



Financing the infrastructure and new homes of the future: the case for enabling acquiring authorities to purchase land for strategic development under a special CPO compensation code

Summary

In establishing the National Infrastructure Commission in 2015, the Government recognised the vital importance of infrastructure. Besides broader economic benefits, infrastructure investment also has a key role to play in fixing the broken housing market. It has the potential to boost both overall supply and the supply of more affordable, higher quality housing, because it can improve viability and increase support for new developments in the planning system and among the public.

Realising these ambitions means a significant increase in levels of investment, after decades of relative under-investment compared to both OECD recommendations and other OECD countries. One significant, largely untapped, source of investment can be found in capturing the uplift in land values resulting from strategic development. Currently, around 75% of this value is not captured,¹ as the land market factors in expected increases in the value of land attendant on changes in land use, the granting of planning permission and Government-funded infrastructure investment. As the Housing Minister recently noted, "there is not a great deal of value in the land for providing the infrastructure that ... is vital to go along with housing."²

Delivering land into development projects at lower values that have not priced in such expectations could release an extra £9.3bn per year, in addition to the £2.8bn a year currently captured from residential projects through Section 106 and the Community Infrastructure Levy. This £12.4bn annual income stream would provide a vital source of finance for infrastructure and new housing.³

Once a public body or combined authority has acquired land at a lower initial price, it can fund projects via the bond markets, with bond holders paid back from income streams generated by capturing land values: developing and selling housing; developing homes for rent with a long-term revenue stream; or selling land at a higher value to construction firms to build. In this way, the value created by public investment

¹ Calculation from [Centre for Progressive Capitalism \(2017\) Estimating land value capture for England - updated analysis](#) [Accessed: 3 May 2017].

² Hansard (2017) House of Commons, Volume 624, Column 191 (28 March)

³ [Centre for Progressive Capitalism \(2017\) Estimating land value capture for England - updated analysis](#) [Accessed: 3 May 2017].

and the planning system can be recycled back into the infrastructure we need to create successful communities and a productive economy.

The UK's current approach of capturing land value at the land trading stage is an outlier amongst developed economies, with many European and Asian countries capturing land value at the development stage. The Government can bring the UK in line with international best practice through a special Compulsory Purchase Order (CPO) compensation code for strategic developments, acting as a deterrent against the extensive land trading which pushes up prices and does not contribute sufficiently to new supply. The market value principle as set out in section 5 of the 1961 Land Compensation Act would still determine the value of the land, but as landowners would no longer be able to benefit from the uplift, the market value itself would remain at levels closer to the original value of the land before it appears in a strategic plan for development.

The governance structures for using a special CPO compensation code already exist in the form of development corporations, combined authorities, and the closer working between local authorities developed by successive devolution policies. The key change needed now is for Government to enable acquiring authorities to purchase land for strategic development under a special CPO compensation code. This would involve three changes:

- 1) An amendment to the National Planning Policy Framework to allow planning authorities to designate land for strategic development;
- 2) An amendment to Section 14 of the 1961 Land Compensation Act to disregard prospective planning permissions on land designated for strategic development;
- 3) An amendment to Section 17 of the 1961 Land Compensation Act to restrict the use of certificates of alternative development on land designated for strategic development.

We do not envisage a significant increase in compulsorily purchased land as a result of this change. In most cases, having certainty around a new way of valuing land brought forward for development will influence negotiations between landowners, developers and planning authorities, with CPO reserved as a tool of last resort for exceptional cases, for example in the event that a single landowner is intent on resisting sensible land pooling or value equalisation proposals, destroying the marriage value of bringing sites together for strategic development.

A special CPO compensation code will readjust landowners' profit expectations where land is identified for strategic development, but also where land *may* be identified for strategic development in the future. This will have a much-needed stabilising influence on the broader market, slowing down the pace of land price growth. This, in turn, will create opportunities to diversify the construction sector as SME housebuilders will have improved access to land in a less inflated market.

This paper outlines:

- 1) How current land valuation practices concentrate the benefits of public investment and the impact of planning policy too early in the development process;

- 2) How creating a special CPO compensation code for strategic developments can advance a range of policy priorities;
- 3) How acquiring authorities could be enabled to capture this value on schemes identified for strategic development;
- 4) How the Government can legislate to bring the UK in line with international best practice;
- 5) How to implement a special CPO compensation code to manage risks effectively.

The Problem: How the current CPO compensation code reduces finance for infrastructure and homes

Land prices are worked out on the basis of the residual land valuation methodology: the total value of a finished development - taking into account any uplift from planning permission, connection to existing infrastructure and planned public investment - minus the cost of building the development and developers' profits. In the current CPO compensation code, the price of land is therefore based not on its Existing Use Value as agricultural or industrial land, but instead on the "hope value": the value the land *would* have if, theoretically, planning permission for a more valuable use of the land were to be granted. Because CPO compensation must include "hope value" – even if the scheme underlying the CPO is ignored, as in the "no-scheme world" proposal - the uplift in value from a change of planning use flows to the landowner at the expense of the community. In most European countries, the landowner receives a fair market value of compensation based on what their land is worth with its existing planning status, plus a premium.

Case Study: Roof vs Newham

A prominent recent case was on the Olympic Park at Carpenter's Estate in Stratford. In 2007, a goods depot owned by building contractor Roof Ltd was compulsorily purchased for the Olympic Park. There was no outstanding planning permission or plan allocation for development on the site at the time of the purchase. A Newham Council certificate had ruled that planning permission would only have been awarded on the site for B1 (business) and B2 (general industrial), informing the values that the London Development Agency sought to attach to the land when acquiring it under CPO.

The then owners of the site argued that because of the public investment in regeneration in the area, the land had the potential to be developed as a lucrative mix of residential and business uses, and sought a Section 17 award. Roof was ultimately successful in its litigation, receiving a much higher value of compensation for their land, and in 2012 the Secretary of State supported this decision.

Basing the appropriate level of compensation on existing planning permissions would have been much clearer, saving considerable legal costs and time. The amount of compensation would have matched the value of the land to Roof at the time, rather than a speculative sum based on an unplanned possible future development, leaving the public purse more to invest in regeneration.

Where landowners have already started the process of developing their land by going through the planning permission process, they should clearly be compensated accordingly in the event that their land

is subsequently needed for a large-scale infrastructure project or new housing development. However, the Land Compensation Act 1961 awards the same level of compensation to landowners who have demonstrated *no intention* to develop their land, if “planning permission for any development could in any particular circumstances reasonably have been expected to be granted”. Landowners sitting on land, without planning permission, benefit financially from the fact that their land appears in a strategic plan for development with no engagement or investment required from them. This severely restricts the supply of land available at values which permit investment in the infrastructure and homes we need.

In this system, any increase in the value of a development due to public investment is factored into land costs, disproportionately benefiting landowners and land traders. Well-founded market beliefs that planning obligations can be squeezed down or overturned at appeal, and that the Treasury will ultimately foot the bill for infrastructure, inevitably increase speculative pressure on land values. This value cannot therefore be harnessed to boost investment in the things that matter to communities and to the broader economy, above all more affordable housing and transport. The effects are felt across the market, not just on sites actively traded in this way, as landowners and traders use wider market activity to assess the value of land.

Case Study: Grosvenor’s appetite to develop St Pancras Hospital site

Camden Council’s 2012 Local Plan allocated the St Pancras Hospital site for redevelopment, with surplus land to be used for market and affordable housing. Grosvenor expressed interest in developing the site for Build to Let, but decided not to get involved as they feared speculative land trading on adjacent industrial sites had inflated land values to the point where private rented housing was unviable.

How land value capture could finance infrastructure and new homes

Financing infrastructure

Case study – The North West Cambridge Development

Cambridge University raised a working capital fund of £350 million from the bond market to invest in the development of 3,000 new homes and supporting infrastructure on its own land, including the largest rainwater recycling system in the UK, all utilities, a site-wide District Heating Network and roads. Sales of market housing and rental income will be used to repay the loan, effectively capturing land value uplift arising from the development. Agricultural land with a nominal book value of around £24,000 per hectare will jump to around £2.4m per hectare.

For decades, levels of UK infrastructure investment have lagged behind those in comparable nations. The WEF's Global Competitiveness Report ranks the quality of the UK's overall infrastructure 24th globally.⁴ Standard & Poor's estimates the UK's accumulated infrastructure investment deficit to be at least £60 bn.⁵ One significant, largely untapped, source of investment can be found in capturing the uplift in land values resulting from development. Currently, around 75% of this value is not captured,⁶ as the land market factors in increases in the value of land attendant on changes in land use, the granting of planning permission and Government-funded infrastructure investment. The Centre for Progressive Capitalism estimates that opening up land for housing and capturing rising residential land values by leveraging CPO policy could free up £185bn over the next 20 years for increased capital expenditure on infrastructure, the result of capturing an incremental annualised uplift of £9.3bn.⁷

Driving up housing supply and quality

Improving transport connections can address one of the major drivers of objections to new housing, and has positive benefits for existing homeowners by boosting house prices and improving local connectivity. Supporting infrastructure is also a key factor in the reclassification of land-use from industrial / commercial to residential, and in enabling higher density housing development. Transport for London has identified a 50 per cent increase in the density of new housing with 500 metres of a Crossrail station compared to areas further away.⁸ By increasing demand, this approach yields greater sales receipts, improving the viability of schemes so that developers have room to build better, more affordable housing that people want to live in. Infrastructure investment and housing supply can therefore support each other in a virtuous circle, if enough of the value created by development is captured.

⁴ World Economic Forum (2016) The Global Competitiveness Report 2016-17, p.355

⁵ Standard & Poors (2015) Global Infrastructure Investment: Timing is Everything (And Now is The Time), p.12

⁶ Calculated from data in Centre for Progressive Capitalism (2017) Estimating land value capture for England - [updated analysis](#) [Accessed: 3 May 2017].

⁷ *Ibid.*

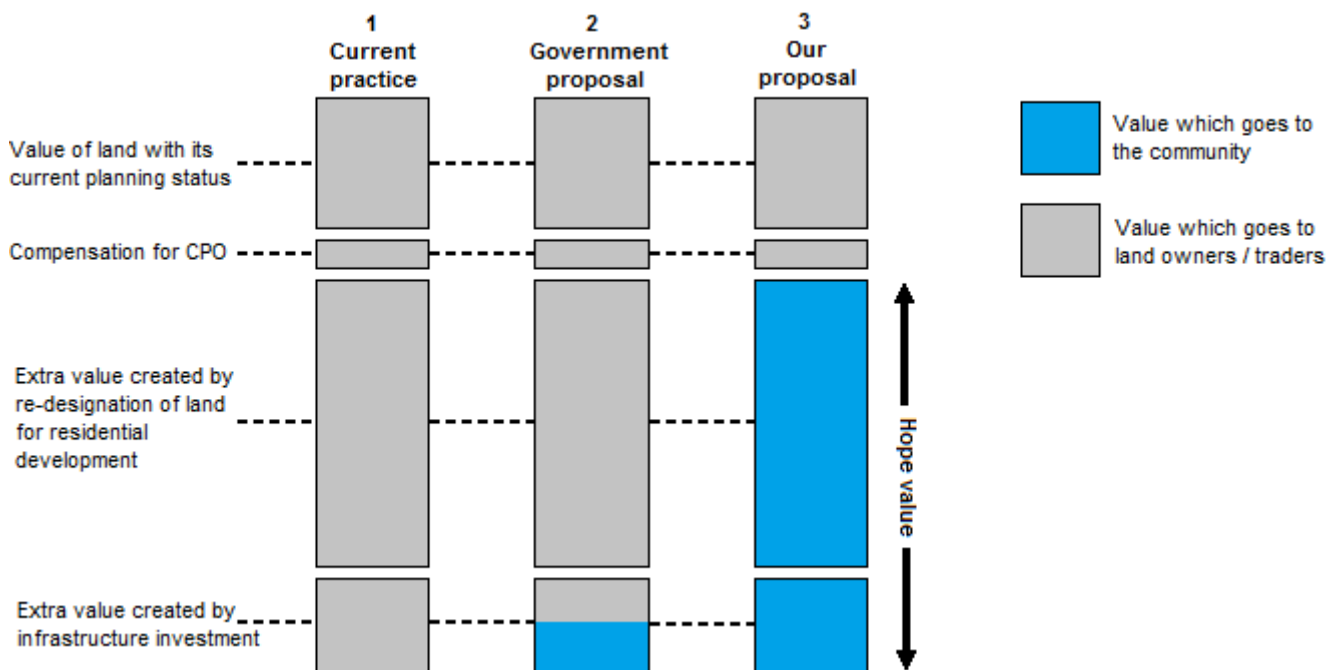
⁸ Transport for London (2017) Land Value Capture, p.7

The Solution: How acquiring authorities could be enabled to capture land values on schemes identified for strategic development

We need to divide the betterment resulting from public investment and the planning system more equally amongst landowners, land traders and developers on the one side, and communities, the infrastructure industry, and the broader economy on the other. This means realigning landowners' expectations of the level of profit due upon the release of land for development. In a highly competitive market for a limited resource for which there is no meaningful holding cost, a realignment of landowners' profit expectations can only be achieved through the use of an effective deterrent against holding out for a higher price – a role which CPO policy is well-placed to play, but currently cannot due to legislative barriers.

In principle, this can be achieved by agreement with landowners (as typically happens on rural exception sites), or by acquiring land in the open market without revealing the intention to develop it (the mechanism used to found the first garden cities in the early twentieth century). In the modern land market, such subterfuge is often impossible, particularly given the extensive use of options agreements. Public authorities cannot acquire land without disclosing the purpose, so the market price of such acquisitions is necessarily inflated by the awareness of development plans.

The graphic below shows how three possible approaches to CPO compensation differ in their reward to the landowner versus the community. The example concerns a piece of land which is affected by both a change of planning use (from, say, industrial to residential) and a major transport scheme, like Crossrail.



Option 1: Current practice

All the extra value created is captured at the land trading stage, by the landowner and land traders.

Option 2: Government proposal - Codification of the “no-scheme world”

The value created by the change of planning use is captured at the land trading stage, by the landowner and land traders. The extra value created directly by investment in the transport scheme should be captured at the development stage for the public benefit, but in fact some is absorbed by land trading. Investors may acquire an asset at a higher price assuming public investment before that public investment has actually been confirmed, pushing up its price and extracting extra value.

Option 3: Our proposal – changing the compensation code

The extra value created by infrastructure investment and the change of to residential use is captured at the development stage for the public benefit, as happens in many European countries. Once a public body has acquired land at a lower initial price, it can capture the value created by public investment and the planning system by: developing and selling housing; developing homes for rent and thus generating a long-term revenue stream; or selling land with planning permission at a higher value to construction firms to build. Public bodies will be able to raise long-term finance using the bond market to invest in infrastructure projects, with bond holders paid back from revenue streams including land sale receipts at residential use value, sales of completed residential units or rental income from affordable rented housing.

The impact of changing the compensation code on the land market

The third proposal, maximising the finances available for infrastructure investment and housing development, can be achieved through a special CPO compensation code for land identified for strategic development, using a new methodology for appraising residual land value. This would be the total value of the scheme at completion, minus the extra value created by re-designating the land as a result of the scheme, minus the cost of providing the scheme (including supportive infrastructure).

In practice, both landowners and local planning authorities would want to avoid using CPO where possible. The CPO process is by its nature adversarial, and tends to be more time and resource intensive

Case study – Fareham

Fareham council has been trying to get two land owning families to bring forward their sites at Welborne as a single development for years. However, arguments between the families about their respective site values has held the scheme up. One of the land owners has consistently argued for a sum based on some speculative future use of the site. After years of negotiation the council decided to compulsorily acquire the site because it has no other options.

Had the level of compensation achievable been clearer to all parties from the outset, the authority would have been less likely to use compulsory purchase as an option, because the land owners would have been more inclined to come to a reasonable voluntary arrangement to combine their sites, maximising their own return and the public benefit.

than a voluntary agreement based on legally established principles of land valuation. Acquiring authorities would be likely to trade the potential costs of undertaking a CPO as a premium for the landowner. We recommend that compensation of 20-30% should be paid above the residual set out above. Landowners would thereby be incentivised to form voluntary agreements to avoid being paid the lowest price permitted by the special CPO compensation code.

The majority of the impact of this change would therefore be as a deterrent: we do not envisage that very much land would actually be compulsorily purchased. In most cases, having certainty around a new way of valuing land will influence negotiations between landowners, developers and planning authorities without the need for compulsory purchase. CPO should be reserved as a tool of last resort for exceptional cases, such as where one landowner is intent on resisting sensible land pooling or value equalisation proposals, destroying the marriage value of bringing sites together for strategic development.

Even though only land within designated areas, where there is a clear public interest case, would be eligible for compulsory purchase at the new lower values, there would be a broader impact from this reform on the land market. Buyers and sellers of land would not know whether their land could be designated in a strategic development area in the future. They would therefore be incentivised to trade land at a lower value, reflecting this risk. This will stabilise the land market and help a greater diversity of housebuilders, including SMEs, to access land, come into the market and start building out sites.

The Solution: How the Government can legislate to bring the UK in line with international best practice

Option 1: Extend the “no scheme world” approach to disregard planning use changes

The “no-scheme world” value of land set out in rules 1-3 of section 22, 6A of the Neighbourhood and Planning Bill, together with rule 4 for CPO valuation, is intended to remove the extra value created by major transport projects from CPO compensation.

However, Section 17 of the 1961 Land Compensation Act will still apply, *and landowners will continue to have a statutory basis from which to litigate against a CPO valuation if they can show that an alternative development on their land could have generated a higher valuation.* Estimates are likely to be based on previous and near-by land transaction prices. These provide poor indicators of the fair market value of an individual holding because they will have been based on the “hope value”. Investors may have acquired an asset at a higher price assuming public investment before that public investment has actually been confirmed. As a result, the land might have already been traded many times, pushing up its value, before it appears in a plan for strategic development.

Without further primary legislation, the “no-scheme world” valuation principles are likely to unravel in case law, and will ultimately preserve land values at or close to current “hope value” calculations. As a result, any extension of the “no-scheme world” concept to disregard prospective planning status as well as infrastructure investment is unlikely to deliver land into strategic developments at the lower prices which allow land value capture to finance affordable housing and infrastructure.

Option 2: Legislate for a special CPO compensation code for strategic developments

The Government can support the delivery of vital infrastructure projects and of more and better homes by unlocking the capacity of CPO policy as a deterrent against land speculation. Three further reforms are needed to achieve this:

- 1) An amendment to the National Planning Policy Framework (NPPF) to allow planning authorities to designate land for strategic development in their Local Plan and Neighbourhood Plans.**

Within these designated areas, no account should be taken of prospective planning permissions or certificates of appropriate alternative development when assessing CPO compensation levels. This would require a final pair of amendments to planning legislation:

- 2) An amendment to Section 14 of the 1961 Land Compensation Act: “In land designated for housing and infrastructure by a planning authority in their Local Plan, no account is taken of prospective planning permissions.”**

3) An amendment to Section 17 of the 1961 Land Compensation Act so that certificates of appropriate alternative development would cease to apply in those areas designated by authorities for strategic development.

In other words, in this special CPO compensation code for land identified within a strategic development, fair market value should take account of existing planning permission only, ignoring any betterment attendant on the development.

The Solution: How to implement a special CPO compensation code to manage risks effectively

Ensuring legal compliance

Many CPO practitioners and policymakers in this area erroneously believe that any change which departs from the current interpretation of “market value”, as the residual land value, would breach Article 1 of the Human Rights Act. Land valuation methodologies which use Existing Use Value⁹ as their starting point are vulnerable to legal challenge on this basis. However, given other European countries have planning systems which *do* capture most of the uplift in land values from planning, there are clearly ways to capture land value uplift within the confines of the law. In particular, a strong public interest case to capture the land value for public benefit overrides Article 1.¹⁰

- In Germany, planning law freezes the value of land when the local municipality decides to specify an area for residential construction. This enables the municipality to acquire the land for what it is worth without any change in planning use or public investment in the new development being factored in. The uplift in values from the sale of housing can then instead pay for supporting infrastructure for the development.
- In the Netherlands, municipalities have the right to use CPO powers if a landowner does not release land needed for the fulfilment of a local Land Use Plan. This provides a powerful incentive for landowners to cooperate and sell their land voluntarily, for more than it would be worth if compulsorily purchased. A clear methodology for calculating CPO compensation enables fair payments to landowners to be determined quickly. As a result, these deterrent powers are rarely exercised in practice. When agricultural land is designated for development, the landowner receives ten times its Existing Use Value, while the municipality receives eight times this new value when it sells the land on as residential plots. Landowners receive a reasonable profit based on the fair market value of their land, and 87.3% of all of the uplift resulting from development flows to the municipality to pay for infrastructure and improve the viability of projects.¹¹ If a Land-

⁹ Existing Use Value (EUV) is the price at which a property can be sold on the open market assuming that it can only be used for the existing use for the foreseeable future, e.g. as agricultural land.

¹⁰ Karen Reid (2012) *A Practitioner's Guide to the European Convention on Human Rights* (4th ed.), p.424

¹¹ Calculation from data in Centre for Progressive Capitalism (2016) *Bridging the Infrastructure Gap*, p. 13

Use Plan has been legally adopted by the planning authority, this is sufficient proof of public interest for any CPO dispute.

In both cases, these compensation systems are used only where there is a clear public benefit, and where they therefore comply with Human Rights legislation. Amending the Land Compensation Act 1961 as outlined will bring the UK in line with international best practice. The market value principle as set out in section 5 of the 1961 Act would still determine the value of the land, but as landowners would no longer be able to benefit from the uplift, the market value itself would remain at levels closer to the original value of the land before it appears in a strategic plan for development.

Devolved government: the acquiring authorities for strategic developments

The governance structures for exercising CPO as a deterrent already exist in the form of Metro Mayors, development corporations, combined authorities, and the closer working between local authorities developed by successive devolution policies. The public interest case for compulsorily acquiring land, as outlined above, is strongest when development is carried out at scale. Furthermore, regional infrastructure projects are best undertaken by bodies covering a functional economic area. Devolved governance structures which cover functional economic areas and cross existing local authority boundaries, such as combined authorities, are therefore the ideal mechanism through which to identify schemes for strategic development.

Conclusion

The way land is currently valued for CPO compensation diverts the majority of land value uplift that occurs as a result of public investment and changes in planning permission to landowners and traders – long before development actually takes place. Landowners who have not sought planning permission or indicated any intention to develop their land benefit financially from the fact that their land appears in a strategic plan for development. An outlier approach amongst developed economies, “hope value” CPO compensation delivers land into schemes at highly inflated prices. At best, this forces compromises on quality and affordability, as acquiring authorities sink public investment into expensive land purchases. At worst, it renders projects unfeasible, stopping the UK from building the infrastructure and homes we need.

The Government can bring the UK in line with international best practice by unlocking the capacity of CPO policy as a deterrent against speculative land trading. The Government has taken important steps to clarify and simplify the rules around CPO, and has created devolved structures well-placed to acquire land for strategic developments in the public interest. The special CPO compensation code proposed in this paper will provide strong incentives for public and private landowners to co-operate with plans for strategic developments, and will ensure that land is released at values that guarantee the viability of projects. These measures would give acquiring authorities a powerful new tool, and a funding stream of £8.6 billion a year, for delivering new infrastructure and affordable, high-quality homes.