Capturing Value

A London 2050 briefing paper
About London 2050

Designed partly to supplement the Mayor’s London Infrastructure Plan 2050, Future of London’s multi-part London 2050 programme looks at the spatial and practical aspects of accommodating growth. It started with an internal FoL Steering Group presentation, and expanded to a June 2014 session at City Hall: London 2050 – Grow up or grow out?

Capturing Value is the fourth in a series of follow-up events and briefings that look in depth at delivery and governance issues. This briefing paper is the follow-up piece to a senior roundtable on the topic, held on 10th December 2014 and kindly hosted by Arup.

Future of London has delivered three additional streams in the London 2050 programme:

Working Beyond Boundaries: Senior roundtable (26th September 2014) and follow-up briefing.

Delivering Infill Development: Senior roundtable (30th October 2014) and follow-up briefing.


#London2050

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ARUP

The senior roundtable at the core of this briefing was kindly hosted by Arup. Arup is an independent firm of designers, planners, engineers, consultants and technical specialists offering a broad range of professional services.

Regeneris

All briefing papers in the London 2050 series are available freely with thanks to Regeneris Consulting. Regeneris is a specialist economic development and regeneration consultancy that provides quality, research-based advice to clients across the UK in both the public and private sectors.

About Future of London

Future of London is an independent not-for-profit policy network focused on the challenges facing regeneration, housing, infrastructure and economic development practitioners in the Capital.

We are a borough-led membership organisation with a number of external partners, which provides top career development, expert-led policy research, and topical networking and speaker-led events.

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**Introduction**

Everything in the London Infrastructure Plan 2050 comes back to investment. Upgrading and building the systems required to accommodate London’s growth to 2050 could cost up to £1.3tn. This means almost twice the current expenditure by 2025, a gap which cannot be covered by the public sector. New mechanisms are needed – and the property market offers some avenues for exploration.

It’s no secret that London’s land and property values are climbing, and this is particularly true alongside the arrival of infrastructure. For example, GVA estimated that Crossrail could help create up to £5.5bn in additional residential and commercial value between 2012-21. These uplifts are felt directly by property owners, but not necessarily by infrastructure delivery agencies or other parts of the public sector.

This paper is about harnessing property value uplift to fund London’s infrastructure needs. It places the public sector at the centre of this discussion, considering how actors are already using existing powers and strategies – and what other mechanisms might offer. In concluding, the paper relates back to the London Infrastructure Plan in exploring what role value capture might have in meeting the Capital’s future infrastructure needs.

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**Practitioner views**

This briefing paper summarises and builds on a senior roundtable on the topic, hosted by Arup in December 2014. The diverse group of experienced practitioners who attended work across London’s public, private and third sectors.

This roundtable was a Chatham House discussion, meaning points raised during the event are not attributed here to an individual or organisation.

This briefing paper also includes attributed contributions from Neil Keogh, Adrian Lee, Toby Lloyd and Joanna Rowelle.
Why value capture?

‘Value capture’ is an umbrella term for mechanisms that harness property value uplift, where “the agency responsible for the development of [the] infrastructure captures part of the financial benefits gained by land developers or the community at large. This benefit is reflected in an increase in the real property values, which can be regarded as a comprehensive index of all the benefits generated by the development, including improved accessibility and an increase in business opportunities.”

Against the backdrop of a shrinking public purse and the localism agenda, infrastructure delivery agencies across the country are looking to property and development to part-fund their schemes. These projects range widely, from the HS2 Growth Taskforce’s recommendation to bring developments forward to capture increases in land value, to Government’s locally-led Garden Cities prospectus which stipulates that proposals need to “make use of the land value uplift to finance infrastructure”.

The London Infrastructure Plan 2050 consultation takes the same line, considering many mechanisms for returning property value uplift to infrastructure delivery bodies:

- **Charging mechanisms**: From tax increment financing (TIF) in Vauxhall Nine Elms Battersea to the raising of £4.1bn for Crossrail through a business rate supplement, innovative mechanisms are already being used. Other sources could include developer contributions, utility or other consumer bill surcharges, and targeted user fees.

- **Joint development**: Over-station development by or with the private sector is in the Crossrail business plan, while public company London & Continental Railways has played a critical role in the regeneration of King’s Cross and Stratford’s International Quarter.

- **Devolution**: At the heart of the 2013 London Finance Commission recommendations is the fiscal devolution of property tax revenue streams to London. More powers and freedoms here could support value capture mechanisms.

These points illustrate something critical. Although the language of value capture doesn’t often feature in London’s strategic planning documents, many applications can already found in the Capital. This fact, coupled with the diversity in mechanisms, means that it might often be more helpful to discuss specific interventions rather than the blanket idea of ‘value capture’.

What is also important to note in the examples presented above is the role that central government plays. Primary legislation was required to apply both tax increment financing and the business rate supplement, while railway property developers London & Continental Railways, once a private consortium, has been owned by the Department for Transport since 2009. The role of central government is an underlying thread in this discussion.

Lastly, value capture cannot be discussed without the temptation to ‘value the value’. Whether it’s in the infrastructure plan or elsewhere, ascribing precise amounts to value capture is complicated due to the breadth of mechanisms: any increase in business rates or council tax receipts from new developments could be considered value capture, as could the Community Infrastructure Levy or Section 106 contributions. For this reason, this paper does not attempt to monetise value capture, instead focusing on the potential application of its mechanisms in London.

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Q. Should the public sector be bolder in employing value capture?

At Future of London’s event, practitioners overwhelmingly agreed that the answer was yes – but that didn’t mean there was necessarily agreement on how...

For example, in its June 2014 publication Garden Cities: Breaking new ground, Savills put forward the graphic below.

It suggests different avenues for greenfield housing development and infrastructure – while also stipulating that “the assumption that all Garden City infrastructure can be funded from land value capture is heroic”.

Another candidate for funding through value capture – at least in conjunction with other tools – is Crossrail 2. In December 2014, Mayor of London Boris Johnson told the Evening Standard “we think [with] the uplift that you’ll see in... property values as a result from Crossrail 2, we’ll be able to fund that project”.

Johnson’s comments followed the release of the November 2014 Crossrail 2 Funding and Financing Study.

The report found that while relatively little of the project’s funding needs could be raised directly through value capture from land and property value uplift, over 50% could be raised through project-generated revenue, a business rates supplement, an enhanced and doubled Mayoral CIL, resale of land and property and a council tax precept.

BRINGING FORWARD LAND

- **Land purchased at existing use value:** would require CPO
  - Value uplift captured to repay debt and fund infrastructure. Principle embodied in the New Towns Act
  - Diminishes the need for public subsidy but would not incentivise landowners to bring forward land willingly

- **National competition:** to encourage landowners to bring forward land willingly
  - Competition would test the market. Competitive element could drive down prices so that gains from value uplift can be used to fund infrastructure
  - Local authority housing targets should add up to 240,000 homes per annum

- **Landowner retains a share in the project**
  - Could complement competitions: landowners benefit from rising land values over the longer term
  - Deal structured via New Town Development Corporations

Practitioner view
Toby Lloyd

The public sector absolutely should be bolder in capturing value – both by using existing mechanisms and developing new ones.

The primary existing value capture mechanism is the use of planning obligations – Section 106 agreements. These have been used very effectively to secure affordable housing and infrastructure contributions by some authorities, particularly in London, but barely at all by others. The strength of Section 106 is its flexibility, as each agreement is negotiated separately as part of the planning application process, which allows the contribution to be carefully tailored to the needs of the particular place and time.

But this flexibility is also its weakness: if developers do not have certainty as to how much contribution they will have to make, they cannot accurately factor these costs into their appraisals when deciding how much to bid for the land in the first place. The successful bidder is likely to be the one that expects to make the least contribution, and hence expects to have the highest ‘residual land value’ to offer the landowner. This makes negotiations protracted and fraught, and makes development highly vulnerable to even small market shocks, which can render developments ‘non-viable’.

To make Section 106 – or other planning-linked value capture mechanisms like the Community Infrastructure Levy – more effective they need to give developers greater certainty upfront. That requires the authority to set a clear policy and to stick to it strongly. Sadly the Growth and Infrastructure Act 2013 took the opposite approach, and gave developers the right to appeal S106 agreements on the grounds of viability. As we argued at the time, while this may improve the short run viability of a handful of current schemes, in the medium term it can only increase uncertainty, push up land values and reduce the ability of authorities to capture value. Affordable housing provision has fallen sharply since.

The justification for these provisions of the act was that property values had fallen since 2008, rendering existing agreements unviable. Now that values in London are well above their previous peak this fatal weakening of the main value capture mechanism open to public authorities must be reversed.

Section 106 can be effective at capturing a portion of planning gain, but the real prize is in capturing development gain itself – and here new powers could be useful. In our programme for the next government, Shelter and KPMG call for authorities to be given powers to create New Homes Zones – integrating land assembly, proactive planning and investment to get major development sites moving and capturing the development gain for the benefit of the area and the community. Drawing on successful models from Germany, the Netherlands and elsewhere, this approach effectively freezes land values very early on in the development process, so that the bulk of development gain can be captured by a powerful development corporation or partnership, and used to support infrastructure and affordable homes.

Yet since the 1970s, case law has critically undermined the power of compulsory purchase, by enshrining the principle that landowners are entitled to the full ‘hope value’ of a site. In London, hope value tends to be huge, for obvious reasons. This means landowners can and do hold out for maximum cash value, drastically reducing the efficacy of public-led land assembly. Reforming the land compensation code would change these incentives, encouraging landowners to invest their assets to benefit from the long term value gain, and enabling a much higher degree of value capture.
Practitioner view
Adrian Lee

Value capture mechanisms for transport infrastructure may well be appropriate in existing high-value areas; however, in regeneration zones there is a risk that it actively hinders regeneration by siphoning off value that would be better used for other community infrastructure. Transport projects should be justified on a transport case in the first instance, together with any additional economic benefits they deliver, and should be funded accordingly. There is a risk that the desire to share in development value skews decision making.

The suggestion that compulsory purchase orders are the route to claw back value is also fraught with moral hazard – the compensation payable to landowners when transport infrastructure diminishes the value of their land (as is often the case for much transport infrastructure which is often ugly, noisy and causes severance) is relatively paltry, so for the state to then take increased value seems a little hypocritical. Furthermore, disaggregating the impact of a particular project from other value-influencing factors is not always easy.

A better solution is for a project to seek a commercial position (such as by buying adjoining land) which sees the project share in both risk and reward over the long term.

Practitioner view
Joanna Rowelle

The public sector are navigating some very difficult times, so whether or not they should be ‘bolder’ depends on their situation and their ability to raise capital or revenue through their assets.

There are certainly encouraging examples from both the UK and globally about mechanisms which have been very successful in delivering city-wide and region-wide benefits.

Devolution is one resolution to this and certainly our major cities are moving towards greater powers, which is a bold and encouraging move. Cities which generate high levels of wealth for the exchequer should have the ability to take funding decisions locally because they have the intrinsic knowledge about what residents want and what business leaders need to deliver for the growth and success of their cities.
Harnessing property value uplift isn’t just about income streams or contributions from private-sector development; it also applies to public-sector assets. Organisations across London are putting their assets to work to raise new income: as an example, over 8% of the GLA Group’s extensive land and property portfolio, mapped below, is either developed, in development, or being prepared for development.

At the same time, TfL is working on plans to develop 75 of its sites, which it estimates have a current land value of £1.9bn.

The appetite to get involved is certainly there. Witness the clamour to get onto TfL’s framework, as more than 50 developers compete to partner on 50+ projects across the organisation’s 5,700-acre property portfolio. With a property advisory group chaired by Land Securities’ former chief executive Francis Salway and support from Deloitte Real Estate, TfL’s commercial property arm has jumped in at the deep end of development.

In a sense, it must, with a goal of contributing £1.1bn towards TfL’s target of £3.4bn in non-fare revenue by 2025. The funds are to be reinvested in the transport network while keeping a handle on fares – and with London’s demand for public transport set to double by 2050, TfL’s assets will have to work hard to help cover costs.

GLA Group assets across the Capital

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**Practitioner view**

Toby Lloyd

Public landowners are generally no different from private ones, and seek maximum cash value for their assets in order to support their public duties.

Instead, public authorities should be more willing to retain their assets rather than sell them, or transfer them to development partnerships or corporations in exchange for long term equity stakes, rather than sky-high cash values.

Joanna Rowelle

The public sector has been experiencing significant challenges through austerity measures over the past number of years, and into the future. Value uplift from the property assets they own could assist with both capital and revenue generation for local authorities.

Disposal of land is one solution for generating income as an interim solution to funding gaps, but there are also long-term approaches to generating value which could be advantageous.
In April 2014, Future of London released Crossrail as Catalyst, a major publication which examined how regeneration and development were being delivered around Crossrail 1 stations across London. Throughout that research, interviewees routinely pointed to international best practice in funding infrastructure through property.

This practitioner and policymaker appetite to learn from other global cities was also considered in the Crossrail 2 Funding and Financing Study. There, eight major transport schemes currently in development in other major cities were considered.

These projects and their funding and financing mechanisms (both considered and applied) are illustrated below.

The Atlanta BeltLine is particularly interesting, since this holistic plan for rail, road, trail and park infrastructure is to be paid for by a cocktail of taxes and fees tied to development, tourism, consumer goods – as well as car ownership, a highly contentious issue for Americans.

Atlanta and Paris also use visitor levies. Linked to land values through the cost of lodging, these levies and other room taxes are a way to extract value from a city’s attractiveness. With an average hotel occupancy rate of 81% in 2013, London might risk a small levy for infrastructure services used by visits, such as water, waste or public transport.

### How are other global cities funding their infrastructure projects?

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Information sourced from: Crossrail 2 Funding and Financing Study
Base map: Wikimedia Commons.
Practitioner view
Toby Lloyd

London is unique among world cities for the paucity of its ability to raise taxes directly – a major weakness in its ability to capture value. Around the world, cities and local authorities rely on property taxation in particular to fund themselves, which also has the benefit of creating direct incentives to promote development and value growth.

Increasing London’s ability to use taxes to capture some of the uplift in property values created by development and economic growth would help to fund the infrastructure and affordable homes the city so desperately needs. There are many options for property tax reform that could be beneficial: at the least, there is a strong case for giving London a greater share of the Stamp Duty receipts collected in the Capital.

Practitioner view
Neil Keogh

Growing global demand for infrastructure, driven by an increasing population, is putting pressure on current financing mechanisms such as direct government funding and public-private partnerships. The fact that the world needs infrastructure as a tool to stimulate economic growth in a post-recession climate makes this even more of a problem. So what can we do?

As a start we need radical change in the way current funding systems function – to enable new infrastructure to be delivered in innovative ways.

New York City is an example of what can be achieved when public authorities take a radical approach. The Hudson Yards redevelopment uses tax increment financing (TIF) to capture future tax revenues associated with the new development, using this to pay for the 7 Line Subway extension.

While TIF mechanisms have been used in the UK, notably to fund the Battersea extension of the Northern Line, there are inefficiencies in the process due to the centralised nature of government. In contrast, New York City demonstrates that devolving financing powers to city authorities can make this process more flexible and efficient, removing the complexity of central government processes and giving the decision making powers back to the city most affected by the project.

The Hong Kong Mass Transit Railway (MTR) also employs an innovative model. It follows the concept of ‘value capture’ and buys land adjacent to future rail lines from the government at pre-development prices. Once the line is built and the land alongside developed, they capture the growth in value of that land through leases and other mechanisms, using it to fund rail operations. The MTR is one of the only underground mass transit systems that is able to cover all of its costs unsubsidised. The success of the MTR strategy highlights the weaknesses of traditional infrastructure financing mechanisms, especially for transport proposals.

There is a limit to the application of these models. They rely on higher land value and liberal planning. What happens when land value is low? In these instances a change to the status quo is required to stimulate private investment. Nothing is a better example than the High Line in New York City, a repurposed disused railway that catalysed the revitalisation of West Chelsea, which led the local government to pursue a re-zoning plan that attracted private investment.

How do you create a system that allows local authorities and private capital to do what is typically done by the state? Can we leverage private sector investment in a more intelligent way and reduce the costs of financing? Governments need to be more ambitious in addressing the world’s infrastructure requirements, implementing radical change in public authorities and giving them greater freedom to apply innovative financing mechanisms for much-needed infrastructure development.
Implications for London 2050

Determining the Capital’s infrastructure needs over the next 35 years has been a major undertaking for the London Infrastructure Plan 2050 – but that is only part of its purpose. The team has also been tasked with costing what is required and determining how to – and who should pay – for the necessary infrastructure.

With estimates surpassing the trillion pound mark, the plan recognises that funding will need to look well beyond the conventional public purse. As set out in the figure below, a combination of linked measures will be critical to sustain investment. These measures are wide-ranging, from increasing efficiency using better data and integration to creating attractive opportunities for private capital.

Value capture is part of the mix. The plan’s consultation document is clear on its position: the Capital should do more to capture property value uplift generated by infrastructure. It cites analysis from the London First Crossrail 2 Taskforce, which suggested Crossrail 1 could generate additional property tax revenues with a net present value of £2.4bn. Almost all of this revenue is accrued by Treasury, while none of it was taken into account to fund the scheme.

The plan could change this experience, with the GLA hypothesising that “while the effect on property values will differ for each project, we have made here a crude assumption of a similar impact from all other new transport investments to illustrate the potential of this contribution to funding. Taken prudently as only 5% of total new transport investments, £23bn could contribute to the funding package for London infrastructure – but only if property taxes were devolved.”

This property tax caveat gets at the interrelationship between these measures, and echoes the familiar call for fiscal devolution. In the two years since the London Finance Commission spearheaded the campaign, many have signed on to the merits of more spending powers for London, including other core cities also championing devolution. This momentum, however, has not yet resulted in fundamental change.

The close link between devolution and the infrastructure plan is underpinned by a shared rationale: more certainty in planning for growth is critical for the city’s success. The London Infrastructure Plan will do its part quantifying need and setting out strategic spatial and fiscal approaches; from there, this plan will need to be as much a call to action for policymakers as it is a strategy document for London’s practitioners.

The London Infrastructure Plan 2050’s web of mechanisms to close the funding gap
