

# Submission

To

**The All Party Oireachtas Committee on the Constitution**

by

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## **Introduction**

Ireland, like many other countries with high rates of economic growth, is urbanising rapidly. There has been considerable emphasis on planning for this through the National Development Plan, the National Spatial Strategy, development guidelines and other measures. Through these the state intends that a proper planning process will lead growth rather than leaving it to market forces to drive development in what are regarded as undesirable directions. The latter it is feared will lead to unsuitable social, economic or physical outcomes.

Unintended results have flowed from the implementation, or flawed implementation of many of these policies and have given rise to the issues noted by the All party Oireachtas Committee on the Constitution in their recent call for submissions on a variety of problems.

All planning suffers from the deficiency that it is not possible to forecast accurately what will be the circumstances that will apply during the currency of a plan or what the outcome will be. Consequently all plans must be tentative and flexible to a greater or lesser extent depending on the accuracy of the information used in the formulation process and the dynamism of the environment in which the plan will operate. Overconfidence in the efficacy of planning and a lack of proper and efficient methods to provide for the necessary flexibility could be among the explanations for the perceived failures in planning. But also the legislative framework for the planning system could contain detailed flaws that mitigate against the plans prepared and operated under it.

This paper discusses issues around these and is intended as a contribution to the deliberations of the Committee.

To do this it considers the nature of spatial planning and its role in providing for the physical development that accompanies economic growth. It then goes on to analyse briefly the property market and to examine some of the characteristics of landed property as an economic good. From that it looks at the interaction between high

house prices and the high price of development land and considers approaches to dealing with problems flowing from those phenomena. Finally it proposes solutions which would be easy to implement and would require only a modest change to existing planning legislation.

The argument underlying this paper is that the planning process is not sufficiently informed by an adequate understanding of urban and property economics. It also suggests that legislative instruments used to implement planning in Ireland and the use of many fiscal supports are flawed. It is these that give rise to high development land prices and the incapacity of local authorities to respond to and provide for the demand for infrastructure and services flowing from economic growth.

## **Planning and Spatial Economics**

Problems of urbanisation are often discussed without a sufficient appreciation of the power of the economic forces that shape the built environment. Indeed it could be argued that inherent in the country's approach to physical planning is an assumption that economic forces can largely be controlled and directed to achieve such ends as balanced regional growth or shaping the development of Dublin. But these economic forces are not understood to a sufficient degree. Intensifying suburban development, increasing one off housing in the countryside and the continued growth of Dublin prevail despite numerous attempts at restraint.

Planning for urban land markets is surrounded by uncertainty due to a range of factors. First the data available to planners about activity in the market is particularly poor. Secondly urban land markets are notoriously volatile and prone to periods of great activity with high prices and other periods when property development is very risky and not profitable. These periods can last for a number of years. Hence the delivery of planning objectives can be frustrated by economic conditions during the currency of the plan, especially if the plan has been devised on unrealistic economic assumptions.

Thirdly, in a free market economy, nimble and opportunistic entrepreneurs will act, as they do in all markets, to seek profitable opportunities created by the planning process. Speculation can be seen as the cause of bad planning but it may just be a symptom of a bad plan or flawed legislation. Speculation is a characteristic of all free markets and planners need to recognise this reality. They also need to understand the motives of entrepreneurs and provide plans that recognise land and property speculation is an economic reality. The alternative approach of making the legislative and administrative framework hugely complex to deal with its worst effects will frustrate the delivery of the physical development needed for economic growth.

Consequently planning requires a proper understanding of the economic and business forces shaping our towns and cities. Policy makers who may not have sufficient understanding of these forces can propose solutions, which will be less than

satisfactory, and in some cases exacerbate the problem. Many of the issues the Committee has asked for submissions on fall in to this area.

In the past, when devising spatial policy and addressing urban and housing problems, both economists and policy makers have not fully understood the economics of landed property and urban areas. As a result some approaches adopted to resolving difficulties arising from administrative instruments such as compulsory purchase orders and the fiscal treatment of development land and property, often made little sense if analysed using theories of urban and property economics.

Moreover spatial planners at both national and local level, politicians (particularly many local councillors) and others involved in the planning process, are not sufficiently familiar with urban economic theory to have an inadequate appreciation of the full effect of these on urban economies.

Spatial economic analysis emerged as a distinct field of academic inquiry during the twentieth century and can be split into two fields, urban economics and regional economics. Urban and regional economics are important parts of the discipline of spatial economics. There is now growing interest in these fields in Ireland in academic other circles but many existing planners and other policy makers were educated when these were of limited knowledge about these fields in Ireland. Internationally over the last decade there has been an increase in interest in spatial economics with the issues involved being brought to wider audiences.

An extensive literature is now available to assist with the analysis of problems of urban development, housing and property economics. This provides insights that may not be familiar to many who are faced with resolving the problems of rapid urbanisation. Indeed many economists whose principal focus and interest has been on other aspects of economics, may not be familiar with the particular methods of analysing urban and property problems identified in the literature on urban and property economics. The familiar tenets of economics have to be adjusted to deal with situations where markets work in a substantially different way than might be expected.

From the literature we learn that there is increasing interest in spatial economics and this parallels the need to better find solutions to the effects of rapid economic growth on our towns, cities and countryside. Some of the insights found in the literature on urban economics will be of assistance to the Committee in considering the issues set out in the notice seeking written submissions. The following draws on urban and property economic theory and should be of help to the Committee when considering the list of issues before it.

### **The Property Market and Landed Property as an Economic Good**

The landed property market is not an efficient market in economic terms and has particular characteristics that make it difficult to analyse using traditional economic criteria. This leads to problems implementing development plans, to high development land values and with access to housing and shelter.

It is crucial to appreciate that property markets are not easily understood and indeed work in ways that are economically idiosyncratic. There are a number of reasons for this. First landed property can be held as an investment and as a consumer good. Second each property is unique. Third, transaction costs are very high and fourth, the property market is not merely a market for land and buildings: it is best understood and analysed as a market in legal rights.

The consequences of each of these characteristics are worth exploring in the interests of understanding the issues before the Committee.

#### 1 Property can be both an investment and a consumer good

Landed property can be bought both for consumption and investment purposes often necessitating finance to purchase as prices are high. Landed property is one of the three main investment media. Consequently capital values will be determined as much by reference to conditions in other investment markets as by demand for the use of accommodation. Hence there is a significant interaction with investment and finance markets. Of crucial importance also is the availability of finance on favourable terms.

Therefore the property market is best analysed as two markets with different influences on each. First there is a consumer market where demand and supply interact to ration space among competing users and determines rent levels. Second there is an investment market where the most significant influence may be sentiment in the equity and bond markets as well as the rate of interest on borrowings. In general it may be said that the investment market determines the capital values of existing property assets while the consumer market determines rental values. This duality has profound implications for policy makers looking at problems in urban areas.

Solutions to urban problems should have regard to the effect on investment capital flowing to the property sector compared with other assets in the investment market. It is entirely possible to create the conditions where too much investment money chases too little investment opportunity in the property market. It is easy to provoke a speculative bubble by unsuitable intervention with the benign intention to help people find a house, an office or a factory.

The tax treatment of property is hugely influential in determining the profile of investment in property markets. In particular the lack of taxes on residential property encourages people to store their investment wealth in houses. In Ireland the lack of local taxes on residential property, a unique characteristic of our tax code, keeps residential property prices here higher than they would be if residential property was taxed as it is in other countries.

In short, the urban land market is prone to speculative bubbles, which can be hugely influenced by government policy. The reverse of this is also true. It is just as easy induce damaging slumps. Much of government policy in the past has acted in a pro-cyclical way and amplified the natural boom/bust cycle of the market.

## 2 Each property is unique

Partly because title issues are complex but also because of the heterogeneous nature of land and buildings, each property is unique. Price comparisons are much more difficult than for other goods bought and sold making valuation difficult. As a

consequence the property market is far from transparent, a normal requisite for an efficient market.

Also, this characteristic makes it difficult to apply generic administrative approaches to solving urban problems. Solutions which involve applying a convenient administrative formula to individual properties will probably fail because every property affected can become an exceptional case due to particular unique features.

Government policy should aim to increase transparency in the property market by insisting on a simple system for land and title registration and making transaction prices public, as is the case in many other jurisdictions. Measures such as this would assist the efficiency of compulsory purchase procedures. They would also assist the process of analysing urban areas by giving the data that is needed to provide the information needed for good public policy.

### 3 Transaction difficulties and costs

Transaction costs for exchanging landed property interests are high. High levels of stamp duty compared to those charged for transferring other property assets add to this. Also, as the public has an imperfect understanding of what is actually bought and sold in the property market, legal and other professional advice is essential when property is being acquired.

Moreover, because the law surrounding landed property has roots deep in history and is surrounded by concepts that are archaic if not arcane, legal and other issues are complex and demand legal advice to sort out. This costs money. These factors impede the operation of landed property markets.

In order to help urban property markets work more efficiently, government policy should have an objective of reducing the transaction costs associated with the exchange of landed property. Measures should include reducing stamp duties and codifying and simplifying the law surrounding legal interests in landed property. Policy in this area should include a statutory legal requirement for the legal profession to use plain English as much as possible. Also all documentation surrounding

compulsory purchases of land and the planning system should also be written in plain English.

#### 4 The property market is a market for property rights

The constitutional protection for landed property can be considered in the light of an understanding of what is traded in the property market and has economic value. The property market rather than being a market for land and buildings is in fact a market in the rights to land and buildings. This is a very important characteristic to understand when considering the question of windfall profits from development land rezoning.

There can be no such thing as absolute ownership of land and buildings. The state provides a system of categorising the types of ownership of landed property by law and a structure defining the rights to property interests.

Also, it is axiomatic that ownership of property rights is constrained by the rights of other property owners. Moreover, other people may have property rights affecting any piece of landed property; e.g. rights of way or of support to adjoining buildings. In short, ownership of property entails responsibility to the community generally and other property owners.

The largest collection, or bundle, of rights to land and buildings that a person can own is a freehold interest and these rights can be unbundled and disposed of separately. The state often has to alter or limit the rights comprising property interests by legislation in the interests of the common good or to regulate social and economic activities. Put another way the state can by law circumscribe or remove particular parts of the bundle of rights than comprise particular landed property interests and has done so in the past. Examples of this include the granting of security of tenure to tenants, control of the airspace over property by the air navigation acts or control of use and development under the planning acts.

What is traded in a property market is therefore rights to use land and buildings coupled with responsibilities to the state and others. These are not immutable and are

subject to law and obligations to others. Development rights, which are regulated through the planning process, are just one of the rights involved. Since the introduction of the 1963 Planning Act these are no longer inherent in property interests. Indeed the planning system is constructed on the principle that the state has the right and the need to alter the bundle of rights that comprise legal property interests.

All property owners benefit from the planning system in that at the very least it protects individual properties from inappropriate development on neighbouring property. More widely, complex modern urban environments require a formal statutory planning system to work effectively and secure the interests of all property owners and the integrity of the property they hold. To have such a system it is necessary to give the state or a local authority control over development. This requires the removal of the right to develop without permission from the bundle of legal rights which a person holds to a piece of property

However, development rights have economic value and the consequences of having removed these rights is that property values are affected. The grant of permission to develop, therefore, confers an economic value to a property owner. Where a property is developed and permission is being granted for further development, such development rights already exist.

Through planning development rights are granted to some landed property owners but not to others and decisions are made on the basis of development plans adopted democratically by planning authorities. These plans are devised and implemented in the interests of the common good. It would seem logical that the community who, through a planning authority, made the development plan and provided the infrastructure and services required for development should get the value of the development rights thereby created. It does not seem to be logical to argue that the constitution would require that a right with economic value created by one body should be transferred as a gift to another who does nothing to create this value.

### **Consequences of the Economic Characteristics of Landed Property**

Where knowledge of market conditions is defective price signals work less efficiently and adjustments to supply and demand are slow. This is the case in the property market. Relatively high transaction costs, incurred either in obtaining market knowledge or in the administrative procedures involved, restrict the extent to which market signals can motivate a response to increased demand.

Eventually the market will respond to signals indicating increased demand and additional buildings will be provided but this will take time, perhaps years. In the meantime limitations on the market, through inadequate or poor planning or other restrictions make it easy for imperfect competition to exist in the short run. In contrast, for people seeking accommodation the near future will be a crucial factor in making decisions about accommodation. They will have to bid against competitors for accommodation available on the market. Hence the effect of restrictions is to drive up prices in the short term.

The consequences of the above and other characteristics of landed property are that the market will respond slowly to increases in demand for accommodation in the economy. Thus, it is in the natural order of the market that periodic shortages occur and these will be associated with high prices. The corollary is also true. When demand falls off the supply of property available in the economy will remain and prices will contract. Consequently the market is volatile and prone to booms and busts when prices overshoot both on the way up and on the way down.

This points to the need for the government to be careful about policies that affect landed property particularly in the area of taxation. Pro cyclical taxation and grant aid policies will amplify booms and busts in the property market. The same can be said of the lending policies of financial institutions.

All in all these characteristics make property markets difficult to regulate and manage from a policy perspective. Understanding them will help to analyse problems associated with high house prices and the price of development land.

One important consequence of the economic characteristic of landed property is that the increase in value created by granting permission to develop agricultural land is not

inherent in the land. Development rights, which are denied to some property owners, are concentrated and increased by the local authority through the planning system and infrastructure provision and transferred to land zoned for development. The economic value that flows from denying development rights to others and from the provision of infrastructure, should not be given by way of gift to the owners of zoned development land. Instead the value of development rights should be kept by the planning authority. The question at issue is just how should this be done and this is discussed later in this paper.

### **House Prices and Development Land**

As we have seen land by itself has little or no intrinsic value above its agricultural value. Clearly if you cannot use land it will have no economic value. The value of land suitable for development is directly related to the value of the buildings that may be erected on it. The value of those buildings will be determined by supply and demand.

The value of landed property is not determined in the same way in the short term as the value of other commodities but is influenced to a substantial degree by the stock of existing buildings which have been constructed in a given location over past years.

Increased economic activity and population growth will give rise to increased demand for accommodation. At first this demand will be met by occupying vacant accommodation from the existing stock. Those requiring accommodation will bid against each other for the available supply and prices will go up. At first this will encourage the more efficient use of existing buildings. It will also act as a signal to developers to provide more accommodation. But in any given period the new addition to the existing stock will be only a very small proportion of that stock. Therefore the market is dominated by the existing stock of buildings. Prices will be set primarily by demand for the existing stock and not by the flow of new buildings coming onto the market in any given period.

The decision to develop or not takes as a given the price that can be achieved for the finished product of buildings available for occupation or use. Thus, for example, in

the housing market builders are price takers and will sell their product at a price determined by the market and not by the value of land and the cost of construction.

The inputs needed to provide buildings comprise the site or development land, to which is added construction material, labour and professional expertise, finance and the enterprise of the developer. All but the first will be in relatively unlimited supply compared to the supply of land. Consequently most of the increase in the value of property resources will descend to the site or development land. In this way the value of development land and sites as a factor of production is what is called a derived demand. Put another way the value of development land is the residual after all other costs involved in the construction process have been taken into account

When analysing problems in housing markets or in other property markets, urban economic theory points to two important principles that should be understood by those framing urban and regional policies. First, the price of landed property, including housing, is not determined by the cost of production. Second the value of development land is the result of high property prices not the cause. These are important insights from urban economic theory, which allow a better understanding of the problems of urban development.

### The perspective of developers

On first consideration these principles might appear to contradict common experience and not appear in accordance with a general understanding of how the market for land and buildings works. This is understandable.

From the perspective of a particular developer or house builder it can appear that high land or site costs drive up the price at which they will offer their product to the market. Indeed, once development land or a site has been acquired it becomes a fixed cost to developers and builders. If there are complaints about the high price of property they will argue that the high cost of land forces them to sell at high prices. If prices stumble but demand remains, developers and builders will argue that the high price of land that is causing the affordability problem. They will suggest that for developers to be able to supply houses and other buildings profitably, government

must subsidise developers or purchasers by tax breaks or grants or some combination of both.

This may appear to be the case from the particular perspective of a developer. But urban economic theory demonstrates it is wrong to conclude that particular examples based on the experience of the individual builder or developer will point to a general truth. In simple terms, in the case of development land it is not correct to argue from the particular to the general. **The general case is that high house prices cause high land prices and not the reverse. This is so even if there are many examples of individual developers who all share the same experience.**

It follows that while it can be prudent at times to provide tax or other subsidies for specific locations or for periods of recession, in times of economic growth they will usually have the effect of increasing the value of development land and sites and drive the prices of houses and building land higher in boom times.

It may be concluded from this discussion that tax and other financial inducements intended to subsidise developers or to assist purchasers with the acquisition of property, including houses, find their way into higher development land values. This is even more the case when there is excess demand for the available stock of accommodation and prices are high. Attempts to deal with say, high house prices, by providing subsidies ultimately have increase the value of development land. Hence, high development land values are and unintended result of government action in housing and other markets. Many government interventions in the market provide a good example of this theory in action.

### **The Introduction of Planning to Ireland**

High development land values are a common characteristic of countries experiencing rapid economic growth. The reverse is also true. Economic recession or stagnation results in relatively low values for development land. Indeed they may not be significantly higher than underlying agricultural values. In the absence of land zoning confining property development to a restricted part of the lands surrounding an urban

area, development land values would eventually decline to agricultural land values the further out from the centre of urbanisation one moved.

In the conditions that existed in Ireland in the late 1950s the economy was stagnant and land values on the periphery of urban areas would not have been particularly high. The main concern of a developer contemplating a housing development would have been the ability to connect to sewers and a water supply. There was no need to seek approval for the development. It should also be noted that at that time capital was scarce and difficult to access by way of a mortgage, and rates were payable on residential property. These factors and others would have kept ambient house prices down and hence development land values were not high.

A person wishing to provide themselves with a house or other property would have had the choice of buying, buying a property built by a developer or buying a site at a price not significantly above agricultural land values and building themselves. During the period of economic prosperity in the early 1960s land values would have increased but in the absence of zoning, which came with the development plans published as in the late 1960s, development land values would not have been dramatic. This was the background against which the Planning act of 1963 was devised and passed.

In the circumstances that applied in Ireland in the late fifties and early sixties it is perhaps not surprising that the consequences of introducing a planning system with development plans and zoning were not given sufficient attention when enacting the '63 Planning Act. The consequences for the value of development land of introducing the planning system, and particularly development plans which allowed land zoning, were not properly addressed in the 1963 Act.

It says something that now we can hardly imagine a situation where such a process did not exist. But it is worth recalling the fact that what the '63 Planning Act did was to remove from property owners the right to develop their property and provide a procedure where if they wanted to do so they needed the permission of the planning authority.

In a sense this was a modern version of surrender and re-grant. On introduction the '63 Act removed development rights from all property owners. It also instituted a process whereby the right to develop was granted by a planning authority following an application for permission to develop. All landowners whose land was suitable for development lost some value in 1964. However, as we see from the earlier part of this discussion, because of the economic conditions at the time this would not have been as great as might be thought if one considered the levels of development land values that now prevail. In any event doing this was necessary to bring into operation the development plans devised under the Act.

The planning process confined development to those lands the planning authority thought it appropriate to develop. By doing so they automatically restricted the amount of development land available. The demand was concentrated on land which had been designated in the development plan as being suitable for development. This has the effect of increasing the value of the zoned land and reducing the value of land not zoned to agricultural land values, plus perhaps some element of value attributable to the hope that it would be zoned in the future.

### **Zoning and Development Land prices**

If a planning authority does not zone an adequate amount of land, the value of the zoned land would be increased by an even greater amount than might be expected. Just what is an adequate amount of zoned land is, of course, a matter of judgement and judgements about this are hard to make and are influenced by political and financial considerations.

In any event it should not be simply based on an estimate of the amount of land required to build new accommodation to house anticipated future population growth. This implies control over the rate at which development land comes to the market during the timeframe of the plan. The Planning Act confers no such power and leaves the rate at which zoned land came to the market up to the individuals who own it

In fact a marginal shortage, resulting perhaps from the personal decisions of individual landowners not to bring zoned land to the market, can have a

disproportionate effect and drive up prices. Such a deficiency of the supply of zoned land on the market, even if it is just marginal, will result in a big increase in value of the land that does come to the market. Indeed, values may have to increase very substantially to tempt a reluctant landowner to sell despite personal reasons for not doing so.

The solution would appear easy. Simply zone and service much more land than that required to meet forecasted development needs. Local Authorities are, however, understandably reluctant to do this because the resources available to service land are scarce. Plainly it would be wasteful to provide services to land that may not be developed for a generation.

It makes sense only to service land that the plan sets out for development within the timeframe of the development plan. The implied expectation is that land will come to the market because of the uplift in values due to zoning. It is questionable whether windfall profits act as an incentive in this way. If they do not it means that development plans are based on what is essentially an act of faith when, as indicated above, no real control can be exercised over the rate at which serviced and zoned land will come to the market.

### **Development Land Values and Speculation**

Inevitably, scarce resources for infrastructure must be used in a cost efficient way and prioritised. As a result there may be a perceived shortage of development land. Once shortages are perceived, speculators will buy land to cash in on anticipated price rises. Moreover, having acquired land a speculator has an incentive to maintain the shortage and keep values up by not developing the land until it suits their business interests. This may not be in accordance with the needs of the market or the timeframe of the development plan.

This is an inevitable outcome of a market economics interacting with the planning system. In a market economy, nimble entrepreneurs will seek opportunities to make money where the system creates suitable conditions. This is not bad in itself but it can be a problem if the planning system facilitates and encourages it. It is clearly

damaging if it results in very high land prices and a shortage of development land coming on the market. **If the planning system creates fertile conditions for speculators to amass super profits from their activities, this should be taken as clear evidence of a defect.**

Plainly there is no sense in only zoning sufficient land to meet projected development needs if enough of it is not available to the market. The reality is that the planning system puts owners of development land in something of a monopoly position. As presently structured, however, it gives an economic and monetary incentive to developers to act against the public interest by timing their disposal decisions to maximise the gain to them. This situation is not a flaw with market economics, it is the way the planning system is allowed to operate that creates the conditions to allow this.

As has been noted above, before the '63 Planning Act, property development took place without planning regulation and the difference between the values of agricultural land and development land were not great. The zoning decision of the planning authority to concentrate development and confine it to particular lands is the mechanism that creates the primary escalation in development land values above those prevailing if the land could be put solely to agricultural use. Clearly the benefit of this should flow to the community and not just to the small number of people who happen to own the land that is zoned.

What was not appreciated nor understood when the planning system was devised was the difference the planning process can create in relative land values if there were marginal shortages in the amount of serviced land or if this land did not come to the market for development. Neither was it appreciated that this would open the way for intense speculation in development land. This lack of appreciation led to flaws in the 63 Planning Act that remain today.

**A Brief history of attempts to deal with windfall profits from high land prices**

Since the introduction of the planning system in 1964 public interest in the problem of high development land values has waxed and waned with the booms and busts of the property market.

In times of economic growth high development land values eventually emerge, hit the headlines and are seen as a problem. First they are perceived to drive up the price of property. Secondly the vast windfall profits made from the sale such property offend many who have an instinctive feeling that something must be wrong with a system that hands vast wealth to a few for so little economic effort. Also high land values cause problems for public authorities in acquiring land for the provision of infrastructure. Eventually there is a move to investigate the situation.

In the past by the time the matter was moved to a point where policy options are considered the economic conditions that created the problem have abated and perhaps this is why the problem remains unresolved. It is interesting to note that there is now increasing interest in finding measures to deal with issues arising from high development land values just as the economy moves down a gear or two. Nonetheless there is a lot to be learned from reviewing past attempts to deal with issues surrounding the high price of development land

### **The Kenny Report**

When the problem of high land values and the windfall profits made from zoning became a problem following the introduction of the '63 Planning Act a Committee on the Price of Building Land produced what is called the Kenny Report. In fact this Committee had divided views about what should be done and majority and minority reports were produced.

The majority report suggested that local authorities designate areas required for development for the next five years (the statutory period for development plans at the time) and buy the land, compulsorily if necessary, at existing use (agricultural) value. It would then be sold to the market at development value. Clearly if all landowners were to get was agricultural land values, the incentive to bring zoned land to the market would have been removed and the state would have had to buy most of the

land through compulsory purchase procedures which are necessarily cumbersome and time consuming.

This would have created a monopoly on the supply of development land. Also, the amount of development land coming on the market would have been dependent on the financial resources of the authority and their efficiency. If they were not able to acquire all the land needed and only acquired some land leaving others to sell privately on the market at development value this would have created the conditions for endless legal challenges to the legislation. The minority of the Committee felt that this procedure would have been cumbersome, unfair and open to constitutional challenge.

Moreover, it probably would have led to some undesirable practices to incentivise those who owned development land to bring it to the market. Developers seeking land on which to build might have created vehicles to arrange partnerships with landowners or other methods to circumvent the measures adopted to give effect to the reports proposals.

The majority proposals were in many ways a product of a time when, politically and philosophically, central planning by government and non-market solutions to economic and social problems were more acceptable. Nothing was done in any event and the problem faded with the recession in the mid 1970's which resulted in falling development land values.

Implementing the Kenny Report proposals have now become shorthand for doing something about the shortage of development land on the market and capturing the windfall profits made from the sale of development land. They remain an attractive proposition for the political left and are often cited as something that could be done by government. However the criticisms remain valid. The administrative problems associated with this solution would still need to be addressed. Moreover, it is unlikely that a public sector monopoly of the supply of development land would be successful in meeting the needs of a dynamic and highly market orientated property industry. It is entirely likely that such a scheme would collapse if it were to be implemented.

## **Joint Oireachtas Committee Building Land**

The problem re-emerged in the late 1970s and early 1980s and a Joint Committee of the Oireachtas investigated the issue. This Committee concluded that the most appropriate approach to recouping the value from rezoning was through a combination of development charges and taxation. In a subsequent budget a rate of 60% (20% higher than the standard rate) was applied to profits from rezoning land through the capital gains tax code. The other part of the solution, development charges, could be applied in particular circumstances under the planning acts.

As a Result of the Report a measures were implemented which dealt to some degree with the problem of speculative profits on building land. It was not an entirely satisfactory solution but it did serve to ameliorate some of the worst excesses of speculation in land.

But these measures did not address the problem of the connection between servicing and zoning particular lands and bringing those lands to the market. Nor did this solution provide the resources to local authorities to provide the infrastructure for development or a means of benefiting from the value they created by the provision of this.

There, however, the matter stood until recently when two things changed. The capital gains tax code was changed and the planning bill published.

### **The Situation Today**

As a measure to encourage supply, the capital gains tax on the sale of residential development lands was reduced following the first Bacon Report. The Minister for Finance made it clear, however, that he intended to re-instate the higher rate in the future-- otherwise a landowner could gain more by holding on to land and capturing any increase in value.

Clearly this incentive depends upon the expectation that the minister will actually apply the higher rate of tax at some specified time in the future. But the argument that landowners need an incentive to bring land to the market will more than likely remain

and will be adduced at any time it is suggested that the higher level of capital gains tax is proposed to be re-introduced.

In reality it seems unlikely to many given the present approach to taxation that the higher rate will be reinstated for the foreseeable future. Therefore, the incentive to bring land to the market early to avoid a higher rate of tax rather than waiting to capture future increases in value fails.

### **The Experience in the UK**

Not surprisingly, given that the original planning legislation in Ireland, the '63 Planning Act, was based on UK legislation there are a lot of similarities both in the measures adopted but also in the problems arising from them.

The problem of the effect on land values of establishing the role of planning in a welfare state had been the subject of much debate in the UK when the planning process was reformed there after WWII. As might be expected in a more urbanised society which had seen a vast amount of urban development in the 19<sup>th</sup> and 20<sup>th</sup> centuries, there was a great awareness of the effects of planning decisions on land values.

By the end of WWII the question of capturing the increases in the value of some property holdings flowing from favourable planning decisions and compensating those who lost the right to develop or were otherwise adversely affected, was the subject of political debate in the UK for well over a century. This was commonly referred to as the Compensation-Betterment problem. Attempts to deal with it had been made in the nineteenth century in England both by Local Authorities and by some railway companies with mixed success.

In the UK also the introduction of a legislative planning process effectively removed development rights from all property owners and created a process where the right to develop any particular property would be granted by a planning authority following an application for permission to so do. This permission was granted following an

assessment of the development proposal against criteria laid down in a development plan adopted for the area in which the property was located

The principal recommendation of the Uthwatt Committee, set up during WWII to consider the issues surrounding the proposed introduction of a new planning regime after the war, were that the development rights in all land outside built up areas should, on the payment of compensation, become vested in the state and that there should be a prohibition against development of such land without the consent of the planning authority.

What it was intended to compensate for was the loss in the value of land which prior to the introduction of the planning system could have been developed but after planning was not zoned for development and could only be used for agriculture. This recognised that the introduction of a planning system which zoned land for development and reserved other land for agriculture or as a green belt increased the value of some land and decreased the value of other land. The intention was to acquire land, zone some for development and sell it at a premium. The resulting profits were intended to provide the funds to compensate those who were not lucky enough to have their land zoned for development.

What was called shifting land values was a consequence of introducing the planning system which provided for land zoning. The Uthwatt Report 1941 discussed in some detail the problem of shifting land values under such a planning code. It defined betterment as *an increase in the value of land resulting from the action of government ( local and national) whether positive, an increase due to public works or improvements, or negative, an increase due to the restriction on the development or use of other land.*

It should be remembered that in the absence of planning all land would have had some development value but as this was spread over all land and not confined to that land zoned for development, land values would have been substantially less. Confining all development to particular zoned lands concentrated development value to those lands.

Two main pieces of legislation The Town and Country Planning Act 1947 and the Land Commission act 1967 were based on this report.

Not surprisingly the UK Labour Party proposed the nationalisation of development values with the Conservative Party arguing against. The Town and Country Planning Act 1947, introduced a system of nationalising development values and the supply of land for development land dried up because there was not sufficient incentive for landowners to free up land for development. Naturally on the return to government of the Conservative Party it was repealed in 1954.

The UK Finance Act of 1965 brought in a system of Capital Gains taxation that captured some of the windfall profits made from development land but the matter still remained one of considerable political contention. A Land Commission Act was passed in 1967 but repealed in 1971. The UK Finance Act again tried to come to terms with the problem in 1974 and again in 1975 a Community Land Act was passed but again repealed shortly afterwards.

It can be seen from the above that many proposals to deal with the issue failed because of insufficient political consensus or because the procedures involved proved to be unworkable or too complex.

It can be said that in the end a pragmatic solution evolved using combination of capital gains taxes, development levies or charges, negotiated planning gain and rigorous enforcement of the Green Belt policies. In short the UK experience indicates that the compensation betterment problem this is a complex problem not amenable to easy solutions.

### **Approaches to be Adopted to Deal with High Development Land Prices.**

Having considered the issue of the high price of development land and the problems surrounding high house and property prices, it can be seen that the issues involved are complex. It would appear from the history of attempts to deal with the question of capturing for the state the value created by the act of granting a planning permission on development land, and providing the necessary infrastructure, that the most

effective solution is a combination of three elements. A capital gains tax on profits made from the sale of development land, negotiated planning gain and development levies.

A combination of these measures could bring down the ambient value of development land and make the market for development land work more efficiently. These are dealt with more fully below.

### **Capital Gains Tax**

An appropriate level of capital gains tax on profits made from the sale of development land should exist. Such a system existed until recently and could readily be reinstated. Reflecting the reality of windfall profits from development land CGT was at 60% in the past a rate of 20% above the standard rate of CGT. There would seem to be strong arguments on equity grounds, and on the grounds of economic efficiency, that a rate of CGT above that applied to other gains should be made in the case of development land. In particular, given the present CGT regime where inflation is not taken into account in calculating capital gains, this would provide a disincentive to holding on to development land for long periods of time. Moreover, such a high level of CGT would provide something of a disincentive to speculation.

### **Planning Gain**

Planning authorities should be given a clear statutory authority to negotiate with developers and get them to provide additional infrastructure facilities to accompany development. This could be done quite easily. Large developments should come automatically with a range of social and public amenities, e.g. playgrounds for children. Also, a specific contribution should be made by developers to the education authorities for the provision of additional schools and to the health authorities for the provision of the local accommodation needed by public health system.

The justification for this is that property is sold on the implicit assumption by purchasers that these will be provided in the area and part of the value of a property is the capacity to access community amenities.

## **Development Levies.**

At present these exist but the schemes devised to apply them are based on the cost to the local authority of providing the infrastructure. This is then apportioned to development land in accordance with a specified formula. This measure is flawed in concept and only goes part of the way to recouping the value created by infrastructure provision. Local authorities should be empowered to devise a scheme for the application of levies in accordance with the value added to development land which is the subject of a planning permission and not on the basis of the cost to them of such provision as is provided for in the legislation.

The Planning Act of 2000, sets out a system of levying development contributions and specifies that these should have regard to the cost of provision of the services. The Act specifically excludes benefits accruing from existing services, which is significant.

This goes to the heart of the problems with the planning code in Ireland including the high price of development land. The formula used in the Act is inadequate to recoup value created by the actions of a planning authority. It also does nothing to encourage the owners of zoned land to bring it to the market speedily.

This can be best illustrated by considering a hypothetical situation where land on the outskirts of Dublin cannot be developed because of a lack of services which would only be provided by a public authority. The market value of this land would reflect the lack of supporting infrastructure and the consequent inability to develop. Clearly, the value would be substantially below that which would apply if planning permission had been granted and the services provided.

The Planning Act allows planning authorities to recoup the part of the cost of providing infrastructure and services but not the increase in value conferred on the owner by connecting to these and the decision to grant planning permission.

It would be more equitable if the basis for estimating the contribution from developers was based on the value created by the activities of the local authority and not on the

cost to them of these. To do this they should be able to charge to the developer the addition to the value of the land arising from the provision of the infrastructure, the services and by the grant of planning permission.

This would be the difference between the value before the services were provided and permission granted and the value afterwards. The 'before' figure would reflect a combination of hope value and existing use value. The 'after' figure would be the market value with the benefit of the services and the planning permission reflecting the certainty that development could proceed immediately. **The difference between these figures should be the development levy.**

To enable a planning authority to encourage landowners to bring land to the market it should have the power to rebate the development charge in the event of the landowner developing the lands within a specified time which could be specified in the development plan. **This measure would deal with one of the main deficiencies of the existing arrangements under which planners have no mechanism for influencing the rate at which development land comes on the market or is developed.**

This approach would change the role of a planning authority from being a regulator and provider of services and infrastructure, to one of development enabler. Under this arrangement the value created by the actions of the planning authority is shared between both developers and the community in proportion to their contribution to creating the development value.

In passing it is important to point out that any schemes for charging development levies should be devised in a form that creates certainty in the minds of prospective developers as to the nature of the obligations they may have to meet in the event of them getting a planning permission.

It would also be important that the planning function within local authorities employ professionals equipped with the financial and economic expertise needed to evaluate development proposals and negotiate with developers. These professionals should be qualified in finance and/or property economics

Using a combination of capital gains tax, development levies or charges and negotiated planning gain would have three benefits. First, it would substantially remove the incentive to speculate in development land. Second, it would help to ensure orderly development in accordance with plans devised by planning authorities by giving them some control over the rate at which the zoned lands will come to the market. Third, by being able to capture the increase in the value of zoned lands it should help to provide planning authorities with the means to service a sufficient quantity of development land to ensure that the market for development land works more efficiently and make the planning system self-financing. Such an approach would reduce the price of development land and contribute to the solution of the housing crises.

### **Summary of recommendations**

- ✓ There is a need for greater research into and understanding of spatial economics at all levels in the planning process.
  
- ✓ Government policy in the area of planning and the built environment should be integrated with tax and other policies more closely to ensure a more joined up approach to providing the physical development which comes with economic growth.
  
- ✓ There is a need for increased transparency in property and urban land markets. This could be achieved by
  - Publishing transaction prices.
  
  - Reducing transaction costs by codifying the legal basis for property ownership and simplifying conveyancing.
  
  - Writing all documents associated with landed property in plain English

- ▼ The mechanisms for dealing with development land in the tax code and the planning acts should be reformed
  - By taxing at an appropriate level the windfall profits made from the disposal of such land
  - By facilitating local authorities negotiating with developers to attain planning gains as part of permissions to develop
  - By changing the Planning Act to allow Local Authorities to capture the value they create by providing infrastructure and services and by regulating development through plans.