THE NEW INFRASTRUCTURE LEVY:
what it means in practice for planning and development?

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WHAT IS THE INFRASTRUCTURE LEVY (IL)?

The IL proposals are contained within the Levelling Up and Regeneration Bill (LURB), which was introduced into the House of Commons on 11th May 2022. The IL is intended to enable local authorities to impose a "tax" on development used to fund traditional infrastructure such as roads, transport facilities and open spaces, as well as additionally defined infrastructure such as childcare provision and affordable housing.

Sound familiar? The new levy aims to replace and address the shortfalls of the Community Infrastructure Levy (CIL), which was introduced by the Planning Act 2008 and came into force on 6th April 2010 through the Community Infrastructure Levy Regulations 2010. Although the introduction of CIL is understood to have increased developer contributions, only around a third of authorities have adopted a CIL charging schedule more than 10 years since it was introduced.

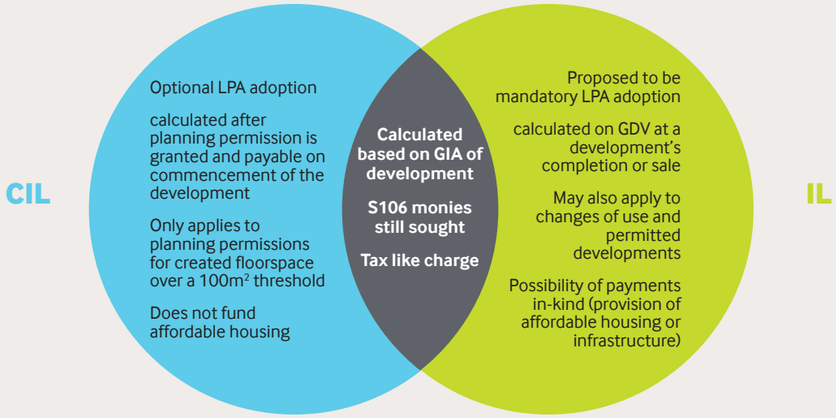
The Infrastructure Levy has been proposed by the Government in order to create a mandatory and locally determined contribution by developers. The proposals will allow charging authorities to determine contributions according to the local context, measured against the Gross Development Value (GDV) of a completed development.

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. The intention of the IL is, therefore, to capture more of the uplift in value created by grant of planning permission than is the case under the current system.

IMPACT ON DEVELOPERS AND LANDOWNERS

The introduction of the IL is likely to significantly impact both developers and landowners. Whilst the IL is intended to reduce the need for Section 106 agreements and thus cut some of the red tape surrounding the planning process, in reality it is likely to increase administrative burdens and the time it takes to achieve consents. This could have financial impacts on both landowners and developers. In addition IL is intended to capture more land value uplift, however, the charging rates that local authorities set will only be able to represent a broad picture of actual development costs and existing land use values thereby creating potential viability concerns and meaning land buyers are likely to be cautious with offers. In addition, the desirability of land may be impacted, as developers reconsider both where and what they develop in response to the landscape of IL rates. This could mean less land is made available as owners wait to see if a change of Government might repeal any new legislation, possibly allowing a greater future land price to be secured. This all adds up to a perfect storm which may stymy the development of much needed homes in the areas which need them the most.

DIFFERENCES BETWEEN CIL & IL



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

Much like CIL, the idea is that Local Authorities will set the parameters for the Levy in a charging schedule based on local circumstances. Before being adopted this will be subject to public consultation and examination.

A key requirement of IL charging schedules will be that all infrastructure necessary to make a development acceptable can be funded whilst ensuring that the level of affordable housing and the level of other developer funding is at least equal to that received prior to its adoption, whilst still having regard to economic viability and matters affecting the value of land.

In terms of calculating the Levy amount; Local Authorities will set a minimum threshold (on a £ per m2 basis) below which the Levy will not be charged. The idea is that this will account for the value of land in its existing use as well as the costs of the development. Levy rates will then be set as a percentage figure of the final GDV (again on a £ per m2 basis) above this minimum threshold. Minimum thresholds will be subject to indexation to avoid the likelihood of the Levy causing sites to become unviable.

Calculation

Gross Internal Area (GIA) x (Gross Development Value (GDV) – Minimum Threshold*) x Levy Rate

*Minimum Threshold = Existing Use Value + Development Costs

Worked Example

Development of 10 new homes @ 100m² on greenfield site

Following the findings of their IL viability study, the Local Authority sets a minimum threshold of £2,000 per m² for greenfield sites which they believe will account for the cost of land and the associated build costs of the development. As part of this initial viability assessment work carried out for the council it was found that greenfield sites in the area were viable and, therefore, the Local authority set the Levy Rate at 50%.

Valuations of the Gross Development Value (GDV) of the scheme provided to the Local Authority during build out estimated the GDV of the scheme to equate to £4,000 per m².

The IL liability would, therefore, in this hypothetical example be as follows:

Internal area of 1,000m² (10 x 100) **x GDV £2,000** (£4,000 GDV- £2,000 Minimum Threshold) **x Levy Rate 50% = Total Liability of £1 million**

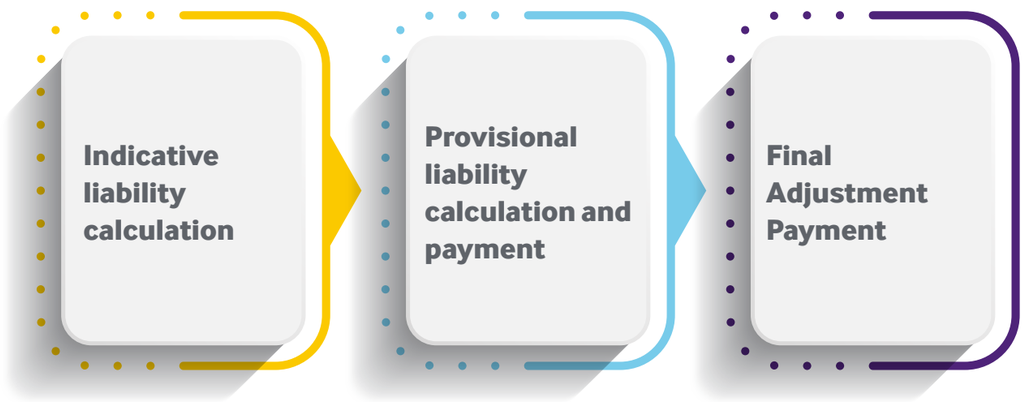
Clearly careful consideration is going to be needed by Local Authorities when setting thresholds and rates to ensure that development viability is not impacted.

WHO WILL BE RESPONSIBLE FOR PAYING THE LEVY AND WHEN

Unlike CIL, where liabilities are set at the point planning permission is granted, with payment broadly alongside commencement, the proposal for IL liability is to be based on GDV at completion.

In reality, however, an estimation of liability will need to be made earlier in the development process as the intention is to register the liability as a local land charge. A developer or other party in the development process must, therefore, assume liability before commencing development subject to the Levy.

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



STAGE 1

Indicative Liability Calculation

At planning application submission an indicative liability is calculated based on the floorspace of the potential site and the average GDV for the area or typology of development set out within the IL charging schedule.

Once planning permission is granted, the developer will need to assume liability in order to commence development. At this stage the liability will be registered against the site as a local land charge.

Although the intention is that the indicative liability will be based on set average GDV's within the IL charging schedule, the current consultation does seek views on whether developers should be allowed to challenge these rates with their own valuations at this early stage of the process.

STAGE 2

Provisional Liability & Payment

Stage 2 is post commencement but prior to first occupation. At this stage it's proposed that payment of the Levy can be initiated by a developer. It's also suggested that an independent valuation of GDV may need to be provided if either the local authority or developer believe the value will be lower or higher (by a specific percentage tolerance) than the stage 1 indicative valuation.

It is intended that the IL payment at stage 2 will make up the bulk of the payment prior to the development being sold.

STAGE 3

Final Adjusted Payment

Following completion or once the development is sold, either the local authority or developer can request a final adjustment payment based on the actual market value of development (evidenced by sale prices, or valuation if development is not sold). If the Levy has been underpaid or overpaid, further payment is made by developer / refund is given by the authority (respectively). Local authorities will be able to charge late payment penalty fees.

EXEMPTIONS & REDUCED RATES

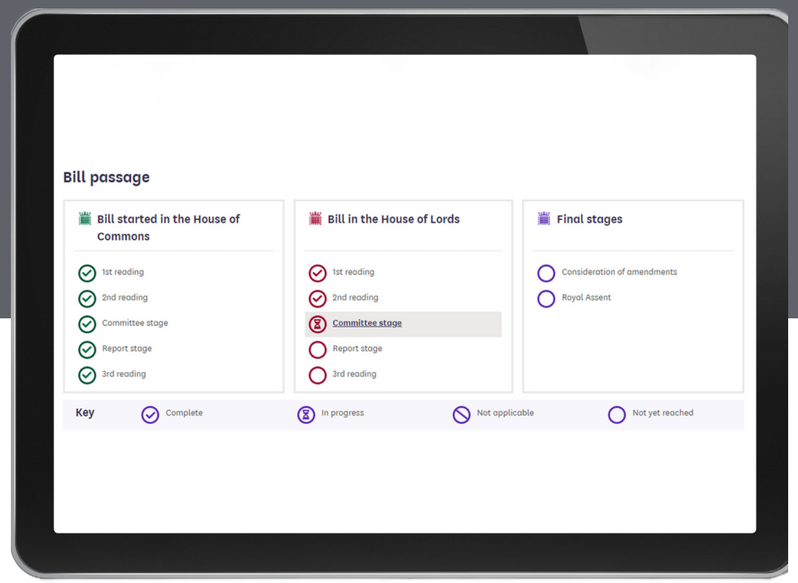
The existing charitable relief for CIL will be mirrored by the IL. In addition, it is the intention to maintain exemptions for self-build housing, residential extensions, and annexes.

Exemptions for affordable housing will work differently, rather than being exempt as is the case with CIL, the cumulative discount in GDV across all on- site affordable housing will be offset from the whole site Levy liability as part of the calculation. It is also suggested that developments which propose a certain percentage of onsite affordable housing may be entirely exempt from the levy.

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

WHEN WILL IT COME INTO FORCE?

The Department for Levelling Up, Housing and Communities (DLUHC) has launched a technical consultation on the proposed Infrastructure Levy and Framework provisions for the Levy are currently included in the Levelling Up and Regeneration Bill which is currently progressing through Parliament.



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 local authorities before it is introduced nationally. This test and learn process is proposed to 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.

Given that the Levy will be introduced at different times across certain authorities it will be important to ensure existing permissions are treated in a uniform manner. Where sites have been permitted before the introduction of the new Levy, they will continue to be subject to their CIL and s106 requirements. Given that the consultation specifically refers to 'sites' rather than 'schemes', it is assumed this will also apply to subsequent section 73 (of the Town and Country Planning Act) related changes to planning permission, which are in effect a new consent. This does, however, require clarity.

It should also be noted that an amendment was introduced to the Levelling Up Bill to allow for CIL to continue in Wales and Greater London, so it is unclear if and when the IL will be implemented in these locations.

HOW IS IT INTENDED TO WORK?

The Infrastructure Levy is intended to replace CIL, Section 106 and affordable housing contributions with a single flat-rate levy based on the final sale values of a development.

Limiting Section 106

S106 Agreements will remain, albeit now termed Delivery Agreements. The IL proposes that planning conditions should be doing much of the heavy lifting in securing site-specific related infrastructure, but that for more complex sites, S106 Agreements will still be needed. On that basis 3 'routeways' are proposed for securing developer contributions which are intended to create a clear distinction over how section 106 agreement should be used.

Core Levy Routeway: The intention is for the majority of new development to follow this routeway. The Levy will be paid in cash by developers with liabilities based on final GDV.

Infrastructure in Kind Routeway: This is intended to be reserved 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. This is known as a 'Levy backstop amount'. The preferred approach is for any shortfall in the value of the on-site infrastructure to be made up through a cash payment to the local authority.

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 minerals and waste projects.

Relationship With Affordable Housing (Right to Require (RtR) and Grant Pots)

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. This will be included within the Infrastructure Delivery Strategy where the preferred affordable housing tenure mix will also be set out. The proportion of the levy liability required as 'in kind' affordable housing will be equal to a monetary amount.

For example, if the levy liability was £1 million and the local authority have set their RtR at 50% then £500k of the total levy liability would be delivered in-kind as affordable housing. In theory, therefore, the level of affordable housing requested on site should not impact development viability, given that it is taken from the total IL receipts.

To calculate the level of on-site provision this actually equates to, it will be necessary to look at the value of the discount of an affordable property compared to an open market sale.

In the above example, 10 affordable homes could be built on site if each was purchased at a discount from market sale of £50k (10 x £50k = £500k).

The key difference here is the intention that affordable housing can not be negotiated away on viability grounds.

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 consultation also suggests that Local Authorities will retain flexibility and not be obliged to seek the full entitlement of on-site affordable housing if they prefer to redirect resources towards other infrastructure priorities.

In addition to the right to require, Local Authorities will be able to secure affordable housing using a 'grant pot' essentially using Levy receipts to top up the price a registered provider is prepared to pay for affordable housing units. This allows a developer to retain the full market value for these additional homes.

Proportionate Contributions based on Market Value

The Levy will be measured as a percentage of the GDV, intended to reflect the market value of the completed development. This is to prevent the need to renegotiate s106 contributions in the event of cost increases and/or value decreases. The "sell" is that IL responds to market conditions as the amount payable will increase or decrease depending on the final GDV, this is stated to remove the need for S106 variations and is more flexible than CIL which is a set rate.

HOW DO WE THINK IT WILL ACTUALLY WORK IN PRACTICE?

Limiting Section 106 (or 'Delivery Agreements' (DA))

Unlike when CIL was first mooted with the intention of replacing S106 agreements altogether, DLUHC are being more realistic this time around, by indicating that S106 or 'Delivery Agreements' will still have a part to play alongside the IL, in securing 'integral infrastructure' which cannot be secured by way of a planning condition. The consultation is, however, hopeful that they will only be required for larger more complex schemes.

In practice, however, given that matters such as Biodiversity Net Gain (BNG), which is soon to become mandatory (November 2023) are likely to be considered 'Integral Infrastructure' (i.e., delivered on-site separately to IL), it is reasonable to conclude that most sites will continue to need a s106 or Delivery Agreement. In addition to securing on-site mitigation, Delivery Agreements are also likely to be used to secure off-site mitigation that cannot be secured through IL.

Although affordable housing and financial contributions may now be removed from s106 obligations, obligations relating to matters such as on-site open space and transport and construction plans, to name a few, all seem likely to remain. In addition, although the "Right to Require" will set out the proportion and tenure mix of on-site affordable housing delivery, the consultation is not clear on how that affordable housing will be secured in perpetuity or as to how site-specific affordable housing matters will be agreed.

For example, will a delivery agreement still be required to agree the triggers for when the affordable units have to be provided? Or the agreed rent levels? If an IL agreement and s106 agreement both have to be negotiated then there won't be any time saving in the determination process and it may in fact have the opposite effect.

In addition, while some infrastructure will obviously fall into either "Levy Infrastructure" (infrastructure not needed for a particular site to function but needed to address the cumulative impact of development) and secured via the IL or "Integral Infrastructure" (on-site infrastructure needed to make a site liveable) secured via DA, the consultation recognises that there will be grey areas such as on-site school provision which could fall into both. It is not yet clear if it is intended that these grey areas will be prescribed in due course or whether this will be a decision made locally on a site by site or authority by authority basis. This uncertainty, and the potential for disparities between authorities may lead to considerable delays in obtaining consents.

Also, it's unclear how the thresholds will be set for determining which schemes are considered 'large and complex' and thus are required to follow the 'infrastructure in kind routeway'. If the threshold for the infrastructure in-kind routeway is low, more sites will qualify and thus more delivery agreements will be required. In addition, if local authorities have discretion over where this threshold is set, they may prefer to set the threshold lower to give them more control over the delivery of infrastructure, bearing in mind that the value of any contributions towards infrastructure will have to equal or exceed the value of what otherwise would be secured through a calculation of the Infrastructure Levy.

Relationship With Affordable Housing

The recent amendment seeking to secure 75% of IL receipts as affordable housing, whilst applaudable in theory, may in practice have the unintended consequence of local authorities seeking to secure more funds for 'integral infrastructure, via a delivery agreement to cover any short falls.

Proportionate Contributions based on Market Value

The IL is intended to simplify the current system of CIL & S106, and to limit the use of viability assessments in negotiating affordable housing contributions, however, rate setting (where the local authority needs to assess the cost of land and the associated build costs of the development) is likely to be complicated and open to challenge given the vast range of land values and individual complexities of sites, even within a single borough.

For example, Levy Rates could be highest for greenfield development, and zero for replacing existing floorspace. 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.

In addition, estimates of GDV may need to be revisited throughout the development process starting at application stage and then through interim reviews during the construction phases, thereby, increasing the role of a viability consultant in the development process.

The Levy also proposes to assess GDV at the 'point of site sale' or 'completion'. The point of completion is not defined within the consultation. This could, therefore, be interpreted in a number of ways. It could relate to Building Regulations completion, or when a property is registered for council tax. In addition, payments will be required when a scheme is 'close to scheme completion' clarity on how this is defined will also be required. It is also unclear whether completion could be identified as phased completion, or even by reference to individual units. The latter is likely to put an administrative burden on both developer and Local Authority if IL has to be assessed and paid on each unit individually in a multi-unit development.

WHAT HAVE WE LEARNT FROM CIL?

Contrary to the Government's original desire to abolish Section 106 Agreements when implementing CIL, they are still widely used and there is clearly a potentially significant role for Section 106 Agreements in each of the IL routeways.

With 'integral infrastructure' and the core levy routeway, the risk seen with CIL whereby developers are effectively being asked to double-pay for infrastructure re-emerges. This has also inadvertently caused in fighting between county and district councils over Community Infrastructure Levy funds. Given that section 106 agreements are likely to remain, careful consideration will need to be given as to what additional contributions will be IL compliant.

According to Planning magazine's CIL tracker service, around a third of local authorities have still not adopted a CIL charging schedule, with many authorities, especially across the Midlands and the North, not implementing it because of fears local land values would make development unviable. With IL being mandatory, there is a real risk of development being stymied in these locations contrary to the aims of the LURB.

The CIL regulations are also very black and white with strict penalties for not following the administrative processes. For example, RPS has recently been successful in appealing a CIL charge on the basis that the Local Authority did not issue a CIL liability notice within a reasonable period after grant of consent. However, this can work both ways, with developers being penalised for not submitting a commencement notice before starting work. If the idea is to reduce administrative burdens, thought must be given to how the process is regulated and consideration given to simplifying the process.

HOW WILL IT IMPACT DEVELOPERS?

The Good

- The ability to pay IL at the back end of the development programme from revenue receipts (in relation to sales or lettings), rather than through development finance on commencement of development could assist with cash flow and potentially reduce borrowing (see 'The Ugly' for counter argument).
- IL allows an LPA to negotiate with a developer to provide a single type of infrastructure in kind, rather than paying contributions towards multiple infrastructure pots. This could simplify some schemes.
- Land and development costs should be factored into Levy rates from the outset reducing the need for site specific viability assessments.

The Bad

- Developers may need to instruct and factor in additional professional fees for viability consultants (to assess GDV) throughout the construction process. Developers may also need to provide IL estimates and viability assessments to lenders.
- Proposed amendments that would require developers of 50+ units to pay their full IL liability before development commences may make it more complicated for the developer to "claw back" payments if IL is overvalued when GDV is assessed at completion.
- There is not intended to be any option for discretionary relief on viability grounds.
- It may bring some developments into scope for developer contributions that have been effectively outside the terms of the existing system (see worked examples).
- There could be complex calculations required in assessing levy liabilities on mixed-use or conversion schemes (see worked example).
- 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 creating potential viability concerns.

The Ugly

- There may be extra administrative burdens around phased completions and payments of IL.
- More neighbour objections? – Will local people be supportive of council's borrowing on taxpayers' money against development infrastructure, rather than the developer paying at the outset?
- A large interim or provisional payment prior to occupation of the scheme with a balancing payment once the development has been sold could lead to cash-flow issues compared with the current system where s106 payments are often staggered through instalments linked to occupations throughout the build programme and CIL payments paid in accordance with a Charging Authority's instalment schedule. In addition, whilst the provisional payment can be related to a phase of the development, many medium sized schemes are not currently phased, and even where they are, payment up front of the IL in respect of a phase could create viability issues for SME developers.
- If infrastructure funded by the Levy is required to be built before development commences or not occupied until infrastructure has been delivered (as is suggested by amendments) this is likely to cause concern to project timeframes given developers may have to rely on a public body to secure land, secure funding, procure a project, and deliver it before they can realise any profits.

WORKED EXAMPLE

Change of use

Current change of use applications are usually exempt from developer contributions. Existing in-use floorspace is offset from being charged CIL, and the vacant building credit means that affordable housing is not usually sought by means of s106. The IL, however, proposes to capture some of the land value uplift from such schemes. It states that in such circumstances a lower Levy rate and higher minimum threshold will be needed for such development to remain viable.

The example below shows how a charging schedule could apply to an illustrative office-to-residential conversion that is also extended:

Development Type	Rate	Minimum Threshold
New Build Floorspace	**50%**	£2,000 per m^2
Change of Use / Conversion	**25%**	£3,000 per m^2

For an office to residential scheme which proposes to convert 10,000m^2 of existing floorspace and add an additional 5,000m^2 whereby the GDV has been agreed at £4,000 per m^2 the calculation would be as follows:

Conversion of 10,000m^2 x GDV of £1,000 per m^2 (£4,000 GDV- £3,000 Minimum Threshold)

X

Levy Rate at 25%

= £2.5m IL liability for conversion

+

New build floorspace of 5,000m^2 x GDV of £2,000 (£4,000 GDV- £2,000 Minimum Threshold)

X

Levy Rate at 50%

= £5m

= Total Liability of £7.5 million

HOW WILL IT IMPACT LANDOWNERS?

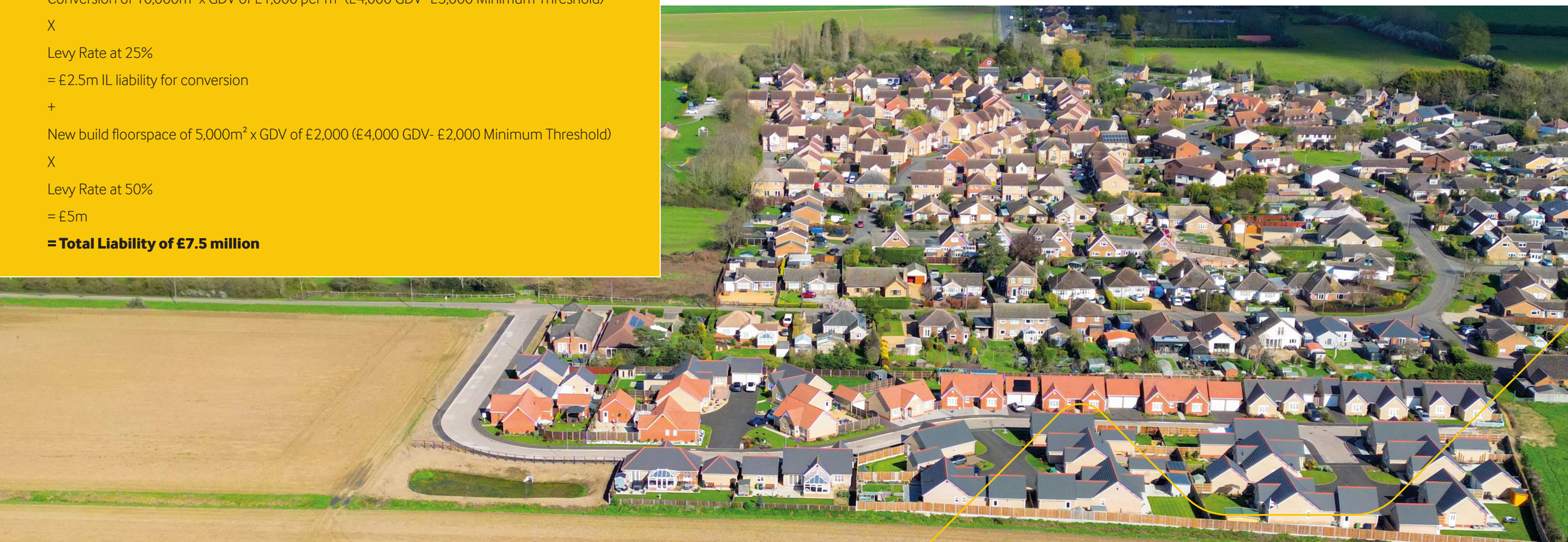
The IL is the latest in a long line of measures aimed at capturing land value uplift and much of the debate hinges on the big increases when farmland gets planning permission for housing development. However, increases also arise for many other reasons and the impact of planning consent on values is particularly significant in areas of high demand and tight planning constraints.

Part of the reasoning for IL is that it provides certainty on the contribution payable so that this can be baked into assessing land values at the point of purchase. However, the final figure will not be known until the development is completed and land buyers are likely to be cautious with offers. This may in effect reduce the amount of land made available for development. Indeed, planning and development uncertainties mean that what is captured by IL may have to be considerably less than the development value to retain incentives for landowners to sell to developers.

With this in mind it is possible that without cross-party support for the IL (The Labour Party is pledging to scrap it), land owners will simply wait to see if a change of Government might repeal any new legislation (possibly allowing a greater future land price to be secured) before bringing forward land for development.

Where land is still made available, its desirability may be impacted, as developers reconsider both where and what they develop in response to the landscape of IL rates. Furthermore, the financial benefit of any change may take some time to filter though, as much land around existing settlements is already tied up under option agreements.

Future IL policy needs to address regional disparities. The evidence clearly shows that land value capture via planning obligations and CIL can work (at least in vibrant market conditions) in London and the South East. It is much more difficult in other regions.



WHERE, WHEN AND HOW CAN RPS HELP?

RPS are able to help clients with a variety of development viability matters including advising on CIL liabilities. We are, therefore, well placed to be able to smooth your transition into IL adoption.

The current IL 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 only. 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.

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 at risk. Everyone with an interest in the development process should consider making representations in response to the Consultation. RPS can help coordinate this response either individually or as a collective.

Once IL is rolled out, 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. RPS will be to offer our development viability expertise at this stage to ensure the correct rates and thresholds are set.

Finally, IL adoption will not negate the need for detailed GDV assessments and it is likely this process will be subject to negotiation. RPS can provide detailed market research to support end value assessments submitted in support of a scheme.

FINAL THOUGHTS

IL is intended to "create a simpler system of developer contributions" and to be "easier to navigate, more straightforward, and transparent" yet there remains a myriad of complexities in setting rates and thresholds, in determining the differences between infrastructure types, in assessing the value of unsold schemes and in determining preferences for delivery.

In our view the proposals are likely to add significant additional complexity and administrative burden to developers (and to local authorities) contrary to what it seeks to achieve. In addition, despite the complexity already evident, a huge amount of detail also remains to be produced.

The government acknowledges that moving from the current system of developer contributions to the Infrastructure Levy represents a significant change and has, therefore, promoted a phased 'test and learn' rollout over a ten-year period. In that time there will be at least two general elections representing a substantial risk of a new Government cancelling the proposals altogether.

ABOUT RPS

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