STATES OF JERSEY

UPLIFTS IN LAND VALUES: LAND DEVELOPMENT TAX OR EQUIVALENT MECHANISM(S)

Lodged au Greffe on 1st June 2011
by the Deputy of St. Mary

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion −

(a) to bring forward for approval, as part of the draft Budget 2012, proposals for a land development tax or an equivalent charging mechanism or mechanisms of any kind to raise revenue for the States from any significant uplift in the value of land when it is rezoned and/or when planning permission is granted;

(b) to agree that it is the wish of the Assembly that the proposals in paragraph (a) should also be designed to have the effect of capturing uplifts in the value of land arising between the date of this debate and the coming into force of the necessary legislation as part of the Budget 2012 and to request the Minister for Treasury and Resources, having sought appropriate advice, to take the necessary steps to achieve this objective if possible.

DEPUTY OF ST. MARY

REPORT

NOTE:

The Treasury has already done substantial work in this area.

I have read 2 reports by Oxera. The first is entitled "Which tax is best suited to Jersey's objectives?" dated February 2005, whose Appendix 2 is entitled "The use of land development taxes to raise revenue". I refer to this Appendix in what follows as "Oxera 2005".

The other is entitled "Further analysis of land/development based environmental taxes" dated January 2008. I refer to this report as "Oxera 2008".

Both reports are reproduced in the Appendices to this report, in the interests of transparent government, in order to help members.

Summary

1 This proposition is about basic fairness. When land is rezoned or receives planning permission its value increases by between 80 and 200 times. This windfall gain goes only to landowners, and only those landowners whose land is developed.

2 These huge gains have been going to the owners of land for years. It is government policy which has created these astronomical land values, and it is administrative decisions and political decisions, taken as part of the Planning process, which decide just who it is who, in the Deputy of Grouville's memorable phrase, "hits the jackpot".

3 Like many other issues, this has been discussed for years. I believe it is high time that the government shares in that enormous windfall, so that the revenue can be used for the good of all Islanders.

Introduction

4 I have long felt, and I am not alone, that this is an issue which deserved to be tackled. But the immediate spur to action was the Island Plan and the 9 amendments to the Plan which seek to change the zoning of pieces of land, namely amendments 2, 4, 7, 10, 12, 17, 18, 29 and 36.

5 Most of these amendments seek to zone land for residential, commercial or community use, this last with "the associated development" needed to pay for it, presumably residential also. Two amendments seek to go in the opposite direction and would have the effect of land passing from a Built-Up Area zoning to a Green Zone zoning (amendment 11) or reverting from a residential zoning to agricultural use (amendment 34).

6 This proposition is emphatically NOT about the rights and wrongs of any of these zoning proposals, or of any other zoning proposals or planning permits.

It is about the fact that in all these cases **the land involved changes enormously in value,** and the implications of this**.**

7 At the stroke of a planner's pen, followed by a political decision, a resident becomes very, very wealthy. And in the Island Plan debate, we States members have the power to make – or in the case of amendments 11 and 34 to unmake – millionaires.

8 I think any right-thinking and sensible States member must see that there is something quite wrong about this. It should make us feel distinctly uneasy, when the financial rewards of getting a permit for development are so enormous and are going to the very few.

9 The situation is blatantly unfair, and cries out to be remedied. The existence of this huge capital gain is due to the policies of government.[1] It is therefore entirely right and proper that a large percentage of the capital gain should revert to the government which created the policies which led to the uplift in value, to be used for the benefit of all the people of Jersey.

10 Members should also consider a wider point about the corrosive effect of these vast financial gains on the process of government in Jersey. They cast a shadow on all discussions and decisions concerning land use. Inevitably the question: "who owns this land?" (in other words – "who will become a millionaire?") is bundled in with the question: "is this the right place to put this sheltered housing/retail outlet/etc.?" However much one might like to believe that the 2 questions can be held apart in people's minds, it is pretty clear to me that in practise they cannot.

11 Let us be quite frank about this. The sweet smell of corruption, or the suspicion of corruption, is bound to be present when financial gains on such a scale are in the balance. I am NOT casting aspersions on those involved in any one decision, or indeed on those bringing amendments to the Island Plan. I am just making it absolutely clear to members that this situation is intolerable, it cannot be reconciled to good governance and it has to change.

Scale of proposal and potential yield

12 In Oxera 2005, page 57 we read –

"Calculations by the States of Jersey estimate the overall uplift in the value of land recently reclassified from agricultural land to housing development land. Although subject to some uncertainty, the overall uplift in value amounted to around £32 million. In addition, a second phase of potential rezoning in the future is estimated to create a further uplift in value of up to £18 million.

[1] These policies include an ever-increasing population, a supply of land restricted by planning policies, and the presence of wealthy purchasers in the market in sufficient numbers to react to scarcity by simply opening their cheque-books a little wider. I am not in this proposition making any comment whatsoever about these policies, nor should the debate go there. I am just pointing out that as a matter of fact this is the policy environment.

On this basis, and given that the value of land is estimated to increase between 80-fold and 200-fold as a consequence of rezoning, there would appear to be significant scope for raising some revenues from the taxation of these gains. (Footnote: the uplift amount (80x or 200x) depends on whether the land is reclassified for building of "Category A" or "Category B" properties.)"

13 On an uplift of £50 million a modest tax of 50% would yield £25 million over a period of years – a sum not to be sniffed at. And at this rate of tax the landowners would still receive an unearned windfall of £25 million.

14 I will repeat it: this windfall is entirely due to government decisions and government policy and it is entirely appropriate that the enormous financial gain involved should come back, at least in part, to government.

How and why land increases in value

15 On the first page of Oxera 2008 we read at paragraph 4 –

"The value of the land that is to be used for housing is determined by the difference between what the resulting house/flat etc can be sold (or rented) for and the costs of actually transforming the land into housing – i.e. the building and other associated costs. Housing land values prior to actually building the housing are therefore the residual of the price that can be charged for the finished housing and the costs of actually doing the construction (and paying for anything else that is required to make the transformation)."

16 In other words, if you take the sale price of the finished house and deduct the building and other costs of making the house, and an amount for the builder/developer's profit, then you get the value of the land as building land.

17 Members should note that the price of land does not "drive" the cost of housing. If it did, then it might be argued that a land tax could affect the end-price of housing. On the contrary, it is the end-price which can be achieved which determines the value of the land.

18 The end-price reflects scarcity, and the willingness to pay of enough people who are in the market for buying a house. This proposition is about finding a way to distribute a vast private unearned gain to the public good.

"Something must be done"

19 There is general agreement that these enormous gains exist and that they are grossly unfair.

20 "I am fully committed to the principle of re-distributing some of the windfall profits from land re-zoning."
Senator Ozouf, first (and therefore prepared) answer to oral question from Deputy Trevor Pitman, ***Hansard, 21st September 2009***

21 “I think, clearly, we are all of one mind in this Assembly on wanting to extract the value out of the planning system.”
Senator Ozouf, later answer to oral question from Deputy Trevor Pitman, ***Hansard, 21st September 2009***

22 “Last July we rezoned 60 vergées of our countryside and developers made millions overnight on the back of that States decision. If we are hard up for cash, why did not Treasury bring in windfall taxes before that decision? The value of the rezoned field in my Parish alone changed from an agricultural field worth maybe £45,000 to a building development site now worth millions, yet the States derived not one penny in tax from developers over a transaction worth millions and millions and we sit back and claim to be so hard up for cash that we have to tax the pensioner on the already expensive bread and milk and tax them on keeping themselves warm in their homes. Is that fair? Can we understand why people are losing faith with this Government? The land development levy was promised years ago, both in the 2005 rural strategy and in the fiscal option strategy approved on 12th May 2005 and still we have nothing.”
Deputy Labey, in debate re GST exemptions, P 28/2009, ***Hansard, 31st March 2009***

23 “I want to be very clear, I do not want to see new taxation, with the possible exception of a green field rezoning levy.”
Senator Cohen, in debate re GST exemptions, P 28/2009, ***Hansard, 31st March 2009***

24 And finally, in the Fiscal Strategy Review June 2010 Green Paper on personal taxation, there is no opposition in principle to the tax. Indeed the tax is listed as one of a number of options which is “under consideration” This proposition seeks to move the land development windfall tax along from the “under consideration” pile (and it is true that much work has been carried out on it) to the “being implemented” pile.

Practical issues – supply of land

25 There are 2 issues which might concern members. One is the fear that the supply of might land dry up. This is what Oxera have to say on this subject (Oxera 2005, A2.2.2. paragraph 3) –

“*However provided the tax is credible*[2] *in the long term, and it still leaves some profit for the landowner, it is unlikely that a DGT (Development Gain Tax) would restrict the willingness of landowners to sell their land, and therefore, that of developers to bring forward new developments.”*

26 Of course this is not to say that it is desirable for there to be a continuous stream of new developments. It just states the fact that a DGT (Development Gain Tax) would not in itself cause the supply of land to dry up.

[2] By “credible” Oxera mean that landowners must have the perception that any form of Development Gain Tax is “here to stay.” If they sense that it might be removed or reduced at some later stage, then of course they may be induced to hold out for the more profitable conditions for selling land which might obtain at some point in the future.

Practical issues – effect on house prices

27 Some members may fear that there would be an upward effect on house prices. However, this should not be the case. First, there is the competitive brake on prices which results from the fact that most of the housing market is a second-hand market, and this acts as a constraint on the prices which can be charged for new housing, even in Jersey! In Oxera 2008 we read (Oxera 2008, page 1, last paragraph) –

"*In economic terms, new and second-hand housing are in the same economic market, which significantly limits the degree to which the price of new housing can deviate from that of existing (second-hand) housing. As a result, if the cost of new housing is raised by applying a tax to it, but the tax does not apply to existing housing, the price of new housing cannot rise to reflect the new tax. To do so would make new housing more expensive than second-hand housing and as a result there would be no (or much reduced) demand for such housing.*

Assuming that the total volume of new housing produced does not change as a result of the imposition of the tax or levy, the final price of housing in general (including the new housing) would not be expected to change. As the non-tax/levy costs of actually constructing the housing would also not be expected to change either, the main impact of the tax/levy will end up in the price of land that can be used for housing, but where the housing has yet to be built."

28 And second, the astronomical price of housing in Jersey, whether second-hand or new, depends on: (a) scarcity; and (b) willingness to pay. And *this* is what determines the price of land. The developer will estimate the price at which he/she will be able to sell any new housing, and will deduct an estimate of the total cost of building, and of the profit. What is left is the value of the land.

29 This value is a fixed amount. If the developer can get the land for less, than he will make a bigger than anticipated profit on the housing. He cannot pay more, or he will lose money on the eventual housing.

30 To make this point abundantly clear, I copy for members at Appendix 3 the second Appendix in Supplementary Planning Guidance (SPG) August 2010 about Affordable Housing which will/may be approved along with the Island Plan in June. This gives a worked example of a hypothetical residential development, and how the calculations actually work out, and it bears out what is said above by Oxera (see section headed '**How and why land increases in value**').

31 At whatever point in the process the tax or levy is charged, the developer will factor in the tax in his/her negotiations with the landowner. The tax will always effectively be paid by the landowner.[3] So this measure will not

[3] This is true in a "competitive market" What happens in non-competitive markets, is considered in Oxera 2005, page 60, section A2.3.2 and page 63, section A2.8. Very, very briefly, if landowners and developers have so much power that the market is not competitive, then they also have the power to pass on the tax to the end-user. But if they have that much power they are in a position to effectively "charge what they like" for housing anyway.

increase the price, it is already high due to other factors. All it will do is to ensure that some of the astronomical value of land comes back to government.

Implementation issues in recovering the uplift in land value

(a) Landowner develops for themselves

32 If, say a landowner builds a house on his own land, and spends £250,000 in so doing, the house is immediately "worth" say £600,000. When the house is first sold that uplift of £350,000 will be realised and should be liable to tax. Evidence would need to be kept of the cost of building in order to assess the underlying value of the land. If evidence is not kept, then the cost of building would have to be on an assessed basis.

(b) The levy must be predictable

33 Only then will developers be able to factor in the future levy or tax into their calculations and negotiations when buying land. Then the landowner ends up effectively paying the tax by being offered less for the land.

34 This requirement goes against the use of planning obligations as a tool to recover increases in land value. Oxera put it like this (Oxera 2008, page 8, paragraph 3.2) –

"However, several issues arise in the context of using planning gains as a tax measure to capture uplifts in land value. Unlike a land development tax, which is set in advance, the financial commitments imposed on a developer by a planning gain are likely to be largely unknown to the developer in advance, as they are decided on a case-by-case basis. At the time of purchasing the land from landowners (i.e., assuming that the developers are not yet in the possession of the land prior to re-zoning), developers therefore cannot fully factor the financial implications of the planning obligations into the bidding price. The uncertainty at the stage of land purchase results in planning gains being less likely to be effective in targeting the tax at the beneficiary of the planning decision (i.e., the landowner)."

35 States members are frequently told that planning obligations are the tool by which some of the uplift in land value is captured for the community. Unless the cost of such obligations is known in advance, this is not true. The developer cannot pass on the cost of the obligation to the landowner by offering less for the land, because he doesn't know what that cost is. It is decided on a "case-by-case" basis.[4]

36 The only way for the charge to fall on the landowner where it belongs is for the cost of the obligation to be known in advance.

[4] This may no longer be true under the new SPG (Supplementary Planning Guidance) quoted in paragraph 30. However the amount being asked for is also an issue – is it enough? See below, paragraphs 43 and 44 for this aspect.

“Hope value”

37 Oxera write (Oxera 2008, page 3 footnote 5) –

“The increase in value may not all accrue to the owner of the land at the time the administrative decision is made. To the extent that such a decision is anticipated, previous owners of the land may have benefited by the inclusion of the anticipated probability of the land being reclassified in the price obtained in previous sales. (This is sometimes referred to as the ‘hope’ value of land.)”

38 Thus, when the land in question is finally rezoned or receives planning permission, then the uplift in value will be reduced by the amount of the hope value already realised in respect of that land.

39 Ideally, both the original increase in value and the later increase in value would be taxed. The same mechanism of rising land values due to zoning and planning decisions is operating in both.

Planning obligations

40 These have the disadvantage that at present they are not predictable (see above paragraphs 33–36) and therefore do not tax the landowner at the start of the chain. It can therefore be argued that they do indeed add to the cost of housing as it is the developer who has to stump up the necessary cash, and he cannot pass this cost on to the landowner in the form of paying the landowner less for the land.

41 When answering questions in the States, Senator Ozouf said this about Planning Obligations: “I cannot answer what the percentage of gain is because that is an issue to be taken on a site by site basis.” (**Hansard 21st September 2009, 4.10.2**). This is precisely my point.

42 Also, whilst they have the advantage that they “avoid the administrative complexity of applying a tax” (Oxera 2005, page 62) they have the related disadvantage that it is difficult to maintain absolute consistency and fairness, and there is the potential for corruption. (see Oxera 2005, page 62).

43 The new draft Supplementary Planning Guidance (SPG), which will come into force if the Island Plan is passed, imposes a set obligation on developers that 12½% rising to 20% of housing on a site must be “affordable housing”, or arrangements made which are equivalent in cost to the developer to create such housing elsewhere.

44 This is indeed a set and predictable cost for each development but it is laughably small, and the effect on the underlying land value and hence the huge windfall which goes to the landowner as unearned income on selling their land is only slightly reduced.

“Super stamp duty”

45 This option appears to capture all the uplifts in land value in a simple and unavoidable manner. A record exists of all land transactions, including full details of the seller. This option would tax the whole value of the transaction. Or, in the case of a transaction affecting a piece of land that had already been sold, then what would be taxed would be the difference between the previous price and the price being paid currently. Some discussion of this option is at Oxera 2005, page 61, section A2.4.1

46 The duty should be arranged so that the windfall that is implicit within self-developed houses as at paragraph 32 above are also captured by the tax. In such cases the landowner has effectively sold the land to him- or herself in order to build the house.

The proposition

47 A few words about the detail of the proposition.

48 Paragraph (a) deliberately leaves it to the Treasury Department to come up with something workable. However, the intention is clear – to find a mechanism (or mechanisms) which catches the increase in value of the land. As I have shown in this report, Oxera have explained that if correctly designed this tax or levy should fall on the landowner, and should not affect house prices.

49 Paragraph (b) means that the States are declaring their clear intention that the changes we will be voting on in the Island Plan just before this proposition is debated should all be subject to this proposition.

50 The reason that paragraph (a) talks of “a mechanism or mechanisms of any kind” is that it may be necessary to use more than one mechanism. For example, a “super stamp duty” may be the simplest way of capturing all windfall gains after the date of the budget from the sales of land, whilst a different temporary levy of some kind may be the best way to catch the increase in land value of land sold between the date of this proposition being passed and the date of the budget being passed.

51 To answer the charge of paragraph (b) being retrospective legislation, under paragraph (b) as drafted, transactions which have already taken place at the date of the budget need not be liable to any charge or tax. If that is not possible, then they won’t be. However, transactions which take place after the date of the budget and which incorporate that uplift, for example, sales of housing whose price incorporates the value of land sold between the date of this proposition being passed and the date of the budget being passed, could be made, in some way or other, liable to a tax or charge. And this is what paragraph b) is asking the Minister to bring forward for approval in the budget.

52 Why take this trouble to capture all these transactions? Because we must be seen to be whiter than white. We HAVE to remove the link between planning decisions and huge financial gains.

53 There is another reason for including paragraph (b). If we do not signal this Assembly's intention to capture all transactions starting immediately, then end-users (purchasers of property) may end up effectively paying the tax and not landowners.

54 This is what Oxera write on page 6 of Oxera 2008 –

"However, where the tax is being introduced, without being correctly anticipated by the relevant economic agents, some or all of the tax may effectively be paid by someone other than the owner of the land in its pre-change state. In particular, sale of land in anticipation of a re-zoning prior to the announcement of the tax is likely to be at a price that does not fully reflect the tax that will subsequently have to be paid. As a result, the original landowner may receive, at the extreme, the full value of the anticipated uplift, while the subsequent buyer will incur the tax. As a result, it is possible that the subsequent buyer would make a loss on the actual development of the site to take advantage of the re-zoning."

55 It is thus essential to ensure that the relevant economic agents know in advance that this is coming, as only then will they factor in the new tax into their decisions, and only then will the landowner be the effective payer of the tax.

Conclusion

56 *"The uplift in land value is not owing to the landowner's efforts in adding value to their land, but is the result of a public agency decision acting on behalf of the wider community. As a result, the decision of the public body acting on behalf of the community provides a windfall gain to the landowner.5 A levy (tax) on land windfall gains can therefore be justified on grounds of fairness, as it distributes (at least potentially) the benefit of that windfall gain more widely, and can be used as a policy tool to share, with the wider society, the otherwise purely private benefits of the decision. In addition, to the extent that (further) development at any particular place imposes external costs (e.g., congestion, need for additional investment in infrastructure, etc) in the immediate vicinity or across a wider area, the use of any tax or levy can be seen as (partially) compensating those who are negatively affected by the change in the use of the land."*
(Oxera 2008, page 3, second paragraph)

57 That is the clear objective statement of the situation. Put more bluntly, if we do nothing, then we are simply giving certain landowners a golden land-shake, which is hard if not impossible to justify.

58 The only serious argument against action is that it is difficult to do. In response to this I would simply say firstly, that I am not so sure that it is true. Secondly, even if it was, even if the net yield was not a vast sum in itself, it would remove a gross unfairness in our society, and that in itself has value and is worth pursuing.

Appendix 2 The use of land development taxes to raise revenue

Development gain taxes can be advocated as a means of capturing some of the substantial economic rents that arise when public planning agencies reclassify greenfield land as development land. Under these circumstances, the rise in land value is not due to the individual efforts of landowners in adding value to their land, or the result of a general increase in land values, but is the result of a public institution's decision, acting on behalf of the wider community. Hence, given that the rise in value is not due to landowners' efforts, or general inflation in land values, it could be considered fair to levy some form of development gains tax (DGT) on the windfall gain, and redistribute the ensuing revenue to the wider community.

The distinction between the increase in value as a result of a rezoning decision and the general appreciation of land values, or the gains made as a result of a particular building decision (eg, refurbishment of building within the same land-use class) is important. Taxing the former gain is taxing the gain arising as a result of an administrative decision; taxing the latter is more like a pure capital gains tax.

This appendix explores the potential of DGT for general tax revenue-raising purposes. Such taxes could also be used for financing specific expenditures to deliver improvements for the rural economy; however, any expenditure to meet environmental or rural development objectives would reduce the amount available for meeting the general government deficit.

The appendix looks at the feasibility of a DGT in Jersey. Issues regarding any impact on property prices are particularly pertinent to Jersey, given its already high housing prices caused by a shortage of housing. The appendix is structured as follows.

- Section A2.1 determines the revenue-raising capacity of a DGT.
- Section A2.2 examines the characteristics of land as a tax base and the conditions under which tax revenues could be collected.
- Section A2.3 investigates the tax incidence under different market structures The tax is only effective in capturing the uplift in value if it does not result in higher prices for the final output (eg, housing, office space).
- Section A2.4 considers tax design options.
- Section A2.5 looks at planning gains as an alternative to DGT in capturing land windfall gains.
- Section A2.6 briefly looks at differences between greenfield development and brownfield redevelopment gain levies.
- Section A2.7 concludes.
- Section A2.8 sets out the conditions under which the general conclusion that end users do not pay the DGT may not hold.

A2.1 Revenue-raising capacity

Calculations by the States of Jersey estimate the overall uplift in the value in land recently reclassified from agricultural land to housing development land. Although subject to some uncertainty, the overall uplift in value amounted to around £32m. In addition, a second phase of potential rezoning in the future is estimated to create a further uplift in value of up to £18m.[74] On this basis, and given that the value of land is estimated to increase between 80-fold

[74] Source: States of Jersey Treasury.

and 200-fold as a consequence of rezoning,[75] there would appear to be significant scope for raising some revenues from the taxation of these gains.

However, the taxable gains in land value clearly only arise when decisions are made to change the permitted land use—so the tax base is unlikely to be steady unless there is a prior decision to permit a steady stream of such changes through time. In addition, until the additional value is realised, those enjoying the increase in value may not have the resources to pay the tax. The realisation of the gains is unlikely to take place until the first transaction involving the land takes place after its reclassification. However, if the reclassification is anticipated, transactions before the reclassification may include some of the predicted increase in value ('hope value'). This makes it difficult to derive the precise increase in value from analysing the relevant land transactions.

Data on the number of transactions that actually take place in any given year and the actual rather than estimated gains is not available. Moreover, the reclassification decision is taken by the Jersey Planning and Environment Department, and the amount reclassified may vary substantially from year to year. Due to these uncertainties, and, given that the amount of land available for rezoning is limited, it is difficult to quantify the amount of tax that may be generated from a DGT-type levy. However, due to the potential cyclicality of building activity and based on the calculations above, it is reasonable to conclude that the revenue potential of a DGT, measured on an average per-year basis, is quite small, although the individual gains on a specific reclassification of land may be significant. Hence, a DGT would not really be suitable as a sustainable means of meeting a significant part of the predicted tax shortfall.

In most cases, the timing of the decision on the change in land use and the actual realisation of the monetary gain by the owners of the land is likely to occur quite close together. Hence, the taxable action (the rezoning) and the taxpayer having the means to pay will occur quite close together. However, this is not necessarily the case if the owners of the land choose to 'enjoy' the benefit of the planning decision themselves—for example, by building a house and living in it. Where a landowner receives planning permission, but does not realise the additional value in a monetary transaction, a decision is required on whether, and, if so, when, the tax is due. Intermediate cases will arise where there is some significant delay between the rezoning and the realisation of the increased value. Again, under these circumstances, a decision would be required as to when the tax was due.

Finally, although the gain arises as a result of the reclassification of land, the economic benefit does not occur until the change of use has actually been made.

A2.2 Land as a tax base

The attractiveness of land taxes resides in the fact that the quantity of land is physically 'fixed' and among the least mobile of all potential tax bases. Thus, a well-designed land tax that provides little or no scope for legal avoidance could be a highly effective instrument for raising government revenues.

A2.2.1 The parties involved in the transaction

To examine the feasibility of a DGT-type tax, which effectively captures some of the uplift in land value, it is useful to consider the parties involved in the transaction. The supply of development land is controlled by the Jersey Planning and Environment Department, but, once development permission is granted, it is effectively controlled by landowners. Before reclassification, the possibilities for landowners to convert their land into income is mainly limited to renting the land out to farmers, or putting it to agricultural use themselves. The (suitably discounted) future income stream generated by this is likely to be substantially lower than the profits that can be made from selling the land following its reclassification. Landowners are therefore the clear beneficiaries of the land rezoning and stand to benefit

[75] The uplift amount depends on whether the land is reclassified for building of 'Category A' or 'Category B' properties.

considerably upon the sale of their land to developers. The other party involved in the transaction, acting as intermediaries between landowners and end-users, comprises developers. These purchase the land from landowners and use it to build properties in order to sell them or rent them out to Jersey residents or companies.

For the purpose of the analysis in this appendix, no distinction is made between the type of end-user who may seek to rent or buy from the developer for private or commercial purposes (eg, private residents seeking a family home, or a business seeking new office space).[76]

A2.2.2 Under what conditions would landowners sell their land?

The decision of landowners to seek change of use is likely to depend on the net profit they expect to make after tax deductions. Assuming that the tax incidence falls fully on landowners, the rezoning would still give landowners large, otherwise unrealised, gains, as long as the tax is set at a reasonable rate and does not try to capture the entire uplift in land value. Thus, provided the expected gains by landowners are in significant excess of the value of the land before reclassification (ie, as agricultural land), it is likely that landowners would be willing to seek change of use and, usually, sell the land to developers (at which point a tax could capture a proportion of the gain).[77]

A further crucial aspect of a DGT is its credibility. If, for some reason, landowners expect the tax to be repealed at some time in the reasonably near future, it is likely to be in their economic interests to hold back the sale in the expectation of making higher (because untaxed) windfall gains in the future.[78] If the repeal of a tax were seen as a distinct possibility, landowners would incur little or no risk in delaying the sale, given that the likelihood of significant amounts of new land being made available for housing in the future appears very low. Land values would be expected to hold up, so the possibility of an untaxed gain in the future may result in a reduction in the supply of (taxed) land in the present.

However, provided the tax is credible in the long term, and it still leaves some profit for the landowner, it is unlikely that a DGT would restrict the willingness of landowners to sell their land, and, therefore, that of developers to bring forward new developments. However, the overall credibility and the design of the tax itself are instrumental in ensuring that landowners choose to come forward and sell their land.

A2.3 Tax incidence: landowners or end-users?

The analysis so far has assumed that landowners would bear the full burden of taxation. Whether this is likely to be the case in practice is now considered, starting with the assumed case of a competitive market and then moving on to a hypothetical case where developers have some market power.

If the existing housing market is assumed to be economically efficient, the price of houses is determined by the supply and demand conditions. Most of the supply is second-hand, and no taxation of this housing is contemplated. If the tax does not alter the supply of new land (see above) then the total supply of houses is unlikely to change as a result of the tax. Thus, the price of houses is unlikely to change, and the tax does not fall on the consumers of housing.

A2.3.1 Tax incidence in a competitive market

In competitive markets, landowners can indeed be expected to bear the full burden of taxation. Although landowners could require buyers (ie, developers) to pay the tax,

[76] End users may also choose to buy directly from landowners and develop the land themselves, or with help of a hired developer; however, as this is likely to be less common in practice, this possibility is not investigated.
[77] In the UK, the 1947 'Development Charge' was set at 100% of the excess value generated by the granting of planning permission. This substantially reduced the amount of land being sold for development, leading to revenues that were substantially below expectations. See, for example, HM Treasury (2004), 'Delivering stability: securing our future housing needs, Barker Review of Housing Supply-Final Report-Recommendations', March (hereafter, referred to as the Barker Report).
[78] HM Treasury (2004), the Barker Report.

prospective land purchasers would take into account any future stream of tax liabilities and formulate their willingness to pay for the reclassified land accordingly. Developers would have a strong incentive to ensure that landowners paid the full amount of tax, as there is no scope for passing higher costs on to end-users. Any relative increase in price would render their properties uncompetitive compared with equivalent properties in the wider housing market.[79] Hence, landowners can expect to receive an amount that is lower by the full amount of the DGT.

Thus, in competitive markets, the full tax incidence is on landowners. This is likely to be the case in large markets such as the UK. A DGT does not increase end-user land or property prices, a condition that is of particular relevance for the Jersey market, where average house prices are already high. [80]

A2.3.2 Tax incidence in non-competitive markets

However, in a small housing market, such as that in Jersey, either landowners or developers could gain control over the supply of new land or new houses, respectively. With such market control, landowners and/or developers may try to pass on the cost of the tax to end-users, for example by reducing the amount of land they actually release (landowners) or develop (developers), thereby decreasing the housing supply and increasing prices. The incentives facing landowners are discussed above and, for the reasons set out, it seems unlikely that a credible tax would result in landowners refusing to sell their land, given the substantial gains that they would still enjoy. Even if all the land were owned by the same person, the rise in final house prices as a result of the landowner restricting supply would have to be substantial, to compensate for the reduction in profits that results from a reduced number of new houses being supplied and sold (or rented).[81] If all new development were controlled by the same developer, who then tried to pass the tax on to end-users, the same logic would apply.

In addition, if either landowners or developers held market power, and it was profitable for them to restrict their output to induce price rises, it would be possible, and likely to be profitable, for them to do so *in the absence of the tax.*

More likely, even a monopolist would expand the output of new houses if allowed to do so, because this would increase profits—ie, the planning system is likely to be restricting the output of new houses even more than a monopoly supplier would do. However, there are some fairly extreme market conditions that would allow developers and/or landowners with market power to pass on at least some of the tax to end-users and it would be prudent to ensure that these conditions did not exist before embarking on a DGT; these are discussed further in section A2.8.

A2.4 Tax design

The discussion so far has not made any specific assumptions about the tax design other than that it should be credible (to avoid landowners postponing their sale) and that it should not be set too high. If the expected return from the sale of the land is low, landowners may not put their land on the market despite a reclassification as development land, thereby limiting the revenue-raising capacity of the tax.

[79] Rosen, H.S (2000), *Public Finance*, 6th Edition, McGraw-Hill.

[80] In 2003, the average price of a dwelling in Jersey was £317,500. Figure from Statistics Unit (2004), 'The Jersey House Price Index First Quarter of 2004', May.

[81] Abstracting from the tax, if the value of rezoned land is 50% of the costs of a new house, it would only be profitable for the landowner to restrict supply of land if a 50% reduction in the supply of *new* houses would induce a 50% price rise in *all* houses. This seems unlikely. If land costs are a higher proportion of prices then the effect on house prices from a reduction in the supply of *new* house has to be even greater.

A2.4.1 Super stamp duty

One possibility would be to capture a share of the windfall gains by taxing it as profits or income under the current income tax system. Clearly, the tax base could be expanded to include one-off land sales that have been reclassified as land for development purposes. One problem, however, would be to establish unambiguously the value of the land without the relevant permission, in order to calculate the increase in value, particularly if the previous transaction involving the land included some 'hope' valuation that the reclassification would take place. This problem can be addressed in a number of ways; for example, the value of the whole transaction could be taxed using a kind of 'super stamp duty' for the first transaction after reclassification.[82] Some issues arise regarding the future use of the land, which would have to be known at the point of sale. While land will be used primarily for the building of residential housing, in some instances this may be less clear. For example, land may turn out to be unsuitable for building residential housing following a developer survey, in which case the land value uplift would be lower and the tax payable should accordingly be lower. Landowners also have the incentive to engage in tax-avoidance schemes.

A2.4.2 Capital gains tax

Another approach would be to subject all transactions involving land to a capital gains tax (with exemptions for first homes, if required), which would also pick up transactions involving 'hope ' valuations. However, this would not offer the possibility to distinguish between agricultural land that has been reclassified and other one-off sales of land or property, although this distinction could be made at additional expense by adding a layer of administration. This would still leave the issue that the tax would apply to the value of the whole transaction rather than purely the uplift in land value. Such a tax would thus be a capital gains tax (CGT), which can have the downside effect of reducing investment activity and therefore be detrimental to economic activity and growth. In addition, experience in the UK and other countries shows that complex avoidance mechanisms limit the effectiveness of CGT in raising revenue. For example, in 2000/01 the net CGT revenue in the UK from sales of reclassified agricultural land disposals amounted to less than £50m.[83] This is despite uplifts in the per-unit value of land following reclassification equivalent to, or higher than, those in Jersey and a much larger tax base.

DGTs have been used in the UK to raise revenue, but with limited success, and were eventually withdrawn. Their success was hampered by the points made above—ie, a lack of credibility and perceived fairness. In addition, the complexity of the taxes allowed landowners to engage in elaborate avoidance schemes.[84]

A2.4.3 DGT levied at the planning permission stage

Another possibility would be to levy the DGT at the point of awarding planning permission.[85] This offers some advantage over a 'super stamp duty', in that the detailed intended use of the land would be clear. The level and rate of charges would be known in advance by developers, and they could take this into account by offering a lower price for the land so the landowner would bear the burden of the tax and end-users would not experience a price increase (unless market imperfections exist, as outlined above). A tax levied at the point of granting planning permission would be more transparent overall, and, given that there would be no uncertainty regarding the use of the land, administrative complexity and the cost of the tax could expected to be relatively lower. However, the tax base would still need to be

[82] HM Treasury (2004), the Barker Report.
[83] Ibid.
[84] For a full description, see HM Treasury (2004), the Barker Report.
[85] This is the DGT recommended in HM Treasury (2004), the Barker Report.

established—ie, estimating the increase in value as a result of the granting of the various permissions (reclassification and planning permission).[86]

Levying the duty at the point of granting planning permission has a further potential advantage that the tax liability could be extended to land that has been rezoned and sold prior to the introduction of the tax, but which does not yet have planning permission. However, assuming the transaction between landowner and developer is completed, this would require the developer (or, if the developer can achieve it, the end-user) to bear the burden of taxation. At the point of transaction, the tax did not exist, so the opportunity to lower the bid accordingly did not arise. Developers may consider such a tax unjustified, as it would be attempting to make them pay tax on a benefit that they have not necessarily received. Moreover, following the announcement of the tax, developers would tend to seek planning permission as quickly as possible to avoid paying the tax.

A2.5 Planning gain

An alternative approach is to tax the rise in value of the land by requiring the developer to pay for infrastructure for the public of Jersey as a condition of allowing the development to take place. The cost of this infrastructure is likely to have been factored into the price the developer was prepared to pay for the land. A variation on this is to require the developer to build something that does not maximise the potential price they could gain for their development—for example, a requirement to build low-priced units for social rental.

Acquiring benefits in kind, rather than tax revenues, does not change the underlying economics—the same general considerations apply, in terms of who actually pays for the benefit of planning gain. However, because there is no need to calculate a precise tax liability, some of the administrative complexity of applying a tax is removed. On the other hand, there is likely to be a degree of uncertainty as to the actual costs involved at the point the land is sold to developers. This is likely to make the success or failure of the policy more dependent on the ability of the government to successfully negotiate with the developer (or equivalent), and to set in place a coherent and consistent policy on what developers can expect in terms of the costs they will bear as a result of the requirement to provide planning gain. In particular, the problem of credibility has not gone away; hence, if landowners/developers think that a future administration would demand less costly 'gains', they may delay development. In addition, the flexibility of planning gain can create situations where the treatment of different developers/landowners is seen to be inconsistent and unfair, and raises the potential for corruption, as the negotiation process over planning gain can alter the profitability of any particular development.

A2.6 Development gains tax on brownfield land

The analysis so far has focused on the rezoning of greenfield land to development land. However, the redevelopment of brownfield land, once permission has been received, may also involve a considerable uplift in value. While the opportunity for levying a tax arises too, there are several reasons why taxes on brownfield land should be relatively lower.

The increase in the value of any given plot of brownfield land is likely to be less readily established than that of a plot of greenfield land. The developer typically has to incur considerable costs during and after the acquisition of land, such as improvements to the land prior to development work. The uncertainty over the uplift in value net of these costs is thus likely to be greater, and a lower tax rate should reflect this greater uncertainty regarding the size of future returns for the developer. This is especially relevant because the tax incidence (and hence the effect on prices) of a brownfield land DGT is likely to be less clear than under

[86] The granting of planning permission may change the value of the land, especially in Jersey where there are a number of different types of housing with different markets attached to them. However, the main increase in value is likely to arise as a result of the reclassification of land from agricultural to housing (or commercial development).

greenfield land (in the absence of market power), given that landowners may choose to develop the land themselves and use it for other purposes than residential housing. Moreover, by setting a lower rate, the right incentives would be provided for developers or landowners to undertake environmentally desirable changes.[87]

A2.7 Conclusion

Overall, there appears to be scope for the introduction of a DGT, in the form of either a direct tax or planning gain. Although there is some uncertainty regarding the degree of competition in Jersey housing markets, which would need to be clarified prior to introducing the tax, it is possible that such a tax would be borne in full by landowners—who stand to gain from the reclassification of land use—and would not result in an increase in housing prices. However, in designing such a tax, or planning gain policy, its long-term credibility is important to ensure that landowners or developers do not restrict the release of land or new developments in order to gain when the tax/policy is rescinded at some time in the future. In addition, the particular market circumstances surrounding the current supply of new housing should be investigated further to establish whether the current restrictions on who can (generally) acquire new housing leads to a market outcome (ie, demand is satisfied by the supply of new housing at the market price), or an administrative outcome (ie, demand is greater than the supply of new housing at the market price, but it is rationed by administrative processes). If it is the latter then the conditions under which some or all of any tax ended up in the final price may be present.

Due to relatively higher certainty over the gains that arise from the rezoning of greenfield land compared with those arising from brownfield redevelopment permission, a differentiated, lower levy on brownfield gains would be useful in providing the right incentive structure. However, it is understood that there is very little brownfield land in Jersey.

A2.8 Further consideration of the conditions under which DGT might end up in end user prices

Where the residential or business property market is fully competitive, and new houses or offices are significantly constrained by planning or zoning restrictions, their price is unlikely to be affected by a DGT. However, if this market is not fully competitive, developers of *new* property may be able to acquire market power with respect to the price they can charge.

If developers have market power, they can raise prices by restricting the supply of new houses. If faced with the imposition of new tax, they may be attempt to do so, particularly if the tax is imposed on developers and they have purchased land prior to the imposition of the tax. Perhaps more importantly, if there are few developers or landowners, the problem of credibility is likely to be acute. In a small market, the relatively few developers or landowners face reduced problems of coordination, and may attempt to face down the government over the tax by restricting supply. This would not necessarily be an economically profit-maximising strategy if the tax remains, but would be if the tax were removed. A serious restriction on the supply of new housing would be likely to have political repercussions, which could easily undermine the credibility of the tax. The cost of attempting this strategy is also likely to be low, because, even if the tax does stick, the value of the houses subsequently built and sold is unlikely to be any lower than it would have been. Under these circumstances, the worst outcome is the value of the timing difference in the sale of the houses, offices or land.

In addition, the conditions for the competitive supply of new housing may not be currently met in Jersey because of the existing constraints on the way new housing is constructed and sold. In general, significant restrictions apply, so that new housing is restricted in terms of who can buy it, or rent it (first-time buyers and social rented housing, respectively). These

[87] HM Treasury (2004), the Barker Report.

markets appear to be somewhat separate from the general housing market, in so far as they appear to be priced below the general housing market, and consumer entry to these markets is restricted by administrative processes. Under these circumstances the final selling price may be more a function of a negotiation process between the developers and the government, rather than the developers selling or renting their properties at market prices. If this is the case, the question of whether any tax ended up in the price of new houses would also depend on the outcome of this negotiation process, rather than on the underlying economics of the general housing market.

If the suppliers of new housing do hold market power, and are already restricting the supply of new housing over and above that which would be allowed by the planning/zoning system as a profit-maximising strategy, then the imposition of the tax will change the profit-maximising price for new houses. This change is to raise the price, by approximately half of the value of the tax. However, further research would be required to establish definitively that the release of land for new housing was being primarily restricted by planning processes or by landowners/developers.

While the possibility of price-setting power could be investigated prior to the introduction of a tax, there are some mechanisms that may act as a constraint on the potential market power of landowner-developers. To the extent that the relative price increase would be fully reflected in a price differential between comparable properties built before and after the introduction of the tax, the relatively more expensive properties would become uncompetitive. Moreover, new houses that include the cost of the tax would become uncompetitive with respect to the second-hand housing market. This requires that the buyers or renters of property take into account and know the premium of new properties over second-hand properties.[88] Furthermore, as long as there are no barriers to entry or exit for developers, new developers could buy new land in Jersey and offer properties at lower prices, thereby inducing existing companies also to cut their prices.[89]

Recent studies demonstrate the existence of a significant housing shortage in Jersey.[90] Given the large pool of potential buyers and the administrative restrictions on purchase/rent of much new property, the demand for new property could be rather unresponsive to price increases, such that there are buyers who would be willing to buy land or property over and above the current prices in the Jersey housing market. Thus, if in addition developer-landowners have some degree of market power and the competitive mechanisms provide insufficient constraint over their price-setting power, there is likely to be some scope for land-owners or developers to pass the cost of the tax on to end-users in the form of higher prices.

Thus, while, in competitive markets, the tax incidence is likely to fall on landowners—ie, those who gain from the reclassification—so the cost of a DGT would not be passed on to end-users, the possible existence of non-competitive market forces may limit this outcome in Jersey. Under these, perhaps extreme, conditions, the cost of the tax may be passed on at least in part to end-users. This may result in a rent or sale price increase for private households, whose real disposable income would fall.

[88] HM Treasury (2004), the Barker Report.

[89] This relies on the fact that some land is available to new entrants. If the incumbent companies control the entire supply, entry is blocked for new entrants.

[90] See States of Jersey (2004), 'Planning for homes', Planning and Environment Department. See also Parr, M. (2000), 'Housing in Jersey', Law and Economics Consulting Group, October.

Oxera

Further analysis of land/development-based environmental taxes

What is the impact on Jersey?

Prepared for
States of Jersey

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Contents

1	**Introduction**	**1**
2	**Development gains tax**	**3**
2.1	Objectives	3
2.2	Planning Gain Supplement in the UK	3
2.3	Economic implications	5
2.4	Ability to meet stated objectives	6
2.5	Practicality	6
3	**Planning obligations**	**8**
3.1	Objectives	8
3.2	Economic implications	8
3.3	Ability to meet stated objectives	9
3.4	Practicality	9
4	**Environmental strategy levy**	**10**
4.1	Objectives	10
4.2	Incentives for brownfield land development in the UK	10
4.3	Economic implications	11
4.4	Ability to meet stated objectives	15
4.5	Practicality	15
5	**Conclusions and suggestions for further work**	**16**

List of tables

Table 4.1 Impact of levy on quality and size 12

List of boxes

Box 4.1 Potential impact of a levy on building costs on the density of development 12

1 Introduction

The purpose of this report is to consider, in more detail, the effects of a number of specific tax proposals—namely, a development gains tax, planning obligations and an environmental strategy levy. For each measure the report will assess the economic implications (in terms of their impact on price, supply and demand of the product being taxed, the distributional impact, and the revenue-raising potential if applicable), as well as their ability to meet their stated objectives and practicality. There will also be initial consideration of any additional measures that could be combined with the environmental strategy levy in order to achieve the stated overall objective of encouraging brownfield development, although, to do this effectively, a more comprehensive assessment of the reasons for the current low level of brownfield development would need to be undertaken.

In the UK, attention has recently been focused on land tax issues, with the publication of the Barker Review of Housing Supply in 2004[1] and the Barker Review of Land Use and Planning in 2006.[2] The first of these recommended a Planning Gain Supplement in order to ensure that part of the land-value uplift arising from the planning process could be captured and used for infrastructure development. After extensive consultation and analysis, the government announced, in its Pre-Budget Statement of 2007, that it would not be introducing such a tax but would, instead, recommend a Community Interest Levy—more details of which will be forthcoming in 2008. Further analysis of the reasons for this decision will be undertaken later in this report.

The UK government has also consulted on the extension of Land Remediation Relief, which was first introduced in 2001. The responses to this consultation have indicated that such an extension would generally be supported by stakeholders, and detailed proposals for such a reform will be announced in 2008. Again, this report will consider these proposals in more detail.

All three of the measures analysed here seek to tax (or apply a levy to) the process whereby land that is currently used for agriculture (or similar) is converted to housing. Three general features of this process are important in analysing these taxes/levies.

– the value of land used in agriculture is very low, while that used for housing has a very high value;

– the value of the land that is to be used for housing is determined by the difference between what the resulting house/flat, etc, can be sold (or rented) for and the costs of actually transforming the land into housing—ie, the building and other associated costs. Housing land values prior to actually building the housing are therefore the residual of the price that can be charged for the finished housing and the costs of actually doing the construction (and paying for anything else that is required to make the transformation);

– the price of housing is, at least in the short term, largely determined by the supply and demand for all housing, most of which is already built.

In economic terms, new and second-hand housing are in the same economic market, which significantly limits the degree to which the price of new housing can deviate from that of existing (second-hand) housing. As a result, if the cost of new housing is raised by applying a

[1] Barker, K. (2004), 'Review of Housing Supply: Delivering Stability—Securing our Future Housing Needs, Final Report: Recommendations', HM Treasury, March.
[2] Barker, K. (2006), 'Review of Land Use Planning, Final Report—Recommendations', HM Treasury, December.

tax to it, but the tax does not apply to existing housing, the *price* of new housing cannot rise to reflect the new tax.[3] To do so would make new housing more expensive than second-hand housing and as a result there would be no (or much reduced) demand for such housing.

Assuming that the total volume of new housing produced does not change as a result of the imposition of the tax or levy, the final price of housing in general (including the new housing) would not be expected to change. As the non-tax/levy costs of actually constructing the housing would also not be expected to change either, the main impact of the tax/levy will end up in the price of land that can be used for housing, but where the housing has yet to be built.

[3] If there are a significant number of people who will consider living in *only* new-built housing, the price of new housing could rise as a result of an additional tax on the transformation process. However, if this were the case, it would pay new house builders to raise the price to this level anyway,

2 Development gains tax

2.1 Objectives

Demand for land is a derived demand and therefore its capital value depends on the use(s) to which it can be put. Because the economic returns to agricultural land or greenfield sites are relatively low, the capital value of such land is also low. However, land that can be (or is) used for housing, offices, etc, can either deliver relatively high returns (eg, rental income) or has a high consumption value in its own right (eg, owner-occupied housing). As a result, the value of development (or developed) land is much higher than that of agricultural land. Therefore, decisions by public planning agencies to re-zone land from agricultural to, for example, development land for residential housing or commercial use tend to be associated with a (very) large uplift in the value of that land.[4]

The uplift in land value is not owing to the landowner's efforts in adding value to their land, but is the result of a public agency decision acting on behalf of the wider community. As a result, the decision of the public body acting on behalf of the community provides a windfall gain to the landowner.[5] A levy (tax) on land windfall gains can therefore be justified on grounds of fairness, as it distributes (at least potentially) the benefit of that windfall gain more widely, and can be used as a policy tool to share, with the wider society, the otherwise purely private benefits of the decision. In addition, to the extent that (further) development at any particular place imposes external costs (eg, congestion, need for additional investment in infrastructure, etc) in the immediate vicinity or across a wider area, the use of any tax or levy can be seen as (partially) compensating those who are negatively affected by the change in the use of the land.[6]

2.2 Planning Gain Supplement in the UK

In the UK the Barker Report of 2004 recommended reform of the planning system in order to make more land available for housing. As more land is approved for housing development, its value will rise. The report suggested that a proportion of this increase in value that accrues to landowners and/or developers could be captured by the government, and redistributed to the wider community by using it to fund infrastructure development in the areas where new housing is proposed. This approach combines both a distribution of the benefits at a general level (when the planning gain supplement is used to fund spending that would otherwise be funded by local or national taxes) and a more directed compensation element (when the investment in the local infrastructure would not have taken place in the absence of the planning gain supplement monies).

Previous attempts with development gains taxes in the UK had not been successful and the Review concluded that, in order to achieve its objectives, any new attempt needed to ensure that only a small proportion of the uplift should be captured, the valuation measure should be

[4] The uplift in land values in Jersey has previously been estimated at between 80 and 200 times—ie, land worth £10,000 as agricultural land would be worth between £800,000 and £2m as housing or other development land. See Oxera (2006), 'Environmental spending and tax policies: What is the impact on Jersey?', November.

[5] The increase in value may not all accrue to the owner of the land at the time the administrative decision is made. To the extent that such a decision is anticipated, previous owners of the land may have benefited by the inclusion of the anticipated probability of the land being reclassified in the price obtained in previous sales. (This is sometimes referred to as the 'hope' value of land.)

[6] In practice, the direct relationship between the incidence of the negative externality and the compensation for any particular development may be limited, but overall there is likely to be some matching between the incidence of damage and the incidence of benefits.

as clear and simple as possible, and it should be designed so as to minimise avoidance opportunities.

The proposed tax liability would be based on an assessment of the difference between the 'planning value' (defined as the market value of the land the moment after full planning permission was granted) and the 'current use value' (defined as the market value of the land the moment before full planning permission was granted).

In order to ensure that there would be no adverse effects on the supply of land available for development, the tax was only one of a series of proposed reforms, which also included measures to speed up the planning process.

An initial consultation document on Planning Gain Supplement (PGS) was issued in December 2005.[7] Further consultations took place in late 2006[8] and the responses to these were published in October 2007.[9] Earlier in the year the government had indicated that it would be prepared to defer legislation to introduce such a tax if a more effective way could be found of ensuring that infrastructure development in new communities could be financed.

As a result of this extensive consultation it was announced, in the Pre-Budget Report of 2007,[10] that the proposed PGS would not be implemented but, instead, a Community Infrastructure Levy (CIL) will be introduced.

This will take the form of a levy, imposed by a local authority, on all new developments in an area, both residential and business, subject to a low minimum threshold. The CIL will supplement existing planning agreements agreed between local authorities and developers for site-specific matters.

The CIL will be based on an assessment of the cost of necessary infrastructure requirements arising from the development plan for the area, while also taking account of land values and potential uplifts. A standard charge will be set which will vary from area to area depending on the nature of the proposed development. Although the levy will be paid by developers, it is expected that its cost will be passed back to landowners through reduced prices paid for land. Detailed proposals for the new levy will be forthcoming in 2008.

The reasons for the abandonment of the PGS are not entirely clear, as a full impact assessment comparing it with the new CIL has not yet been completed. However, from the initial impact assessment, it appears as though concerns had arisen as a result of the costs of the proposed system and the uncertainty it might create. Both the planning and current use values would have to be assessed each time planning permission was granted. In an attempt to reduce the costs of doing so, a standard formula was proposed, but consultation showed that this would be difficult to apply in many cases. Once the complications of individual planning application characteristics were factored in, the process would involve significant administrative costs for both developers and HM Revenue & Customs. It was also felt that the process would create uncertainty for developers over the precise amount that they would have to contribute. This would make it more difficult for them to pass on the costs of the tax by negotiating lower prices with landowners. As a result, the number of planning applications might fall. Finally, there was also concern that, in complicated development proposals, there would be uncertainty about who was responsible for actually paying the tax liability. This would increase the risk of tax avoidance.

[7] HM Treasury (2005), 'Planning Gain: a consultation', December.
[8] HM Revenue & Customs (2006), 'Paying PGS: a Planning-gain Supplement technical consultation'. HM Revenue & Customs (2006), 'Valuing Planning gain: a Planning-gain Supplement consultation'. Department for Communities and Local Government (2006), 'Changes to Planning Obligations: a Planning-gain Supplement consultation'.
[9] HM Revenue & Customs (2007), 'Planning-gain Supplement: Consultation on paying PGS and valuing planning gain: a summary of responses', October.
[10] HM Treasury (2007), 'Pre-Budget Report and Comprehensive Spending Review', October.

It is hoped that the nature of the proposed CIL will serve to alleviate some of these problems, although a comprehensive assessment can only be undertaken when more details of the proposal are made public. However, it is pertinent to note that, even at this stage, it appears to be the administrative difficulties that are primarily underpinning the move to abandon a direct tax on the uplift of land values caused by the granting of planning permission.

2.3 Economic implications

The economic impact of any tax can be assessed by reference to three broad parameters relating to the objectives of the tax:

- the impact on the price of the good or service being taxed and the subsequent effects on supply and demand;
- whether the tax has redistributional effects;
- the revenue-raising potential of the tax.

Previous Oxera reports have examined the use of a land development tax as a revenue-raising instrument.[11] Although it was concluded that there appears to be considerable scope for raising revenues as a result of taxing gains arising from re-zoning, the reports also highlighted the fact that such revenue will be variable, as the potential tax base only arises when there is a change to permitted land use, and the actual monetary gain arises only after the asset is sold. The exception to this would be if a steady stream of such changes could be guaranteed over time. Overall, however, it is difficult to quantify with any great certainty the amount of tax that would be generated by such a proposal.

The impact of such a tax on the supply of land made available by owners will depend on several factors, including the credibility of the tax (in terms of it not being repealed quickly) and the proportion of value uplift that would be taken. Assuming that the proportion of the increase in value to be taken in tax would be relatively small, even if the full incidence of the tax fell on owners, it is likely that there would be little effect on the overall supply of land made available for development. However, more critically, the perceived credibility of the tax regime is likely to have a more significant impact on the willingness of landowners to sell. If there were any suggestion that the tax would be repealed at some stage in the foreseeable future, it is likely that landowners would hold back the sale of land and/or an application for change of use in expectation of the higher profits they could make in future when the tax was repealed (or tax rates were lowered).

The distributional effects of the tax will depend primarily on the use to which the tax revenue is put. If it was used for infrastructure development, which would benefit those who purchased the new homes or businesses built on the redeveloped land, then this could be seen as transferring some of the gains arising from land re-zoning to other stakeholders and away from landowners. However, the full extent of this redistribution will only be felt if there is no increase in property prices as a result of the tax being introduced. If the price of the new homes or businesses built on the developed land is higher than in the absence of a tax, owners of these properties will not benefit fully from the infrastructure developments. Examining the possible impact on property prices of a development gains tax, the previous Oxera reports (2005 and 2007) concluded that, in the case of Jersey, the possible existence of certain non-competitive market forces might mean that some of the cost of the tax might be transferred to end-users—namely, those buying the residential or commercial properties built on the land.

There are some potential distributional consequences of the tax itself. Where such a tax is well established and credible (in that there is no perception that it will be repealed and/or the

[11] Oxera (2005), 'Which tax is best suited to Jersey's objectives?', February; and Oxera (2007), 'Environmental spending and tax policies', November.

rate changed significantly), the tax is 'paid' by the owner of the land when its value is changed by the relevant administrative Act. If that person is also the person to whom the tax bill is sent, the effect of the tax is to leave the value of land in its new use unchanged, but the landowner will be worse off by the amount of the tax. If, however, the actual tax bill arises after the sale of the land (eg, on the sale of the houses built on the land) then the landowner will receive less for the land, by the amount of the tax that the developer will have to pay later.[12]

However, where the tax is being introduced, without being correctly anticipated by the relevant economic agents, some or all of the tax may effectively be paid by someone other than the owner of the land in its pre-change state. In particular, sale of land in anticipation of a re-zoning prior to the announcement of the tax is likely to be at a price that does not fully reflect the tax that will subsequently have to be paid. As a result, the original landowner may receive, at the extreme, the full value of the anticipated uplift, while the subsequent buyer will incur the tax. As a result, it is possible that the subsequent buyer would make a loss on the actual development of the site to take advantage of the re-zoning.

2.4 Ability to meet stated objectives

If the principle objective is to raise revenue then it is necessary to quantify the extent to which this can be achieved by use of this tax. The previous Oxera reports (2005 and 2007) contained estimates of the revenue-raising potential based on calculations by the States of Jersey of the overall uplift in the value of land reclassified from agricultural to housing in 2002. In order to quantify fully the potential revenue, it would be necessary to assess the likely uplift in values arising from planned re-zoning in the future. It would also be necessary to estimate the likely rates at which the tax would be set, and whether differential rates would be set depending on the nature of the proposed development (commercial or residential) and the nature of the land being developed (greenfield or brownfield). At present, therefore, it is not possible to quantify the revenue that could be raised from such a tax without undertaking further analysis.

2.5 Practicality

The consultation process on the PGS undertaken in the UK highlighted some of the practical problems that might arise in introducing such a tax. These relate to the potential difficulties when calculating land values both before and after re-zoning or the granting of planning permission. It might, of course, be that some of the increase in land value occurs in anticipation of the re-zoning, in which case basing the calculation on the value immediately prior to the event may not capture all of the gain. In addition, if the tax were based on the value of land immediately following re-zoning, it would not capture any of the additional gain that may be realised when planning permission is granted. The difficulties in undertaking such calculations could give rise to significant administrative costs (a major concern in the UK) and create uncertainty over the precise tax liability to which a landowner might be subject.

It is therefore the detail of such a tax that will determine its practicality. In particular, if the objective of the tax is to raise a set amount per area of re-zoning, rather than a specific proportion of the uplift in value, it may be easier to devise an administrative system that is practical and (reasonably) fair. As demonstrated by the recent experience in the UK, devising a practical process is a considerable undertaking (and is beyond the scope of this report).

[12] There may be some difference in the cost of the tax due to differences in the timing of the tax liability relative to the sale/rental of the asset to the end-consumer/user.

Even though there appeared to be broad support, from stakeholders, for the need to fund additional infrastructure and that capturing some of the land-value uplift arising from the granting of planning permission was an appropriate method of doing so, the consultation process also revealed a large divergence of views over the most appropriate mechanism to be used. On the one hand, there is a need to ensure that estimates of both the pre- and post-planning permission land values take as much account as possible of the complexities and uncertainties of the planning process for individual cases, making an overly simplistic approach inappropriate. On the other hand, a more rigorous approach might involve significant administration costs for both developers and the agency served with undertaking the valuations.

Specific concerns raised in the consultation responses related to the following:

- uncertainty around land not in the applicant's ownership and how this would be treated;
- in order to simplify the process, the proposals assumed that all developers held freehold interests with vacant possession, but this may not necessarily be the case;
- planning permission might include property outside the developer's control but the developer would be required to value the whole site for PGS purposes, and, thus, pay tax on a gain it would not benefit from;
- concern was expressed about how remediation works would be treated and their impact on valuations, depending on whether they were carried out before or after the valuation date;
- the planning system might be burdened with additional requests to renew planning permission in order to preserve a beneficial current-use valuation, irrespective of whether that scheme was ever likely to go ahead;
- phased developments might be a problem as separate valuations might have to be undertaken for each phase, which would add to the administrative costs;
- the collection of the tax in the event of re-planning, when the developer has to alter the details of the development having already commenced it, might be problematic, as valuations would be complex.

These practical problems appear to be behind the UK decision to seek an alternative to the PGS. They also highlight the difficulties and complexities inherent in developing such an approach.

A similar approach to the CIL but using specific infrastructure obligations is discussed in the next section.

3 Planning obligations

3.1 Objectives

Instead of recovering some share of the uplift in land value through a formal tax, developers could be required to provide a specific benefit through a system of planning obligations. Such obligations impose a cost to the developer and therefore have a *theoretical* outcome similar to that of a land development tax, by ensuring that some of the uplift in land value is transferred away from the developer. The monetary value of the planning gain is equivalent to the tax imposed on the uplift in land value. Alternatively, it could be argued that, if the requirements relate to infrastructure improvements for a development that would otherwise have to be funded publicly, this represents a budgetary cost saving to the authorities.

3.2 Economic implications

However, several issues arise in the context of using planning gains as a tax measure to capture uplifts in land value. Unlike a land development tax, which is set in advance, the financial commitments imposed on a developer by a planning gain are likely to be largely unknown to the developer in advance, as they are decided on a case-by-case basis. At the time of purchasing the land from landowners (ie, assuming that the developers are not yet in the possession of the land prior to re-zoning), developers therefore cannot fully factor the financial implications of the planning obligations into the bidding price. The uncertainty at the stage of land purchase results in planning gains being less likely to be effective in targeting the tax at the beneficiary of the planning decision (ie, the landowner).

There are a number of impacts that could arise from this uncertainty, given the likely information asymmetry between those involved (landowner, developer, government). It is likely that the developer will have the best estimate of the price that the finished development will command (ie, the value of the land with the planning permission), the planning obligations that might be imposed (ie, before the planning gain requirements are agreed between the developer and the government), and the costs of any specific planning obligation actually imposed. In turn, it is likely that the developer will use that information in its negotiations with landowners (on land acquisition) and with the government (in the negotiations on the specific obligation to be imposed). If the information asymmetry can be successfully exploited, the likely outcome is that landowners suffer a penalty of (slightly) more than the cost of the planning obligation, and that government receives (slightly) less than it could from the planning obligations that the developer would actually be willing to pay. As a mechanism of funding specific projects, planning gain is likely to be less *economically* efficient than a broadly equivalent land development tax.

In terms of distributional effects, planning obligations could be used to ensure that the beneficial impact of a development is disseminated as widely as possible, particularly if they ensure that improvements to infrastructure are undertaken or that any adverse environmental effects are minimised. Any new developments will create externalities and having planning obligations is a way of ensuring, at least in theory, that the developers can take into account the costs of any potentially negative externalities.

3.3 Ability to meet stated objectives

The objective of planning obligations cannot be to raise revenue directly. However, as stated previously, they can be used to replace public expenditure. Their main objective is, however, to ensure that potential externalities arising from specific development projects are taken into consideration by developers, and that any positive externalities that emerge are disseminated as widely as possible. This appears to be the rationale behind the decision to make use of the CIL on all new developments in the UK together with project-specific obligations where necessary.

3.4 Practicality

Planning obligations can create uncertainty in the development process and can delay the time it takes for new developments to come to fruition. In addition, the fact that they are usually based on a bargaining process between developer and local authority means that both parties will have to incur transaction costs through the bargaining process. It has been argued in the UK that the CIL will alleviate some of these problems by making the potential cost of obligations clearer to developers, while also removing some elements of the bargaining process that are not development site-specific.

4 Environmental strategy levy

4.1 Objectives

The main objectives of an environmental strategy levy (ESL) are to provide disincentives to the development of greenfield sites, together with concurrent incentives to develop brownfield sites. An additional, secondary, objective would be to provide a source of revenue that could be used for environmental purposes. The levy would take the form of a flat-rate proportion of the cost of development, which would be set at an extremely low rate for developments on brownfield sites and at a much higher rate for greenfield site developments. The tax would be levied on developers and would be collected on completion of the development.

4.2 Incentives for brownfield land development in the UK

The Barker Review of Housing Supply (2004) recognised that brownfield land was typically more costly to prepare and build on than greenfield land, but that it offered greater opportunities for positive externalities (for example, through urban regeneration). In addition, the Barker Review of Land Use and Planning (2006) recommended that fiscal incentives be used to encourage efficient use of urban land. It also recommended that the government consult on reform to land remediation relief in order to provide further encouragement to developers faced with brownfield sites that were particularly costly to develop.

Land remediation relief was first introduced in the UK in 2001. It was designed to provide tax relief in the form of a 150% accelerated payable tax credit for owners and investors for any costs that were incurred in cleaning up contaminated sites. In March 2007,[13] the government issued a consultation paper with proposals to extend the scope of this relief (while also targeting it more effectively) and reform the system of landfill tax exemption, which has also been used as an incentive to encourage brownfield site development.

Consultation responses were published in October 2007[14] and a government response to these is now awaited. In general there was a favourable response to proposals to extend the relief to provide additional help for long-term derelict land where derelict works, buildings and structures were a particular barrier to development. There was a more mixed response to proposals to link the tax relief to the granting of planning permission. In the past, relief has been available to landowners for remediating land or buildings where no development was planned. The main objections to tying it to planning permission came from industry bodies, which felt that this would add even more complexity and bureaucracy to a process that already incurs significant administration costs. This, in turn, would add a further element of uncertainty to the planning process.

Land remediation relief is seen as providing a clear incentive to undertake brownfield site development, but it has been claimed that it is still too early to quantify the effects of the measures that have been introduced, and there is no indication as to the extent to which they are contributing to the government target of 60% of new homes being built on brownfield sites.

[13] HM Treasury (2007), 'Tax incentives for development of brownfield land: a consultation', March.
[14] HM Treasury (2007), 'Tax incentives for development of brownfield land: a summary of consultation responses', October.

4.3 Economic implications

The UK approach is clearly different to that proposed for Jersey, as it relates to specific financial incentives in the form of tax relief being provided for brownfield site development, rather than relying on differential tax rates to encourage brownfield rather than greenfield site development.

In assessing the economic impact of the ESL, it is important to make a distinction based on whether it is seen as credible or not.

The immediate effect of the imposition of the levy, assuming that it is seen as being credible and sustainable over the longer term, will be to considerably reduce the price of undeveloped greenfield sites with planning permission, while also reducing the potential value uplift for greenfield sites which have not yet been re-zoned. There will also be an initial slight reduction in the price of undeveloped brownfield sites, as the levy will still apply to them, but will not be as great. This is because developers, faced with higher costs, will attempt to pass a proportion of these on to the landowner by negotiating lower land prices where possible.

If a greenfield site has already been re-zoned and has had planning permission granted, it will still be sold for development as long as the value uplift offsets the cost of the ESL. Therefore the supply of land, in terms of the total acreage of greenfield sites being developed, will not change. However, the nature of the development may be affected, depending on the binding constraint on the density of development. If the binding constraint is administrative such that housing land would be developed at a higher density than allowable under the detailed permission given, the levy is unlikely to have any impact on the density of development. However, if the maximum permitted density is above the economically profit-maximising density, the impact of the tax will be to *reduce* the density of development—ie, to build fewer houses on any given greenfield site zoned for housing.

This arises because gardens will be more or less 'free' of the levy, while buildings will incur it. There will therefore be an incentive to build fewer houses on a given plot of land, but for each house to have a larger garden (see below for more details of this impact). There is also an incentive for developers to build according to lower specifications, as the additional cost of high-quality buildings will increase. As a result, the economics of, for example, energy saving measures will *worsen*. This effect will be exacerbated if subsequent improvements not requiring planning permission are not subject to the levy. As it is usually (considerably) cheaper to raise building standards and quality at the initial build, rather than retro-fit them, the impact of the levy on economic efficiency could be detrimental.

The levy has some features that make it similar to the taxation of the uplift in land values or the imposition of a development fee on new development in greenfield sites. For this reason the analysis set out below looks first at the impact of the levy on greenfield development taken in isolation, and then the impact on the relative impact on greenfield versus brownfield development.

4.3.1 Greenfield development

The effects of greenfield development on the price of completed homes will depend on market conditions and whether it is the detailed planning consents that are the binding constraint on the density of development. If it is planning consents that are binding, the impact of the tax on the total development in the greenfield is likely to be minimal (assuming that the levy is credible—see above). This is because the incidence of the levy will be reflected in a reduction in the price of new (ie, re-zoned) housing land. As long as the levy represents a relatively small proportion of the total value of housing land before the imposition of the levy, it will act in a similar way as a tax on the uplift in land value on the supply of new housing land. However, because the levy is linked to the cost of the building, not the cost of the land (or the change in the price of the land), the levy is likely to have an impact on what is built.

If the current set of prices in the housing market approximately reflects the differences in the costs of different levels of quality in construction and differences in building costs depending on the size of the actual house/flat, the application of the levy based on the build costs will create an incentive to reduce the building costs—along either the quality or the size dimension. Table 4.1 sets out this impact in a highly simplified way for illustration purposes.

Table 4.1 Impact of levy on quality and size

	Basic price	Construction cost—basic (incl. levy at 50%)	Land cost	High quality	Larger	Low quality
Second-hand market	400,000			425,000	450,000	375,000
Marginal cost (excl. levy)				25,000	50,000	–25,000
Costs, new build:						
pre-levy	400,000	200,000	200,000	425,000	450,000	375,000
post-levy	400,000	300,000	100,000	437,500	475,000	362,500
				(additional £25,000 cost, plus additional £12,500 levy)	(additional £50,000 costs plus additional £25,000 levy)	(reduction of £25,000 in costs, plus reduction of £12,500 of levy)

Source: Oxera.

Given the vagaries of the housing market in general, and the significant lags in the way the housing stock reacts to changes in demand, the assumption that the pattern of relative prices in current housing market reflects the marginal costs of higher or lower quality, or (slightly) larger or smaller buildings, may not be realistic. However, unless the relative prices in the housing market adjust quickly to reflect the cost differentials of construction *with the levy* (which seems unrealistic, particularly if the levy is not applied to changes to existing stock), the general impact of the levy will be as illustrated above: it creates an incentive at the margin to build smaller and/or lower-quality new housing.

As indicated above, if the detailed planning requirements in the density of development are not the binding constraint, another impact of the levy would be to reduce the density of development on greenfield sites. Box 4.1 below sets out how this effect operates. Whether it would actually have this impact depends on the relationship between the economic density of development and the planning constraint.

Box 4.1 Potential impact of a levy on building costs on the density of development

Assumptions

Housing market

- the new greenfield site developments are small compared with the total housing market;
- prices in the final retail market are not significantly affected by the change in greenfield developments.

The current market has the following characteristics:

- price of a three-bed house with large garden (density 5 to the acre) = £450,000
- price of the same three-bed house with a small garden (density 7 to the acre) = £400,000
- undeveloped land price per acre = £2,000
- costs of building three-bed house = £200,000

Assessment/analysis

Scenario 1

If given a choice of putting five or seven houses on this land, the developer will choose seven, and will be prepared to pay £1.4m for the land.

Economics of seven houses:

- sale price = £400,000 * 7 = £2.8m
- construction costs = £200,000 * 7 = £1.4m
- value of land = £1.4m

Economics of five houses:

- sale price = £450,000 * 5 = £2.25m
- construction costs = £200,000 * 5 = £1m
- value of land = £1.25m

Scenario 2

If the levy is 50%, given a choice of building five or seven houses, the developer will choose five, and will be prepared to pay £0.75m

Economics of seven houses:

- sale price = £400,000 * 7 = £2.8m
- construction costs = £300,000 * 7 = £2.1m
- value of land = £0.7m

Economics of FIVE houses

- sale price = £450,000 * 5 = £2.25m
- construction costs = £300,000 * 5 = £1.5m
- value of land = £0.75m

Conclusion

In general, as the tax rate increases, the economically optimal number of houses per acre falls. However, because of the adjustment of land prices, the levy does not make building on greenfield uneconomic.

If the levy did have the effect of reducing the density of development then, all other things being equal, there are a number of knock-on impacts that could be expected:

- fewer houses would be built on greenfield land (but the amount of field used for housing remains the same);
- more greenfield is used up to deliver the same number of additional houses;
- fewer new houses are built, and the price of all houses rises slightly.

An additional impact could arise if some greenfield developments are not subject to the levy (such as sheltered housing). If the planning system is not the binding constraint then building 'exempt' developments will (relatively) increase the value of the land used for these purposes; as a result, relative increases in the supply of this type of development would be expected.

4.3.2 Impact on the relative development of greenfield and brownfield land

The levy proposal has been put forward as a specific device to encourage brownfield development and discourage greenfield development to meet any particular housing (or other) need. The levy would apply at different rates to the (re)building cost depending on the designation of the site. That which would be applied to brownfield sites would be very low.

The impact of the levy on brownfield sites is more complex because there is no obvious point of uplift of land values which could be directly influenced by the levy. However, to simplify the analysis, it is perhaps helpful to investigate whether the imposition of the levy for brownfield sites could increase the incentives to develop these, compared with a situation where all other things are equal (including the levy on greenfield sites), but no levy is applied to brownfield sites. Increasing the costs of (re)development seems to be very unlikely to *increase* the incentives to undertake such (re)developments. At best, therefore, the positive impact on the incentive to (re)develop brownfield sites would arise if no levy were applied to their (re)development. As this is the current position, the optimal outcome for development of brownfield sites arises from the reduction in the incentives to develop greenfield sites. On this reasoning, the levy will have no independent positive impact on brownfield (re)development.

Under the optimal outcome, therefore, the levy proposal has very similar characteristics to the development gain tax (and possibly the planning gain proposals), which is only applied to greenfield developments, leaving brownfield sites untaxed. The change in the brownfield incentives arises from the reduction (if any) in the incentives to develop greenfield sites.

Given a credible tax based on changing land values, or a levy based on building costs, the value of the under-developed or pre-tax-paid land changes to reflect the incidence of the tax or levy. If this adjustment is complete (ie, it changes by 100% of the value of tax or levy) then, at a general level, the *relative* incentives to develop greenfield or brownfield sites remain unchanged. With the tax, and potentially with the planning obligation if this does not vary with the detail of the development, the economics of greenfield development remain unchanged. As indicated above, with the levy, what is built may change and there is, therefore, the potential that this change in mix, quality or size could alter the relative incentives on brownfield sites. However, it is difficult to immediately trace the linkages from this change that would significantly alter the overall incentives to develop brownfield sites, although it might change what is built.

As the various policies that have been attempted in the UK demonstrate, the problems of brownfield development (or lack of it) are complex. As a result of the ability of land prices to adjust, just making greenfield sites more expensive to develop may not have the desired outcome. Given this potential, if the objective is to obtain more development on brownfield sites, a more detailed understanding of why such development does not take place now would be a useful input into developing more effective policy in the Jersey context. Issues that have been identified in the UK that inhibit brownfield (re)development include:

- uncertainty of the costs of preparing the land (eg, decontamination costs);
- uncertainty of the outcome of the planning process as to which developments will, in the end, be allowed. (This also makes it difficult to arrive at a fair valuation of the land);
- an economically more attractive use which the planners will currently not allow, but which might be agreed in the future (particularly if the current state of the land becomes an eyesore);
- the additional transaction costs of changing the current usage, compared with more of the same, which discourages change;
- a potential benefit in the future if development has not started (eg, if it is believed that grants for decontamination will become available shortly, this may delay development until the measure is introduced).

If similar issues apply in Jersey then directly addressing them may be more effective than seeking to make greenfield sites less attractive through taxation or levies, which, if credible, may not have this impact. (Although there may be other good reasons to do this.)

Finally, if the levy is perceived not to be credible and likely to be repealed at some point, the owners of existing greenfield sites with planning permission would not commence building (or at least would do no more than is necessary to secure the planning permission). This will, therefore, have the intended consequence of reducing the development of greenfield sites in the short term. Brownfield sites will become more valuable and may be more likely to be developed; although, again, a fuller analysis of the factors affecting their development would have to be undertaken before this could be stated conclusively.

4.4 Ability to meet stated objectives

Given that the main objectives of this levy are to reduce the level of greenfield development and increase the level of brownfield development, the above analysis has shown that this may not be achievable unless, perversely, the policy is not seen as credible and it is believed that the levy will be repealed at some stage.

4.5 Practicality

In terms of its practicality, the levy does have similar attractions to the CIL proposed for the UK. As it would be collected at the end of the development process, it would not need to be based on estimates of development costs; rather, it could be based on actual cost. It would also be set at a flat rate of the development cost, so developers would be able to estimate their potential liability with some degree of certainty. There would be some administration costs, but these may not be particularly significant. In addition, there would be scope for arguments about the precise expenditures that were subject to the levy and the extent to which the levy could be avoided by delaying certain expenditures until after the development was nominally completed.

5 Conclusions and suggestions for further work

As the recent UK experience has demonstrated, the practical taxing of the windfall gain as a result of re-zoning is complex, and the devil is in the detail. Further (and hopefully better) details of the reasons why the UK has changed its approach are due in early 2008, and these could provide some more valuable indications as to what might work in the Jersey context. However, given that some of the detailed issues arise as a result of the interactions with the planning system itself, and the local market characteristics, it is possible that Jersey would need to devise more or less from scratch a structure that worked for Jersey. Therefore, if it is decided that this windfall gain should be taxed, it may be advisable to start devising the infrastructure of the tax, taking into account the specifics of the Jersey planning and land-use system (eg, the Island Plan), as well as the Jersey market.

However, there is one important caveat to this conclusion. Because of the importance of the credibility of the tax on its impact, the introduction of such a tax without very strong political backing, which is believed to be long term, could result in an economic disruption as additional land is held back from development. Therefore, unless there is a strong *political* will for this tax, there is a significant risk of negative consequences, even if all the detailed issues of practicality are successfully addressed. As a result, for this tax, the next efficient step may be to establish if the political will is present to enable this tax to be credible if it were introduced.

A similar, but less acute, issue arises with respect to planning obligations. However, as this approach is already reflected in the existing planning structure and appears to be thought reasonably credible, its further extension may be less problematic on this point. Nevertheless, the overall point remains: if the obligation is thought to be non-credible, this induces behaviour that can have negative consequences and bring into further question the future of the obligations. Non-credibility can, therefore, be self-fulfilling.

The conclusion on the ESL is rather different. From the analysis presented, if the levy is thought to be credible, it is unlikely to achieve its objective of transferring development from greenfield to brownfield sites. In addition, there are circumstances when the impact of the levy might actually be counterproductive to this policy, as it may reduce the density of the development of greenfield sites and as a result require more land to be developed. There are other consequences of such a levy that may be undesirable, including an incentive to reduce the size of homes, the quality of construction and the energy efficiency of the building.

Given these consequences, the use of the ESL to raise revenue is also problematic, and there are few, if any, advantages in this approach over a more direct taxation of the windfall gain on land values as a result of greenfield developments.

The objective of encouraging brownfield development is, however, not necessarily flawed. Given the experiences of the UK and others in this area, if this objective is to be pursued, it is likely to be advantageous to establish the particulars of why brownfield development does not take place in Jersey now, and, if possible, to address these issues directly once these have been established.

Appendix 2 Economic Viability Model (sample site)

Development Value	Area/ number	Rate £	Value
Gross Site Area	4,371		
Remediation Area	0		
Site Cover %	75		
Gross Housing Floor Area	16,391		
Gross to net ratio	85		
NIA	13,933		
Social Housing Area	1,742	2,300	4,006,600
Jersey Homebuy	0	3,000	0
First Time Buyer	0	3,200	0
Market Housing Area	12,191	3,750	45,716,221
Number of flats	6		
Number of House	20		
Public Car parking surface	0	0	0
Public Car parking covered	120	0	0
Public Car parking underground	0	0	0
Private Car parking surface	0	0	0
Private Car parking covered	96	0	0
Private Car parking underground	0	0	0
Gross Development			49,722,821
Construction Costs	Area /no	Rate	
Demolition			100,000
Remediation	£0	30	0
Social Housing	1742	1,500	2,613,000
Jersey Homebuy	0	1,500	0
First time buyer	0	1,500	0
Market Housing	12191	1,500	18,286,488
Car parking surface	0	15,000	0
Car parking covered	216	20,000	4,320,000
Car parking underground	0	35,000	0
Public open space			250,000
Rockface stabilisation			2,850,000
Urban improvements			100,000
Contingency	10%		2,851,949
Total Construction Costs			31,371,437
Fees			
Architect	5%		1,568,572
Quantity Surveyor	3%		941,143
Structural Engineer	2%		627,429
Planning Consultant	2%		470,572
Other	0%		0
Planning Fees			
Flats	6		1,950
Houses	20		15,500
Building Control			
Flats	6		4,000
Houses	20		22,375
Contribution to Art	0.75%		235,286
Stamp Duty			
Total Fees			3,886,826
Developers Profit	15%		7,458,423
Cost of Sales			0
Agents fees	1.5%		745,842
Legal fees	1.0%		497,228
Marketing Costs			1,000
Total Cost of Sales			1,244,071
Finance Costs			
Construction period	1.5		1,586,622
Interest rate on borrowing	6%		
Total Costs			45,547,379
Residual Land Value			**4,175,442**