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PLANNING UPDATE
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THE INFRASTRUCTURE LEVY TECHNICAL BRIEFING NOTE: ALL A LITTLE FIDD-IL-Y

Summary

1. Land capture, planning gain and the funding of infrastructure remain a key area of contention and complexity for the planning system.
2. Periodic attempts to secure more of the perceived increase in land value realised by the grant of planning permission remain a semi-permanent feature of the planning reform landscape. The increasing reliance of development, and developers, to fund both affordable housing and other forms of infrastructure simply exacerbates the sensitivity of this issue.
3. The latest iteration of this reform is the proposed Infrastructure Levy ("IL"), on which the Government is currently undertaking a technical consultation. The framework for the IL has been set out in the Levelling Up and Regeneration Bill, which is currently making its way through the House of Lords. In its simplest conceptual form, the Government proposes to (largely) replace the existing Community Infrastructure Levy, which is based on a £/sqm basis on new development, with a compulsory charge based on a percentage of gross development value.
4. Whilst adopting CIL is optional for local authorities, the IL will be compulsory.
5. A summary of the proposed differences between CIL and the Il is set out in Table 1.
6. If introduced as proposed, IL would be one of the most significant changes to both the planning system and economic and fiscal context for development in recent decades. However, the current Government intends to introduce it gradually, over the period of a decade, with the earliest schedules in place late next year at best.
7. Labour have, conversely, suggested that a Labour Government would not proceed with this reform. Local authorities have, generally, also expressed concern.
8. As is always a theme with planning reform – especially in the UK in the 2020s – the IL still has a considerable gauntlet of political uncertainty left to run. Further change to the proposals, not least from a potential change of government, therefore remains.

CIL	IL
Optional	Compulsory
Cannot be used for affordable housing	Can be used for affordable housing
Cannot be used for revenue funding	May be used for revenue funding
Paid at implementation, or soon thereafter	Paid before occupation, balanced at conclusion of development
£/sqm charge	%age of GDV above a threshold
Works alongside s106	Retained s106, but reformed and more limited scope
Borrowing position unclear	Borrowing permitted from Public Works Loan Board ('PWLB') against income stream

Table 1

Proposals

9. The proposed new system is complex, and the technical consultation, in some areas, raises more questions than it answers. We set out our understanding of the proposals.

10. Local authorities would adopt an Infrastructure Delivery Strategy, which would be independently examined and tested. This would set out a strategy for how IL would be spent on providing infrastructure.

11. Local authorities would also set out a charging schedule, as with CIL. This would need to address a range of rates, with rates (that is, the percentage of GDV sought by the IL) varying by land use and location within the authority's area.

The consultation indicates rates should be set to balance the objectives to capture land value uplift whilst ensuring that development remains viable. The consultation suggests that a premium above existing use value should be allowed to ensure landowners remain incentivised to release land. A buffer is also proposed to allow for some flexibility. Additionally, the local authority would need to set a "minimum threshold", which is envisaged as a £/sqm rate, below which IL would not be charged. These rates will be locally determined, rather than set nationally or regionally.

Example

If the "minimum threshold" was £1,500/sqm, and GDV was £2,500/sqm, the levy percentage would be charged on the £1,000/sqm above the minimum threshold. The examples in the consultation suggest a charge of 33% for new floorspace.

12. To add further complexity, the consultation also envisages that different rates would be applied to new floorspace, existing floorspace and floorspace that is being replaced.

13. Table 2, below, illustrates the rates and thresholds potentially required:

	Office	Retail / Leisure	Residential
"Standard" rate	%age GDV	%age GDV	%age GDV
Regeneration Rate - applied to repurposed floorspace	%age GDV – perhaps 0%?	%age GDV – perhaps 0%?	%age GDV – perhaps 0%?
Regeneration rate - applied to demolished floorspace	%age GDV	%age GDV	%age GDV
Minimum Threshold	£ / sqm	£ / sqm	£ / sqm
Minimum Threshold - Existing use	£ / sqm - likely to be higher values	£ / sqm - likely to be higher values	£ / sqm - likely to be higher values

Table 2

14. These could in turn vary by geography within a borough.

15. The minimum threshold would be set, within the charging schedule, to allow for build costs and account for the value of land in its existing use, with values achieved over that threshold then being subject to the appropriate levy. The consultation now envisages that this minimum threshold would be indexed against cost price inflation. The concept being that this would enable the Levy to be charged on the increase in land value created by a development.

16. The consultation envisages that the rates could be introduced at a low initial level and then automatically stepped up over time.

17. There would be three stages to charging the IL:

    - At planning application stage, a provisional estimate of IL liability would be calculated, based on either an agreed valuation or generic values for the charging area, to give some indication of the likely IL receipts.
    - After permission is granted and commenced, but before occupation, a provisional calculation would be made, based on an independent valuation, including price paid for any affordable housing. This would need to be paid before occupation to remove occupancy restrictions.
    - Post completion, a final adjustment payment would be made, to reflect the actual market value achieved, or a valuation to establish GDV. This could be from the developer to LPA, or vice-versa. The consultation indicates that the arrangements for more complex sites, and those where the asset would not be sold, will be left for the detailed regulations.

18. Local authorities would be able to exercise a "right to require", whereby they could specify, in the Infrastructure Funding Statement, a proportion of IL receipts that should be spent on providing affordable housing within individual developments. Again, the detail of the exercise of the right to require is unclear, but appears to be based upon using IL receipts to bridge the value gap between the market price for accommodation and the value to the Registered Provider. The Government has indicated that there would be a requirement for this to deliver "at least as much" affordable housing as the current system.

19. Infrastructure would be categorised as "integral infrastructure" and "levy-funded infrastructure". The latter would generally be provided as part of development proposals and secured through conditions, or if necessary a "Delivery Agreement", which may have similarities to a s106 agreement. The latter would be delivered by the local authority and paid through IL receipts. The distinction between the two types will be addressed through "regulations, policy and guidance" – but this will no doubt remain a key source of contention and uncertainty.

20. The role of s106 would change, but it would not be completely removed, with some provision remaining to use it for "matters than cannot be conditioned for", which we anticipate may address matters such as biodiversity net gain, carbon offsetting, public realm works and other, non-financial, commitments. In some instances on the "larger and most complex" sites s106 could be used to deliver infrastructure as an in kind payment of the Levy. In some instances, such as minerals or waste, the IL may not apply and s106 would remain as it does at the moment.

21. Neighbourhood areas will continue to receive a share of IL, in a similar way to CIL.

22. Within London, IL would operate in parallel with the Mayor's Crossrail 2 CIL charge, requiring developers and local authorities to manage the two systems in parallel.

23. The Government suggests that, by charging the IL on the basis of final sale, the effect of changes to permissions, for example through s73 applications, will naturally be captured in the final sale value.

Considerations

24. Complexity. The complexity of the proposed system is a key concern. Whilst the changes made since the informal technical consultation last year to attempt to address the issue of retained floorspace by allowing for different rates to be set is welcome, this adds yet additional complexity, both from a valuation perspective when rate setting and in the calculation and agreement of potential liabilities. The uncertainties and complexities of CIL charging are well know, but CIL is based on a comparatively straightforward £/sqm charge; the complexities and resourcing requirements of a system based on GDV with multiple different rates being applied depending on the nature of the development and the approach to existing floorspace will multiply these concerns.

25. At a time when local authorities are already struggling in terms of resource, the complexity in respect of bringing forward an Infrastructure Delivery Strategy and setting the various IL rates may be a challenge for many local planning departments.

26. Re-use of existing buildings. Anything that disincentivises or adds further complexity or cost to the re-use of existing buildings, would, surely run contrary to the growing expectation that existing buildings are retained, retrofitted and reused, rather than comprehensively redeveloped. The potential inclusion of whole buildings within scope of the IL, rather than just new elements, could still lead to unexpected consequences and unnecessary complexity in the structuring of planning applications, especially if the rates and minimum thresholds are set inappropriately.

27. Use of GDV. Given the high GDVs of central London development, we remain concerned that application of the IL will have a disproportionate impact on development within the CAZ, especially if the rates are set inappropriately and / or if the design of the system does not properly take account of the marginal nature of development in central London, by addressing the uplift in floorspace and value created by development above the value of existing assets, rather than being charged on the GDV of the asset as a whole, even if this would only marginally increase above the existing.

28. Values vs cost. Concerns have previously been raised that a charge based on values, rather than profits, would leave developers exposed to considerable risk if costs increased but values did not. The consultation has gone some way to addressing this, proposing that the Minimum Threshold would be indexed against cost indices, although the Government still appears to struggle to distinguish GDV and profit, suggesting that basing IL on GDV at final sale would avoid the need for negotiations in response to changed market conditions. This would still rely on the minimum thresholds being set at the correct level at the outset, and developers would remain exposed to the lags between actual price inflation and updates to the indices, especially in inflationary climates .

29. Treatment of non-sale assets. Our impression remains that the concept would be best applied to greenfield sites, rather than more complex regeneration or urban development projects, especially where the final assets are held rather than sold. The detailed academic paper recognises that the "window" for seeking IL payments is largest on greenfield sites, with little benefit identified on brownfield sites. The valuation of non-sale assets, such as commercial buildings, will still require subjective valuation judgements rather than being based on achieved sales prices. This creates the risk of considerable uncertainty, until late in the development process, and for protracted valuation discussions.

30. Right to Require. The right to require is likely to raise further valuation implications, as establishing the opportunity cost between affordable and market values, especially in advance of sales, to establish the amount of affordable housing required, will require subjective valuation decisions. It is also unclear how the physical design changes to schemes that will be needed to accommodate the right to require housing will be provided. The effect of IL on developments delivered directly RPs, and the ongoing role of s106 in addressing matters such as nomination rights, is also unclear. Given the costs associated with new residential development in London, local authorities are concerned that there will be a reduction in the overall percentage, and number, of homes provided in this way.

31. Affordable housing and commercial development. Allowing IL receipts to be spent on affordable housing represents a key change from CIL. It is unclear from the consultation whether or not the Government intends that commercial, and other non-residential development would be expected to contribute to affordable housing in this way. It does not seem practical that the 'right to require' could be applied to commercial development sites that would not be providing residential accommodation. However, given the Government's intention is to capture developer surplus from development of all forms, it seems likely that rates would be set with the objective of maximising receipts from commercial development as well as from residential, even if the funds raised were then spent on affordable housing elsewhere rather than to support affordable housing delivery within the proposed development.

32. This is a key potential change in the economics of the delivery of commercial development. At present, affordable housing policy effectively seeks to maximise the delivery of affordable housing and uses viability testing to maximise the extraction of the perceived economic surplus. This approach is not currently taken to commercial development, as long as it can afford to pay the baseline CIL charges and any other local s106 contribution. The proposed IL could, therefore, lead to a substantially greater liability arising from commercial development than currently exists.

33. Balance of infrastructure and affordable housing. Considerable local authority concern has been voiced about the potential for the IL to lead to less affordable housing being provided, if the receipts are focused either on infrastructure provision or, indeed, backfilling the funding of other council services. Local authorities have also raised concern that the current process of viability testing does ensure that the maximum reasonable affordable housing is secured, up to the relevant policy requirement, whereas there may be some developments subject to IL where, if the rates are set too low, it will not achieve the maximum provision on all developments, especially higher value ones. In areas with a complex and varied market with high existing values, setting rates will be particularly difficult and local authorities have expressed concerns that IL's broader approach may capture less value than achieved by fine grained viability testing on a site-by-site basis.

34. Timing. Shifting the point of payment until later in the development process is likely to be welcome, to assist with cashflow. However, the lack of certainty on the final liability until after completion and sale – or the vagaries of a valuation for non-sale assets – will be a challenge and may affect developers' abilities to make other commitments such as the delivery of onsite – or "integral", in IL's terminology - infrastructure. Local authorities will face similar challenges in forward funding infrastructure (on which developers will be relying) without certainty on the funding that the levy will realise.

34. Statutory nature. As with CIL, the infrastructure Levy will be a creature of statute rather than planning policy. As has been seen with CIL, the statutory nature of the system will mean the scope for flexible solutions in unusual circumstances will be far more limited.

35. Integral and levy infrastructure. Distinguishing between integral infrastructure required from developers as part of development proposals, and the infrastructure to be funded through IL, is likely to remain challenging. In practice, given the pressure on local authority finance and the potential ability for local authorities to use IL receipts to contribute to funding wider council services rather than purely providing new infrastructure, pressure will remain on securing as much infrastructure as possible as "integral infrastructure." In central London, as at present, we anticipate that much of the public realm and highways improvements associated with new development will continue to be delivered as "integral infrastructure" rather than from IL receipts.

    Moving some of the infrastructure delivery into the hands of the Council (the 'Levy funded infrastructure'), and away from the developer, may also further exacerbate the relationship issues between developers and local communities through breaking the connection between good development actually delivering planning benefits for the community.

36. Transitional arrangements. The Government proposes to introduce the IL relatively gradually, on a 'test and learn' basis. This is welcome, given the complexity of the system as proposed. There are likely to be significant market distortions created, however, both through the time required for land prices and expectations to potentially adjust (insofar as they will) to a greater tax requirement and if different approaches to IL are taken in different boroughs, especially if they are close to one another or in the same functional market. For example, were one central London borough to impose IL early and create a substantially greater, and more complex, liability as a result, it is likely to significantly discourage development and investment in that borough, in favour of other adjacent areas where the IL may be some years away.

Next Steps

38. The IL **consultation closes on 9 June**.

39. Once the Levelling Up and Regeneration Bill has received Royal Assent, the Government will prepare the secondary regulations on which the operation of the IL will depend. It has indicated that there would be further consultation on these regulations.

40. There would then be a rollout over a decade, although the "test and learn" authorities would aim to have charging schedules in place by late next year, with developments being charged in 2025 or 2026.

41. The IL would, therefore, have a transformative effect on the planning system and the economic context for development, but very considerable uncertainty remains at this stage as to what, if anything, will actually emerge..