# Executive Summary

Knight Frank LLP was commissioned by a pan-industry alliance comprising the British Property Federation (BPF), the Confederation of British Industry (CBI), the Home Builders Federation (HBF), and the Royal Institution of Chartered Surveyors (RICS) to carry out independent research on how Planning-gain Supplement (PGS) would work in practice, including its effect on individual schemes and financial viability.

The Treasury and Department for Communities and Local Government published a consultation document on Planning-gain Supplement in December 2005. PGS, described as a *'fair, efficient and transparent levy',* is meant to take forward recommendations made by Kate Barker in her independent review of housing supply in 2004. Barker proposed a Planning-gain Supplement as one method of overcoming shortcomings to the planning obligations system and challenges for infrastructure provision, both limiting housing supply.

The characteristics of PGS, as set out in the PGS consultation document, prompted concern amongst property developers and wider business interests that have significant interaction with the planning system. Considerable uncertainty remains regarding the proposals for PGS and the form a future arrangement for PGS might take. The Government received over 700 responses to the PGS consultation document, very few of which are in the public domain. Nevertheless, there is little empirical evidence of how PGS would impact on the actually viability of different types of development.

From July 2006 to September 2006, Knight Frank Planning carried out research on the impact of PGS on examples of property development. We appraised eighteen case studies for the effect of PGS, together with a number of interviews with developers and land owners to identify possible market responses to PGS should it be implemented. The case studies consist of 9 residential developments, 7 mixed-use developments, 1 industrial development and 1 example of mineral extraction.

Excluding householder applications, which make up roughly half of all planning applications in each year, it could be expected that PGS could apply to over 300,000 planning applications in any year. However, the payment of PGS will only be triggered on implementation of planning permission, and therefore it is less clear how many development schemes would be affected by PGS. PGS will result in the creation of a wider tax base for contributing to the funding of local and regional infrastructure by raising infrastructure funds from across a wide range of developments.

PGS would have a considerable and variable impact on the selection of developments we have studied. Our main findings are as follows:

1) ***The findings suggest that the planning-gain supplement as proposed at a modest rate and a scaled back Section 106 system, may not result in the necessary additional funds for local and strategic infrastructure to support housing growth, as envisaged in the PGS consultation document.***

The total planning gain contribution of all eighteen case studies under the current Section 106 system is approximately £375 m. Under a scaled back Section 106 system, together with PGS, planning contributions would be approximately £195m for a PGS rate of 10%, £279m for a rate of 20%, and £363m for a PGS rate of 30%. Overall, for this selection of case studies, this represents a reduction in planning gain, in relation to the case study examples included in the research, of 48% for a PGS rate of 10%, 26% for a PGS rate of 20%, and 3% for a PGS rate of 30%.

This result is drawn from our case studies. However further research might show that the increased funding generated from small scale developments taken at a modest rate, that might pose less of a threat to the viability of such schemes, could compensate for the loss of community infrastructure funding from the large scale developments. If not, then there would be pressure for a higher rate, which might push many smaller schemes into non-viability, thus requiring substantial funding from other government sources to meet the shortfall. Given these uncertainties, it is clear that extensive further research is needed to achieve sufficient public confidence that PGS would work effectively and meet the required increase in housing output. At present it is not clear whether this would be the case.

2) ***The impact of PGS on developments would be variable. In financial terms some developments would "benefit" from lower planning gain charges overall, whilst others would "suffer" a greater planning gain charge, when taking both the scaled back Section 106 contributions and the PGS charge into account and comparing this with the current Section 106 deals that are negotiated*****.**

It is not simply the case that all development would face a higher development tax burden were PGS to be introduced. The rate of the PGS charge would influence the extent to which any particular development would contribute more or less planning gain than under the current Section 106 arrangements. This could therefore be a significant factor effecting individual development viability, but will vary from case to case. It is not simply a matter that PGS would universally create an unsatisfactory tax on development gain.

3) ***Whilst relatively few in number, large scale urban expansion developments and large town centre developments would be likely to contribute significantly less planning gain with PGS and scaled back Section 106 agreements compared with current Section 106 agreements.***

At a PGS rate of 10%, 20% and 30%, the large scale urban expansion developments and large town centre development included as case studies in this research would (with the exception of one case at a 30% charge) have a reduced overall development tax burden, in comparison to the current Section 106 system.

Large scale developments, whether these are for urban extensions or major town centre schemes, currently contain planning gain packages comprising a significant amount of community infrastructure.

The current Section 106 arrangement, although contested and negotiated by developers and planning authorities, normally results in a planning gain contract that is viable to the developer whilst meeting wider community objectives. This approach is acceptable to developers on the basis that they retain some control over the delivery of the community benefits, since these will add value to the new development that is being undertaken. Under the PGS arrangement, this control would be lost as community benefits related to a site could no longer be negotiated under Section 106 agreements.

4) ***The largest impact of PGS is likely to be on relatively small scale development proposals compared with current arrangements. Our research indicates a possible adverse affect of PGS on schemes which have not had Section 106 agreements in the past, such as one example of industrial development. Minerals development would have to absorb the full impact of PGS.***

Certain types of development would be penalised by PGS through the imposition of additional costs, which would be offset by the reduction in Section 106 liabilities in other forms of development; one such example being mineral development.

***5) The calculation of the Planning Value (PV) is volatile, and to an extent subjective, with slight variations giving rise to the possibility of significantly higher PGS liability.***

Sensitivity analysis on the case study selection, where planning value was adjusted by +/- 5%, demonstrates the variability in the range of tax that could be raised at each PGS level. There is a potential difference of approximately £10m, £20m and £30m at the 10%, 20% and 30% tax rates respectively between the higher and lower sensitivity bands in relation to the eighteen case study examples alone. This small range of variation represents a fluctuation of 12% on the tax raised under each scenario. It is anticipated that in reality the variations in many assessments could be significantly wider. There is therefore likely to be considerable opportunity to mitigate the uplift in value in the preparation of self assessment to minimise PGS liabilities.

The significance of the sensitivity testing is that due to the way in which appraisals are cast to assess planning value, there are likely to be a range of value and cost inputs that might be applicable to particular development proposals. Future valuations of rents and sales prices are, inevitably, subject to considerable uncertainty. It is thus possible that there could be significant variations in the assessed planning value made by different valuers relating to the same property benefiting from the same planning permission. Thus there is likely to be a range of uplift in value, subject to PGS which may prove acceptable under the proposed self assessment method. In relation to development appraisals, making small changes to a number of variables can result in a wide range of residual value outcomes. The sensitivity testing simply illustrates how PGS payments might vary and indeed, the percentage change around a central figure could in fact be much larger than +/- 5% used in our case study examples.

***6) As proposed in December 2005, uncertainties in estimating the current use and planning values, upon which the PGS liability is assessed, would influence the behaviour of developers as they attempted to minimise PGS payments.***

It is possible to mitigate the uplift in value and hence reduce or increase the PGS payment that might be expected at a given rate of PGS. In the case of phased development, where there may be significant infrastructure or remediation costs, there may be benefits to developers in securing full planning permission for the entire development project and at least implementing part, triggering an assessment in relation to the whole proposal. The planning value, and consequently the uplift liable to PGS, would be reduced, compared with a more conventional approach whereby an outline permission might be first obtained followed by the grant of full planning permissions for phased development. This will need to be assessed on a case by case basis in order that PGS charges are mitigated.

***7) Enabling development will be more difficult to achieve with PGS and may harm the delivery of conservation and regeneration projects.***

There is likely to be a PGS down-side in relation to “enabling development”, where development value is used to cross-subsidise unviable development. This is likely to be the case, for example, where charities are involved in using their assets to provide enhanced benefits derived from property development.