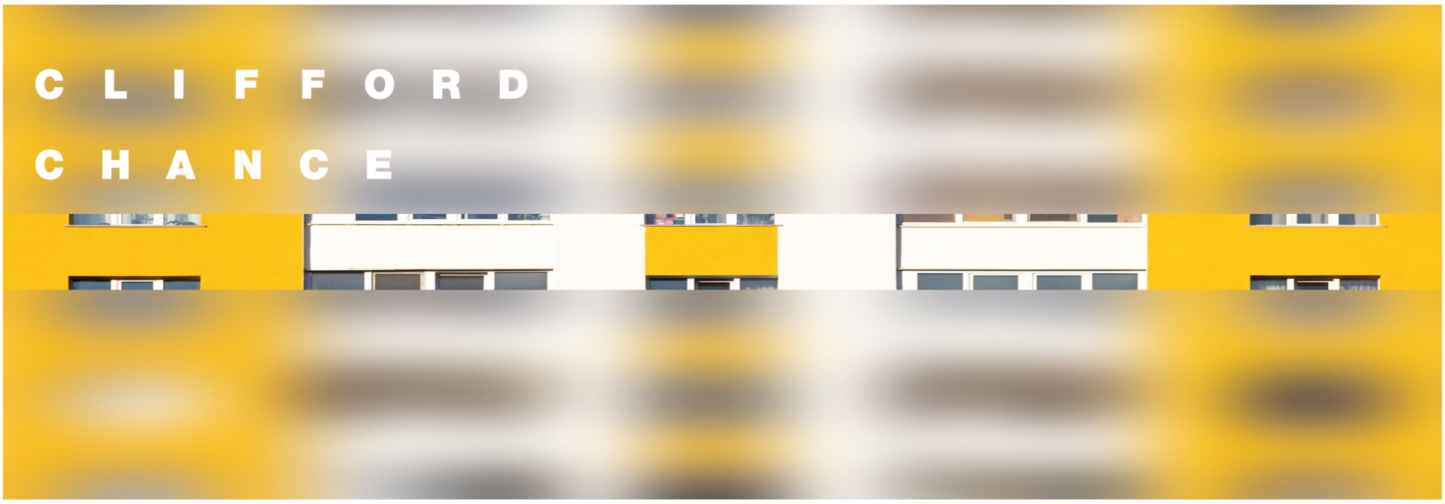

CLIENT BRIEFING: 10 QUESTIONS ON THE PROPOSED INFRASTRUCTURE LEVY

The Department for Levelling Up, Housing and Communities (DLUHC) has launched a technical consultation (the Consultation) on the proposed Infrastructure Levy to increase the infrastructure funding support that local authorities receive from real estate developers in England. Framework provisions for the infrastructure levy are currently included in the Levelling Up and Regeneration Bill which is currently progressing through Parliament. In this briefing we answer 10 key questions on the proposed levy.

1. WHAT IS THE INFRASTRUCTURE LEVY AND WHICH DEVELOPMENTS WOULD IT APPLY TO?

The Infrastructure Levy (Levy) has been proposed by the Government in order to create a mandatory and locally determined contribution by developers to infrastructure and affordable housing. The intention is that the Levy will replace Community Infrastructure Levy (CIL) and partially replace Section 106 Agreements. The Government believes the ability for developers to negotiate obligations in Section 106 Agreements has been a significant reason for inadequate provision of funding from the development industry to match infrastructure needs. Although introduction of CIL in 2010 is understood to have increased developer contributions, putting CIL in place was optional for local authorities, and around a third of them have still not done so more than 10 years since it was introduced.

The Levy will be a charge on development of real estate. It will be set by local authorities with intention of capturing more of the uplift in value created by grant of planning permission than is the case under the current combination of CIL and Section 106 Agreements. The idea is that Levy amounts will be factored by developers into the value of land, and therefore the amount they are likely to pay for it.

The Levy would in principle be applied to all types of development including permitted development, although different rates and thresholds might apply (See Question 2).

Key issues

- DLUHC has provided proposals for technical detail of a new Infrastructure Levy to replace Community Infrastructure Levy and partially replace Section 106 Agreements.
- This briefing considers ten key questions on the proposed levy:
    1. What is the Infrastructure Levy and which developments would it apply to?
    2. How will the Levy be set and how will levy liability be calculated?
    3. Will there be different rates for different development of different types or in different locations?
    4. Can infrastructure be paid in-kind by on-site works? What is the role for section 106 agreements?
    5. How will affordable housing be dealt with?
    6. Will there be any exemptions?
    7. Who will be responsible for paying the Levy and when?
    8. How will Levy proceeds be used?
    9. When will it come into force?
    10. What are the next steps?

2. HOW WILL THE LEVY BE SET AND HOW WILL LEVY LIABILITY BE CALCULATED?

Local authorities will set the parameters for the Levy in a charging schedule based on local circumstances (similar to the current CIL charging schedule), and this will be subject to consultation and public examination. A key principle will be that the Levy should secure necessary funding to pay for the infrastructure in a local authority's area made necessary by development, and provide at least as much funding under CIL, and affordable housing under Section 106 Agreements, as is currently provided, all while keeping development viable.

In basic terms, local authorities will charge a percentage that they choose (the Levy Rate) of the Gross Development Value (GDV) per square metre of internal area of completed development above a "Minimum Threshold". They will set the Minimum Threshold to take into account (i) development costs and (ii) the existing use value of land so that the Levy is only charged on the additional value created by development.

Calculating the Levy

Liability = internal area x (GDV - Minimum Threshold) x Levy Rate

Where Minimum Threshold = Actual use value + Development Costs

So, if the authority sets a Minimum Threshold of £1500 per sq m and Levy rate of 30%, and the GDV of the completed development is £2,500 per sq m, the Levy would be charged at 30% on the residual £1,000 per sq m of internal area over the Minimum Threshold. On a 10,000 sqm development this would lead to Levy liability of £3m. Choosing Levy Rates and Minimum Thresholds are likely to involve a delicate balance to avoid affecting development viability.

The final amount of Levy liability will be based on the GDV of the development *at completion* as reflected in sale prices or market valuation and may involve further payments or refunds of Levy liability. See Question 7 for the process for Levy payment. An appeal process similar to that for CIL will apply to an authority's assessment of Levy liability.

3. WILL THERE BE DIFFERENT RATES FOR DIFFERENT DEVELOPMENT OF DIFFERENT TYPES OR IN DIFFERENT LOCATIONS?

Clearly, development costs, existing use values and development profits will depend on many variables. Accordingly, authorities will be able to set different Levy Rates and Minimum Thresholds for:

- Greenfield / vacant land development, change of use development, demolition & replacement of floorspace;
- Different types of development (e.g. commercial or residential), and for different areas within their charging boundary; and
- Permitted development as against development under planning permission - the Government proposes setting a *cap* on Levy Rates and a *floor* for the Minimum Threshold for permitted development to constrain local authorities and minimise the likelihood of impacts on viability.

Levy Rates could, for example, be highest for greenfield development, and zero for replaced existing floorspace to reflect value uplifts from those different types of development. For mixed use developments, or those containing some greenfield development and some rebuild, the Levy and Minimum Thresholds would be applied separately, resulting in some complex calculations. Minimum Thresholds will be subject to indexation and, an authority's charging schedule may also increase Levy Rates over time, to avoid the likelihood of the Levy causing sites to become unviable.

Unlike CIL, there is not intended to be any option for discretionary relief on viability grounds. In a nod to the complex situations the proposal is seeking to cater for, DLUHC appreciates that the options available for rate setting may be insufficient in all cases to avoid viability problems (particularly for brownfield redevelopments), and calls for views on whether additional circumstances need to be catered for.

Levy Rates and Minimum Thresholds will only ever be able to represent a broad and average picture of actual development costs and existing land use values. However, the more granularity there is in the options set Levy Rates and Minimum Thresholds, the less likely there is to be major disparity when applying the Levy Rates and Minimum Thresholds to actual development scenarios (e.g. identifying that a developer's costs are much greater than those assumed in the Minimum Threshold for a particular type of development). This will be important since the only opportunity there will be to challenge Levy Rates and Minimum Thresholds will be upon consultation on, and public examination of the charging schedule, not when individual charging liabilities arise.

4. CAN INFRASTRUCTURE BE PAID IN-KIND BY ON-SITE WORKS? WHAT IS THE ROLE FOR SECTION 106 AGREEMENTS?

The Consultation notes that some infrastructure is typically required on site in any event from a functionality perspective (e.g. cycle park works, Biodiversity Net Gain enhancements, highway works). The developer will need to provide these and the cost will simply be part of the development costs for the site and will not be funded by the Levy (but should be factored into the authority's determination of Levy Rates / Minimum Thresholds). The Consultation labels this "Integral infrastructure".

Other infrastructure required as a result of local area growth to mitigate the impact of development (e.g. expanded health facilities or local road improvements) should be funded by the Levy or other contributions. The consultation sets out three "routeways" for making Levy contributions:

- ***Core levy routeway***: this will be the general route for payment and will be a cash payment to satisfy Levy liabilities. However, affordable housing requirements will 'predominantly' be provided in-kind on-site under Section 106 Agreements (labelled a *delivery agreement* in the Consultation) as a set-off against levy liability. In addition, DLUHC proposes that delivery agreements might also be used to fund offsite habitats compensation, or additional payments "outside Levy liability" where the development does not meet planning requirements. This looks worryingly close to a reversal of the current rule that planning permissions cannot be bought. DLUHC is even suggesting that some Levy liability could be secured through a delivery agreement for specific infrastructure or by way of land payment (similar to the CIL land payment). Section 278 and 38 highways agreements can also continue to be used to provide highways infrastructure.

- ***Infrastructure in-kind routeway***: for 'large and complex sites' based on a threshold development size, Section 106 Agreements will be retained due to the bespoke nature of infrastructure needs and long-term, and potentially phased, delivery requirements. Section 106 Agreements would formally need to provide at least as much value as the amount that would be secured through calculation of Levy liability for a development. DLUHC seeks views on various options for the threshold for this routeway (from 10,000 homes and complex urban regeneration sites at one end, to sites of over 500 units at the other).
- ***Section 106-only routeway***: These will be used for developments which do not amount to development as defined in the Bill such as mining and waste projects.

Contrary to the Government's original desire to abolish Section 106 Agreements, there is clearly a potentially significant role for Section 106 Agreements for integral infrastructure and in each of the routeways. With integral infrastructure and the core levy routeway, the risk seen with CIL re-emerges, of developers effectively double-paying for infrastructure (because it is required in a Section 106 Agreement in circumstances where the costs have not been fully built into local authority calculations of Minimum Thresholds, and so also funded by Levy payments).

5. HOW WILL AFFORDABLE HOUSING BE DEALT WITH?

It is proposed that local authorities will set a percentage of the Levy (in monetary terms) that will be delivered 'in kind' through on-site provision of affordable housing through a right-to-require. The *right-to-require* will apply to residential development and could be used to secure all relevant affordable housing tenures including Social Rent, Affordable Rent, Shared Ownership and First Homes. In setting their percentage, local authorities will aim to secure at least the amount of affordable housing that was provided by Section 106 contributions. The value of affordable housing provided in-kind (i.e. the discount against market value) will be set off against Levy liability.

The local authority could decide to reduce the affordable housing requirement in any particular case. However, since the full Levy amount would need to be satisfied, developers would have to make up the balance in cash in such a case, thus removing any negotiations over viability. It could also decide to pool Levy funds to provide additional funds to registered housing providers to allow increased levels of affordable housing to be provided in a development, without affecting the financial return for the developer.

Local authorities will set out in their charging schedules, an expected tenure mix for *right-to-require* homes. Based on the expected Levy liability at pre-commencement *indicative liability* stage (See Question 7), and authority's chosen the percentage of Levy to be provided in-kind, developers would know in advance of commencement, how many units of each type of tenure would be required. Since the GDV figure (and therefore final Levy liability) may change as negotiations with registered housing providers are finalised, and as the development progresses, any reconciliation in the final Levy charge would be satisfied through a change in the cash payment element of the Levy (rather than a change in numbers of affordable homes / or tenure mix).

The Government might set a cap on the percentage of the Levy covered by the *right-to-require* - to restrict the ability of local authorities to set it at 100% of the levy.

6. WILL THERE BE ANY EXEMPTIONS?

DLUHC plans to mirror CIL to some degree and exemptions will therefore apply, for example, to development under 100 Sq m, certain industrial buildings, and development that does not involve buildings (e.g. pylons and wind turbines).

The existing CIL exemptions for charitable relief residential self-building / extensions etc. will also be maintained under the Levy. However, as mentioned in Question 3, there is no current intention to replicate a discretionary relief on development viability grounds.

Sites providing wholly affordable housing will not be subject to the Levy and DLUHC is considering providing an exemption also where a minimum percentage (to be decided) of the units provided on a site are affordable housing. Presumably where there are other non-residential uses in the proposed development, the Levy would still be chargeable. Any such exemption would need be designed carefully to avoid salami-slicing of development to reduce Levy liability.

In addition to exemptions, reduced rates might be charged on sites with fewer than 10 homes.

7. WHO WILL BE RESPONSIBLE FOR PAYING THE LEVY AND WHEN?

A developer or other party in the development process must assume liability before commencing development subject to the Levy. It is not clear yet whether residual liability will lie against those with interest in the land who are not involved in the development, alhtough Levy liability will be secured as a local land charge.

A three step process for payment of the levy is proposed:

Indicative liability calculation: At planning application stage, indicative liability is calculated based on floorspace contained in the application – no valuation is required. Local land charge is created.

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Provisional liability calculation and payment: Prior to first occupation (or of any phase) provision liability is calculated (potentially based on an independent valuation of GDV). Payment of provisional liability leads to removal of local land charge. DLUHC is considering whether local authorities might call for earlier payment.

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Final Adjustment Payment: Following completion or once development sold: Either the local authority or developer requests payment based on actual market value of development (evidenced by sale prices, or valuation if development is not sold). If Levy underpaid or overpaid, further payment is made by developer / refund is given by the authority (respectively).

8. HOW WILL LEVY PROCEEDS BE USED?

The Levy will be used by Local authorities to pay for infrastructure that is made necessary by development in its area. They will need to produce an Infrastructure Delivery Strategy setting out the need for infrastructure in their area and how receipts from the Levy and other sources (e.g. Section 106 funds) will be used for infrastructure and affordable housing. Significantly, however, the proposal provides that the local authority would have flexibility to allow authorities to use an 'element' of their Levy funding towards non-infrastructure matters such as social care or child care, or improving local services. Developers will be concerned that funds could be collected for purposes that are somewhat distant from the impacts caused by their developments to fund, what many would consider are, core public services.

Unlike the current position for CIL, Local authorities will also be able to borrow against Levy receipts, which DLUHC feels will alleviate developers concerns about the failure to provide for infrastructure which should be paid for by the Levy. However, similarly to CIL there is no proposal for developers to be able to compel local authorities to provide necessary infrastructure. The possibility that Levy funds could be used for other local purposes (e.g. social care) is likely to heighten any concern in this regard.

9. WHEN WILL IT COME INTO FORCE?

The Government sees the new regime being introduced over the next decade. Recognising the failure of previous proposals to introduce value capture levies, the Government will pilot the Levy in a "representative minority" of representative local authorities before it is introduced nationally. This *test and learn* process would begin in 2025 with the first permissions subject to the Levy being those granted in 2026.

The test and learn pilot would then be extended from 2027 to additional authorities, before finally being introduced on a national basis from 2029.

10. WHAT ARE THE NEXT STEPS?

The consultation will run for 12 weeks until 9 June 2023. The Government will then continue to develop its thoughts on the Levy.

It is worth remembering that this Consultation concerns the detailed elements of the Levy which will be set out in Regulations. The principle of the mandatory Levy, the intention to increase infrastructure and affordable housing contributions beyond past levels, and the setting of the Levy by local authorities by reference to an Infrastructure Delivery Strategy, are already settled and set out in the Bill. As such these elements are not subject to consultation.

There is clearly a great deal at stake to ensure that the Levy works properly and does not create an unacceptable burden upon developers, putting development viability widely at risk. All those with an interest in the development process should consider making representations in response to the Consultation.

Technical consultation on the Infrastructure Levy - March 2023 - DLUHC: Link

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