

20 OCTOBER 2016

Infrastructure investment and land value uplift

Presentation to London
Finance Commission



EVERY JOURNEY MATTERS

Funding future transport investment

- Without alternative funding sources, such as land value capture, there is no obvious way of funding major network upgrades and extensions, such as Crossrail 2
- Substantial investments in transport and regeneration are required
 - London's population is growing and people are using public transport more
 - TfL needs capital funding for renewals and for new capital investment, to respond to anticipated increases in demand
 - London Infrastructure Plan 2050 (published 2014) projected £269 billion (2014 prices) of required capital expenditure by TfL from 2016 – 2050
- Traditional funding sources are scarce
 - There are funding pressures (and opportunities) – withdrawal of government operating grant; capital funding link to business rates devolution; need to grow non-grant sources of income; central government financial position
 - Limited property related funding mechanisms linked to transport; CIL/developer contributions are targeted at developers, business rates supplement targeted at high value non-residential rate payers



What is land value capture?

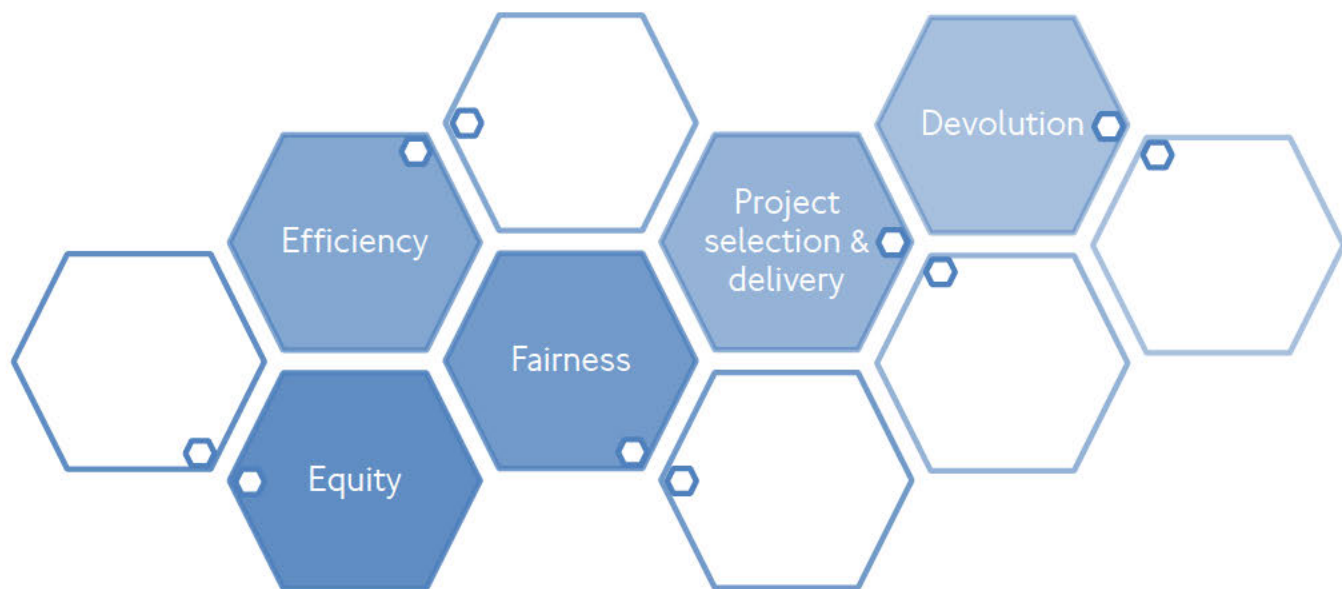
- A set of mechanisms used to capture some proportion of the increase in transport-induced land values that arise in the catchment areas of such projects
 - Needs a definition of the “zone of influence”
 - Needs a way of isolating the effect of transport on land and property values
 - Needs an extraction or capture mechanism
- Isolating the effect of transport on property values
 - Hedonic pricing
 - Controlled experiments
- Why does it occur?
 - User benefit capitalisation occurs because users compete for property near tube stations
 - Planning gain results from changes to planning policy (e.g. change of land use or density)
- LVC is not the same thing as tax increment financing (TIF)



Linking transport funding to land value capture

Extracting land value uplift catalysed to help pay for the catalyst

- Users place a value on public transport and the accessibility it provides
- If this value exceeds the cost to the user (ie through fares), the excess (consumer surplus) is capitalised into land and property values
- This materialises as higher prices for existing stock or is embedded in the value of new development
- Large positive externalities make it inefficient to capture this surplus through fares



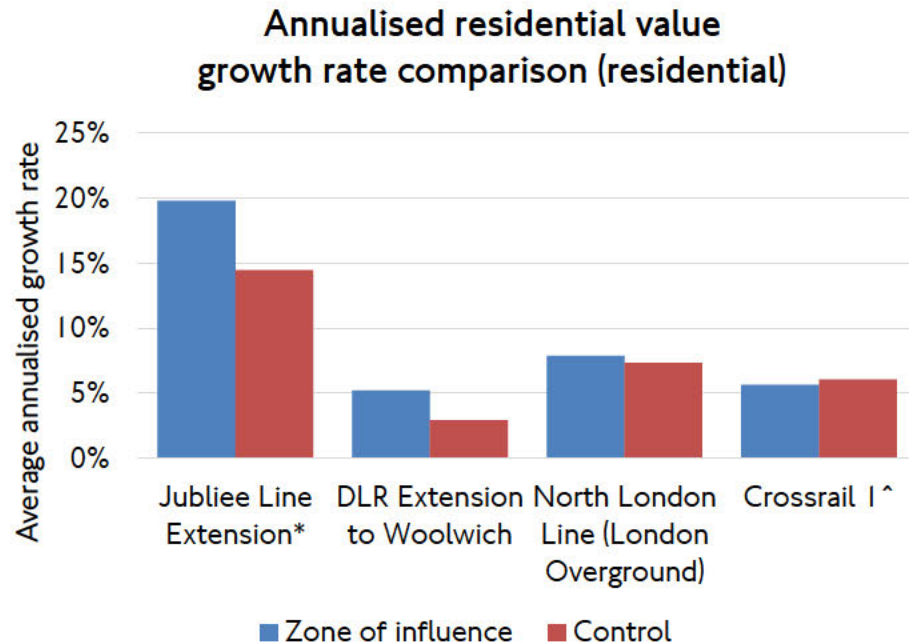
Land value uplift from transport projects

- **Value uplift:** A large number of studies point to value uplift, albeit with a wide transport premium range (-42% to 71%). Mohammed et al (2013) reviewed 26 studies:
 - 20 focused on residential, of which 16 found significant positive effects
 - 6 focused on commercial, of which all but one found positive effects
 - 2 studies focused on London, both positive (9% and 42-71%)
- **Gradient:** the “zone of influence” over which uplift effects decay
 - Effects on commercial premises decay much faster (500m) than on residential (1.5km). This gradient clearly exists in London property prices (see next slide)
- **Timing:** Some studies document a pattern where value uplifts are anticipated from the announcement of the scheme and continue right through the construction period
 - We have found this pattern in the Jubilee Line Extension, but not Crossrail
- **New development:** Little existing quantitative research on effect of transport on new development
 - Savills research for TfL shows significant positive effects of the JLE, North London Line (London Overground) and Crossrail 1 on density of new residential development in the zone of influence (relative to controls), but not for the DLR extension to Woolwich



Land value uplift from past London transport projects

Savills research for TfL shows value link; premia reduce with distance from node

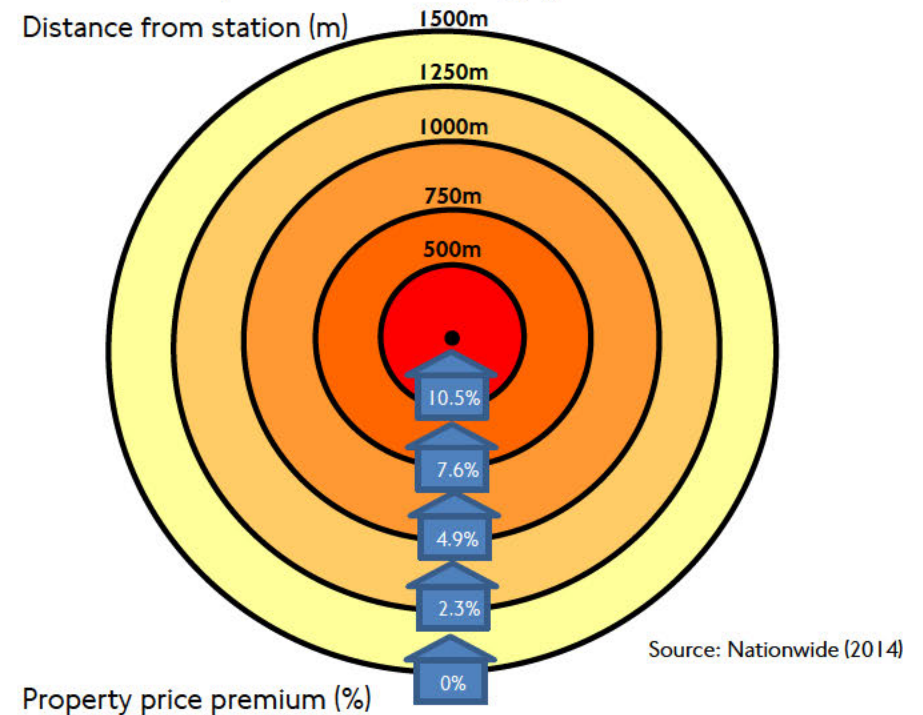


Savills analysis of HM Land Registry Data, 2016

Zone of influence: up to 500m from station; control: 1-2km from station

From 1 year prior to construction to 5 years after service commencement (* except JLE, for which data is only available from 1995 to 2004; ^and CRI, which is under construction). North London Line includes the amalgamation of existing lines, transfers to TfL and upgrades to the service, infrastructure and rolling stock.

Transport premium in London property prices (from mortgage data)



Results of analysis presented are preliminary and subject to further review, and should not be relied upon.

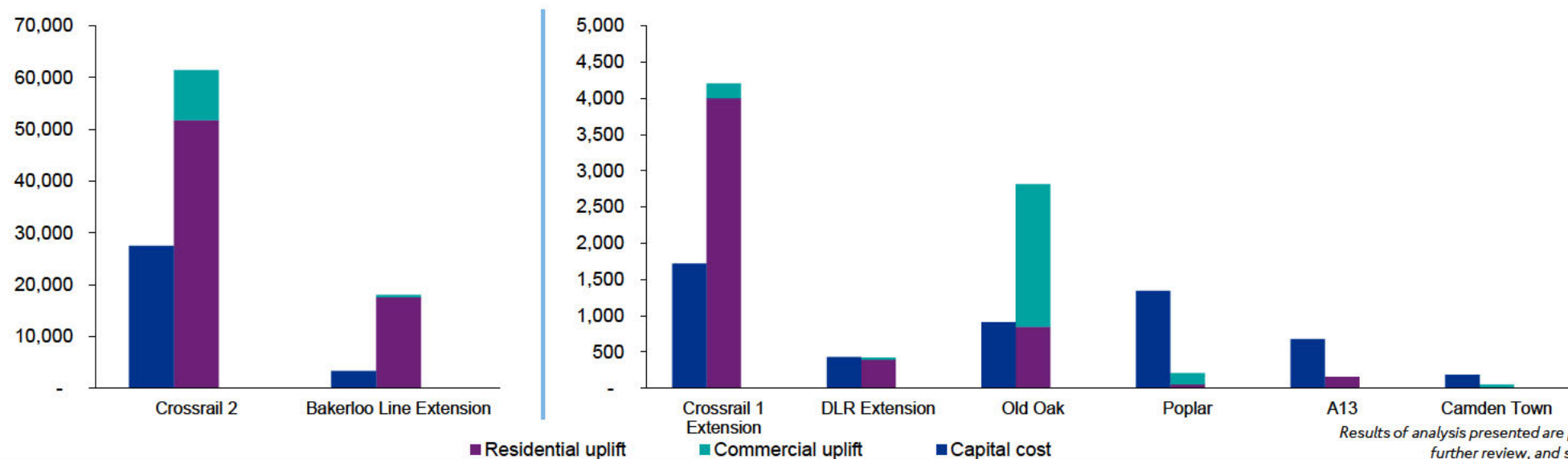


Significant uplift potential from potential future TfL projects

Approximately £87 billion of value uplift on sample of projects

- KPMG/Savills estimate total value uplift over 30 year period from FY19 to FY48 of £87.3 billion (PV in FY17 prices) on a sample of potential future TfL projects (compared to total estimated capital cost of £36 billion (NPC, FY17 price))
 - £74.8 billion from residential properties, £12.5 billion from commercial; £63.3 billion from existing stock, £24.0 billion from new stock

Comparing total uplift (FY2019 to FY2048) with capital cost (£m, PV in FY2017 prices)



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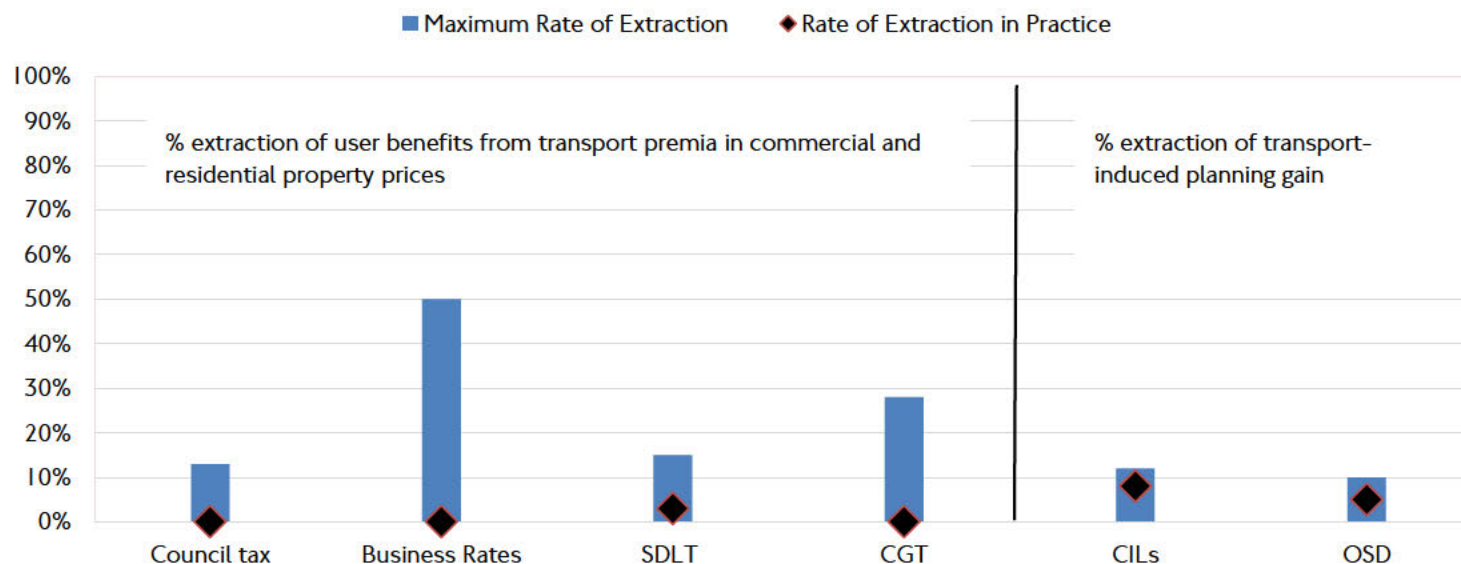


Most of the value created flows untaxed to landowners

Current mechanisms don't capture land value uplift effectively

- There are few taxes on existing stock respond well to increases in land or property values, and limitations to capturing value from new development
- Of the estimated £61.5 billion of uplift estimated to be generated by Crossrail 2, only ~2% of this can be captured through over station development (OSD) and Mayoral CIL

Maximum and typical rates of extraction of land value uplift using existing instruments



Options for improving value capture using property tax system

- Passive approach: link the general tax base to land or property values
 - Capital gains tax
 - Stamp duty land tax
 - Business rates
 - Council tax
- Active approach: create a specific tax base, based on a measure of land value uplift in each location
 - Supplemental charges



Options for improving value capture from planning gain

- Higher or better development taxation
 - Zonal CILs
 - Zonal planning gain supplement
- Enhanced Direct development
 - Strategic land acquisition
 - Land pooling
 - Compulsory purchase
- Hybrid methods:
 - Development rights auction model



How land value capture fits in with LFC priorities



- Significant benefit flowing untaxed to private landowners as a result of public sector investment
- Limited current ability for public sector to capture this benefit
- Value capture proceeds can be used to fund the transport project itself and/or support regeneration investment
- LVC may be necessary to fund future transport and regeneration

London Finance Commission



Business Rates Reform



- Devolution of SDLT and council tax reform would increase passive land value capture
- Powers to introduce new levies and charges would improve ability to implement active LVC mechanisms
- Business rates reform (regular revaluations and revaluation growth retention) would enable more efficient LVC without raising tax rates





Contact

TfL Commercial Finance

[REDACTED]

[REDACTED]@tfl.gov.uk

020 [REDACTED]



Rt Hon Philip Hammond MP
Chancellor of the Exchequer
Her Majesty's Treasury
1 Horse Guards Road
London
SW1A 2HQ

Date: 27 January 2017

Dear Chancellor,

Devolution: a capital idea – the report of the London Finance Commission

I am writing as Chair of the London Finance Commission and am delighted to enclose a copy of our report – *Devolution: a capital idea*, launched officially today at City Hall. The Commission was reconvened last year by the Mayor for London, Sadiq Khan, to improve London's tax and public spending arrangements in order to promote jobs, growth and greater equality. This builds on the Commission's work in 2013 under the previous mayor, Boris Johnson.

The Commission has restated the core economic and democratic arguments in favour of fiscal devolution: that it embeds a powerful economic incentive at the heart of local decision-making and makes local representatives more accountable to Londoners. This is in line with the Government's own rationale for strengthening the fiscal powers of the devolved parliaments and moving to 100 per cent retention of business rates in England. It is also aligned with the Government's ambitions as set out in the recent Green Paper, *Building our industrial strategy*. The consultation recognises that the UK is one of the most centralised countries in the world and that the local context is critical to addressing long-standing issues of productivity, skills and competitiveness.

As *Devolution: a capital idea* makes clear, ensuring the future economic health of London is good for the country – when London grows, the UK grows. However, the Commission believes that the United Kingdom's vote to leave the European Union places additional expectations on London. As the most internationally focused part of the UK, London might expect to be more exposed to this uncertainty but also to be able to drive post-EU national growth through its leading global position.

Our report sets out a number of recommendations which, we believe, will deliver greater certainty for business, fairer and more efficient local taxes and a stable fiscal base to support long term investment in infrastructure and delivery of public services. Although we welcome the progress on business rate retention, our concern is that London's government will rely on a single source of income, one over which it has limited controls.

In order to utilise the value of business rates, retention needs to move to full devolution, alongside the other property taxes – Council Tax, Stamp Duty Land Tax, in particular. This will enable London's government to manage revaluations and ensure the necessary safeguards are in place to protect business. We believe that this will lead to a rebalancing of business rates across the country as the impact of London's property market on national valuations is reduced. In the longer term, it

would allow London's government to consider wider reforms, including using evidence from Land Value Capture pilots.

As part of our research, we commissioned the University of Toronto to update the international comparison work it carried out in 2013. This found that a broader range of fiscal controls would allow London to benefit from revenue growth from some taxes, revenue stability from others, and to pursue greater equity overall. A broader tax base available to local areas allows for greater sharing of the overall tax burden. Therefore, we have made the case for London's government to have a small hypothecated share of national taxes, such as income tax and VAT, in exchange for reducing the amount of grant from central government by an equivalent amount.

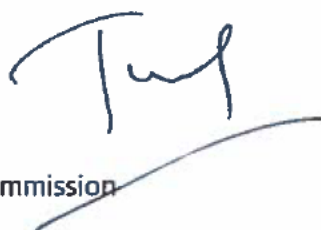
We believe there is much to be gained by the Government adopting a bolder approach to devolution in the capital, one aligned to the changes in the devolved nations and many other international cities. This includes permissive powers to introduce new taxes and to manage London's contributions to national levies. For example, we have analysed the potential for establishing a tourism levy which, we believe, could operate across the capital and other parts of the country. This could be used to enhance London's cultural tourism offer and would, we believe, carry broad support within the sector if mandatory. A similar argument is made on skills, where control of the capital's share of the apprenticeship levy would allow London's government to work with business to boost productivity and generate more higher-skilled opportunities for Londoners.

Finally, our recommendations will be fiscally neutral to national government (and in relation to all other parts of the country) on 'Day 1' of any reform. London's government will shoulder the risk of its devolved tax income; any growth in the yield will also be reflected across a number of centrally controlled taxes. London will continue to be a net fiscal contributor and an important driver of economic growth across the country.

The Commission is confident this report will carry broad support – across political parties, business sectors and the country. The Commissioners reflect this diversity and, in collecting evidence to inform our considerations, we held evidence sessions in London, Birmingham and Manchester. We also had a separate event in London for representatives from the capital's not-for-profit organisations and local communities. Many of the recommendations we make will apply to other cities and regions. We believe there is a unique opportunity to reshape the way government works, equip local areas with the tools to support innovation and economic growth and to strengthen local citizenship.

I would be pleased to discuss the report with you or your officials in due course.

With best wishes,



Tony Travers
Chair, London Finance Commission