/land-value-estimates-for-policy-appraisal-2019-guidelines-for-use

B J Henneberry: 'Development viability'. In T Crook, J Henneberry and C Whitehead: *Planning Gain: Providing Infrastructure and Affordable Housing*. Wiley Blackwell, 2016, pp.115-39

C A Lord, R Dunning, M Buck, S Cantillon, G Burgess, T Crook, C Watkins and C Whitehead: *The Incidence, Value and Delivery of Planning Obligations in England in 2018-19*. Ministry of Housing, Communities and Local Government, Aug. 2020.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907203/The_Value_and_Incidence_of_Developer_Contributions_in_England_201819.pdf

The results for each region of England based on these starting assumptions are shown in Fig. 1 on the following page, together with the average for England as a whole. They show that most of the IL goes towards funding affordable housing, with less for infrastructure except in the southern regions of England; and that in two of the northern regions the IL produces negative land values.

We have also calculated the total yield from the IL for every region and aggregated it for England as a whole, using the total numbers of new homes completed in 2018-19 as the basis for grossing up; i.e. assuming that there are no exemptions for any tenures or development types. On this basis the IL yields around £5.6 billion in all, somewhat less than the £7 billion agreed for Section 106 and CIL in 2018-19. Then there were significant exemptions, especially with respect to small sites and permitted development (for Section 106), and little agreed for commercial development. In our modelling, just

over 66% of IL is raised in London, the South East and East, only slightly higher than the equivalent proportion (64%) for Section 106 and CIL in 2018-19.

The main reason why the simple version of the national system generates less revenue is because, while the rate is national, market conditions vary greatly both between regions and between localities. Thus high-value areas can bear a higher proportionate tax than is being required, while in low-value areas the basic IL level cannot be achieved – as a result, developments end up either below the threshold or non-viable. A fixed-rate levy across the whole country (depending on the rate) could be expected to increase housing output in the South and reduce it in the North.

We have examined how the results are affected by assuming different thresholds (made up of different allowances for land values and construction costs), but these changes have little impact on the amounts achieved. The problem is not that these

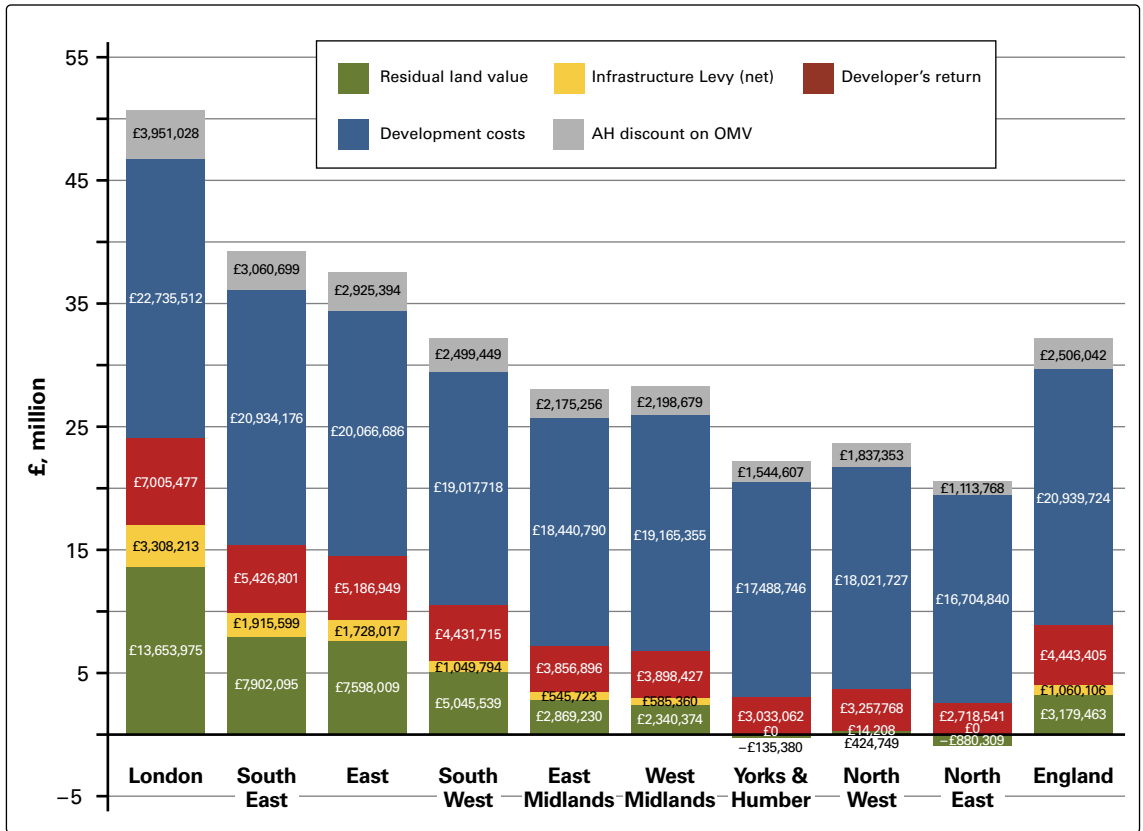


Fig. 1 Infrastructure Levy impact by region

costs vary but that values in some areas are inadequate. Only if the levy rate is raised and/or varied between regions (or local authority areas) can the revenues achieved be significantly increased.

Varying the rates

If the IL rate is raised to 30% (while leaving the requirement for affordable housing provision at 20%) it increases the total yield to £7.9billion, somewhat more than Section 106 and CIL has been raising. But it further worsens the inter-regional stresses – with a higher proportion of the total (71%) being raised in London, the South East and the East and none being raised in the three northern regions, where there would be negative land values.

We also modelled the impact of levying regional rates to reduce the issues around viability on the one hand and funding loss on the other – but this inherently worsens the regional distribution. If, say, rates were 40% in London, 30% in the South East, the East and the South West, 20% in both the Midlands regions and 10% in the three northern regions, the IL would bring in £8.4 billion in total for England. However, none would come from the North East and very little (3% of the national total) would be raised in Yorkshire and Humberside and the North West, with £6.2 billion (74%) of the total

being raised in London, the South East, and the East. What we cannot estimate is the impact of such an approach on output across regions, although we would expect some increase in the northern regions and some limited reduction in the South.

Taking both the fixed and regional versions, our model suggests that:

- On a like-for-like basis the IL would probably raise less revenue than that which has been raised by Section 106 and CIL, although the IL would be less complex and revenues more certain across the country.
- If, however, the wider set of planning reform proposals lead, as the government anticipates, to an increase in the numbers of new homes being built, the new IL has the capacity to raise more.
- The lack of widespread exemptions with respect to affordable housing and the better coverage of commercial development and change of use should also raise more, even if the total new build output does not increase.
- A simple national rate would work against the levelling-up agenda. The ways in which that issue might be addressed are by enabling variable regional levy rates or by requiring some of the sums raised in southern regions to be transferred to northern regions.

So is it worth changing the system – what is right and wrong with Section 106/CIL?

Significant sums have been raised by Section 106 and CIL. These increased by 170% in real terms from the £2.6 billion agreed in 2003-05 (at 2018-19 prices) to the £7 billion agreed in 2018-19. Within this total £2.3 billion was for infrastructure via either Section 106 (£1.3 billion) or CIL (£1 billion). The £4.7 billion for new affordable homes provided for 44,500 homes. Nearly half of all new affordable homes completed in 2018-19 were delivered by planning obligations on which no public subsidy in grant was paid.⁴

The success of Section 106, compared with previous nationally levied taxes on development values, is seen to be because obligations are a *de facto* and locally negotiated means of capturing development value that take account of specific site circumstances and values, as well as directly benefiting local people. Section 106 agreements have secured the confidence of local planning authorities because they are legal contracts that place obligations on both parties to deliver what has been agreed in a timely manner. They also give considerable certainty to developers that the infrastructure that is needed to complete their developments will be provided. We calculate that, because ultimately landowners pay the cost of these obligations, Section 106 and CIL capture about 30% of development value on greenfield sites, although there is usually less available on most brownfield sites.^{3, 5-7}

Because Section 106 policy has emphasised on-site provision of affordable housing it has also contributed significantly to the mixed-communities agenda, with new occupants of market and affordable homes moving to the same new residential developments. These have tended to be in more 'upmarket' locations and have thus also enabled many deprived households (often with young children) to move to areas of lower deprivation.⁸

However, there are a lot of problems:

- Most importantly, local planning authorities feel that the negotiations not only hold up development but also that authorities are disadvantaged in negotiations as compared with developers – who undertake them all the time.
- Although there has been an increase in tariff-type charges in Section 106 policies, negotiations on Section 106 obligations are often drawn out, complex and uncertain, raising costs to both the local planning authority and the developer, as well as impacting on development viability.
- SME (small and medium-sized enterprise) developers find it particularly hard to engage with Section 106 requirements and negotiations, reducing the diversity of housing supply.
- Section 106 works less well in low-value areas

and in times of stagnant or falling markets – and renegotiations can make everything slower and more expensive.

- There are big variations in outcomes between local planning authorities, partly as a result of local discretion in policy and practice – if good practice were more widely adopted, more could be raised.
- There are many exemptions in terms of both site thresholds and types of development (importantly, permitted development is exempted from Section 106), indicating that more could be raised were there to be fewer exemptions.
- CIL has 'de-linked' the contractual relationship between developers' payments and the provision of infrastructure; CIL money often sits in authorities' balance sheets for years. Regular changes in rates also add to uncertainties.

Will the IL overcome the limitations of planning contributions?

The proposed IL has the potential to overcome many of the limitations of Section 106 and CIL listed above. It will also allow the mixed-communities agenda to continue to be secured through on-site provision of new affordable homes.

Importantly, it removes the Section 106 negotiating complexities and many of the variations in local policy and practice. It will be a charge on all development – so is far more broadly based – and will be levied on the final value of completed developments (i.e. the GDV). Conceptually, the IL is a simple sales tax. This distinguishes it from Section 106 obligations that are designed to make development acceptable in planning terms by securing funds to cover the *costs* of infrastructure and affordable housing. As many of the lengthy timescales and risks that developers face under Section 106/CIL will be reduced under the IL, their cost of capital should be lower. This should make some additional development possible, as well as providing a more level playing field between larger and smaller builders.

What are the benefits and risks to developers and local authorities?

The IL, at least in principle, has an attractive simplicity and addresses many of the problems with Section 106 highlighted above. However, the details that will need to be decided suggest that the IL poses a different set of challenges. These include fixing thresholds, agreeing GDV valuations, determining the IL percentage, and dealing with the TIF (tax increment financing) style borrowing costs for local authorities that will reduce what the IL can fund.

Moreover, if market conditions change and the GDV differs from that projected at planning consent, there will be adjustment issues. If the GDV is lower, the government suggests that this might be dealt with by 'flipping' any on-site affordable homes into

the market sector. However this is likely to be problematic as affordable homes are generally the first to be built and sold to housing associations, helping developers' cash flow, and thus occupied by tenants well before the development is complete. If the GDV is higher, this will result in more income for the local authority, which may compensate for lower-than-expected incomes during market downturns. In addition, the IL will shift the balance between certainty and risk both for local authorities and for developers. There are also suggestions that the IL income will not always be ring-fenced for infrastructure, affecting who in the community will actually benefit from the levy.

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For local authorities there will no longer be the need for exhaustive analyses of the needs and costs for site mitigations and infrastructure to justify Section 106 policies on a site-by-site basis or wider CIL charge regimes (nor public inquiries into the same). If local authorities want IL to fund on-site affordable housing they will still need to have clear policies on this, but will be undertaking such analysis for their Local Plans anyway. IL income will depend on a range of factors, including levy rates and thresholds (and who will set them), valuations of GDV, and the changes in market prices that will occur between those estimated at planning consent and those achieved at the final sale of completed units (indeed, if they are completed). This will make the IL income to local authorities uncertain and will affect the costs of TIF-style up-front borrowing against that anticipated income.

For developers, large and small, certainty will increase. The complexities of negotiations will largely be eliminated (save for sharing their GDV estimates when applying for planning consent). They will know their liabilities well in advance, although these will not crystallise until completion, and they will not

need to pay the IL charge until the development is finally completed. This will help with their cash flow. But one key aspect of risk will increase compared with Section 106. Developers will have no certainty that the infrastructure that their IL payments will nominally be funding will actually be delivered in a sufficiently timely manner to enable their development to proceed.

What is the best way forward?

While the IL has the potential to raise as much as Section 106 and CIL and address many of the problems of the current system, it will take time to introduce and 'bed in' the IL and to address its own problems – notably that it will not work well in the northern regions of England and the delivery of infrastructure is not contractual. The choice therefore is either to add some complexity to the IL so that it achieves its objectives as a simple value-based approach to contributing to the provision of infrastructure and affordable homes, or to simplify the existing Section 106/CIL system to achieve similar aims with less disruption but maintaining its cost-based approach.

There are ways of addressing some of the concerns about the IL, including:

- introducing regional IL rates, with the additional potential of having varying rates for different types of development or even rates specific to each local authority (or rates for sub-regions, for example the combined authorities) – this approach could include a standard minimum fixed rate across all regions, with regional or local 'top-ups';
- enabling infrastructure to be provided in kind by developers, which can be netted off from their IL liabilities, just as for affordable housing, although this will make both contractual arrangements and the valuation of such provision more complex; and
- addressing the levelling-up agenda by ring-fencing some of the IL yield in higher-value, mainly southern regions to help fund infrastructure in the lower-valued, generally more northern regions.

An alternative approach would be to secure the objectives of greater simplicity and certainty by amending the existing Section 106 and CIL system, including by:

- ensuring that the Local Plan is in place and clearly states infrastructure requirements, so there is much greater certainty on all sides;
- using a fixed tariff for smaller sites (say, up to 100 dwellings for residential and an equivalent for commercial) for affordable housing and site mitigation with no exemptions;
- retaining Section 106 for larger, more complex sites where discussions and negotiations are required for what is needed, whatever system is employed;

- for very large sites using a partnership-type approach, as suggested by the Letwin Review;⁹
- retaining CIL only for Mayoral CIL (London and combined authorities) for sub-regional/regional infrastructure; and
- incorporating CIL into the tariff, which should better link funding to requirements.

Conclusions

There is an attractive simplicity about the IL, although it will not be without complexities in its operation. There is also, as always, the challenges of introducing a new system. It is unlikely to secure as much as Section 106 and CIL currently do unless regional (and indeed intra-regional) variations in rates are used. It almost certainly cannot address the levelling-up agenda unless the government decides to redistribute at least part of the revenues – which has currently been ruled out. As it is envisaged in the White Paper, it cannot ensure that the necessary infrastructure is put in place in a timely manner.

We therefore argue that changes to what was initially outlined with respect to the value-based IL in the White Paper must be made if government objectives are to be achieved. We have suggested what some of these changes might be. An alternative would be to modify the existing cost-based arrangements to achieve similar objectives with less disruption. Based on the evidence, we leave the reader to decide which should be the preferred option.

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Notes

- 1 *Planning for the Future*. White Paper. Ministry of Housing, Communities and Local Government, Aug. 2020. www.gov.uk/government/consultations/planning-for-the-future
- 2 In addition, to simplify the IL further, some organisations have suggested removing the funding of new affordable homes from the proceeds of the levy to enable it to be used wholly for infrastructure funding (see, for example, *Written Evidence Submitted by the Royal Town Planning Institute*. FPS 113. Evidence submitted to the House of Commons Housing, Communities and Local Government Committee Inquiry into the Future of the Planning System. Royal Town Planning Institute, 2020. <https://committees.parliament.uk/writtenevidence/13631/pdf/>). However, while removing affordable homes from the IL might make it even simpler, doing so would raise key questions. How would affordable homes be funded in the future? How easy would it be for affordable housing providers to find suitable land to build on? What would such a change mean for the mixed-communities policy? Because of these

uncertainties, other organisations want to retain the existing Section 106 arrangements (see, for example, *Written Evidence Submitted by the National Housing Federation*. FPS 158. Evidence submitted to the House of Commons Housing, Communities and Local Government Committee Inquiry into the Future of the Planning System. National Housing Federation, 2020. <https://committees.parliament.uk/writtenevidence/15244/pdf/>)

- 3 Projections of income from the proposed IL are set out in T Crook, J Henneberry and C Whitehead: *Additional Evidence Submitted by Professors Tony Crook, John Henneberry and Christine Whitehead*. FPS 164. Evidence submitted to the House of Commons Housing, Communities and Local Government Committee Inquiry into the Future of the Planning System. <https://committees.parliament.uk/writtenevidence/18315/pdf/>
- 4 A Lord, R Dunning, M Buck, S Cantillon, G Burgess, T Crook, C Watkins and C Whitehead: *The Incidence, Value and Delivery of Planning Obligations in England in 2018-19*. Ministry of Housing, Communities and Local Government, Aug. 2020. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907203/The_Value_and_Incidence_of_Developer_Contributions_in_England_201819.pdf
- 5 T Crook, J Henneberry and C Whitehead: *Planning Gain: Providing Infrastructure and Affordable Housing*. Wiley Blackwell, 2016
- 6 T Crook, J Henneberry and C Whitehead: *Written Evidence by Professor Tony Crook, Professor John Henneberry and Professor Christine Whitehead*. LVC 053. Second Memorandum of Evidence to House of Commons Housing, Communities and Local Government Committee Inquiry on Land Value Capture, Mar. 2018. <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/housing-communities-and-local-governmentcommittee/land-value-capture/written/79512.html>
- 7 T Crook and CME Whitehead: 'Capturing development value, principles and practice: why is it so difficult?'. *Town Planning Review*, 2019, Vol. 90 (4), 359-81
- 8 T Crook, P Bibby, E Ferrari, S Monk, CTang and C Whitehead: 'New housing association development and its potential to reduce concentrations of deprivation: an English case study'. *Urban Studies*, 2016, Vol. 53 (16), 3388-3404
- 9 O Letwin: *Independent Review of Build Out: Final Report*. Cm 9720. Letwin Review. Ministry of Housing, Communities and Local Government/HM Treasury, Oct. 2018. www.gov.uk/government/publications/independent-review-of-build-out-final-report