Inclusionary Housing, planning and land value recapture

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ABSTRACT

It has been argued that increases in land values do not generally result from the owner’s efforts, but rather from public investments and government decisions and are, therefore, “unearned.” This paper analyzes how Inclusionary Housing has been utilized as a land value recapture mechanism in different countries. We distinguish four distinct models: 1) Countries with explicit recapture (Spain and the UK); 2) A country, Ireland, with explicit but limited recapture; 3) Countries where recapture is implicit or ambiguous (Italy, France and Canada) and 4) A country, the United States, where value recapture has not been part of the planning culture.

Introduction

From its humble beginnings about forty years ago in the United States, where it gained ground slowly and haltingly for the first twenty years or so of its existence IH has spread its reach since the 1990s to other parts of the world, most notably in many western European countries and Canada, and intensified its reach in the United States. The causes of its recent popularity are multiple -- most importantly the shifting balance between the private and public sectors, with central governments reducing their provision of social housing and shifting housing responsibilities to regions and localities. In addition, the respective roles of the private and public sectors in the land development process have shifted as well, with private developers made to assume more of the costs associated with development. Finally, concerns over social and spatial segregation, a major factor in the rise of IH in the United States, have risen in many other countries as a consequence of globalization, economic restructuring and increases in social segmentation and immigration.

IH seems an obvious response to these changes. If the central government is unwilling to dedicate significant resources to provide housing to those the market cannot serve, then it
is quite willing to mandate or allow lower levels of government to extract that housing from private developers through the planning process. After all, the development industry is now paying most of the costs of development, and IH can be considered an additional cost for the privilege to develop. It helps to assume, as many European countries do, that IH is paid for by the landowner and not the developer or the buyer of market-rate units. Policymakers in other countries, most notably the United States, generally believe instead that the costs of IH can and should be offset through incentives, such as density bonuses. Finally, building social or affordable housing within or adjacent to a market-rate development is viewed in all countries as an excellent instrument to foster social and geographic integration and avoid segregation.

Not surprisingly then, many countries have turned to IH. Less predictable is the great variety of responses in the different countries and, within each country, in their regions and cities. While they have in common one broad strategy -- to utilize the private housing market to generate non-market housing and to mix the two together -- they have gone about implementing that strategy in distinct ways.

This is notable in Europe where the advent of the European Union led some to expect a gradual convergence and increasing uniformity of European planning systems (Davies 1994). Newman and Thornley (1996: 27) in their thorough analysis of urban planning in Europe, acknowledged that a process of Europeanization was affecting urban planning but, consistent with the disparate approaches discussed here, noted ingrained differences among European planning national systems…”which are not likely to disappear overnight.” Since, following the EU principle of subsidiarity, social housing remains a matter for the competence of individual nation-states, it is not surprising, as a recent report has noted, that “social housing in the European Union is characterized by the wide diversity of national housing situations, conceptions and policies across member states and, thus, by the lack of a common definition of ‘social housing’ at [a] European level” (Czischke and Pittini, 2007:9). The same diversity is found with respect to member states’ IH policies.
While the global forces affecting these nation states might be similar, the inclusionary responses of each country vary, depending on their history, culture, economy, politics, legal and administrative traditions and institutional settings.

To understand the origins and evolution of inclusionary housing in the US, Canada, Italy, Spain, France, England and Ireland, a study funded by the Lincoln Land Institute has analyzed how a country’s housing system has changed in recent decades in a context of privatization and deregulation, and examined the nature and historical evolution of its planning system. This dual analysis is necessary for three separate reasons.

First, housing provision and land use planning are inextricably linked, since plans designate the amount of land to be dedicated to housing development and lay out the ground rules for that development. When plans create shortages in the supply of land needed to accommodate growth—by reducing or keeping artificially low the quantity or densities of residentially designated land uses—they increase the cost of that land and hence of housing. The rigidity of plans in a context of rapidly changing circumstances may also contribute to a scarcity of land for development and lead to higher housing costs.

The trend toward deregulation has also affected the planning field. The shift toward more flexible planning approaches—and away from both strict regulation of private development on one hand and the public sector’s provision of infrastructure and public facilities on the other—emphasizes land market liberalization, negotiation, public-private partnerships, and higher levels of developer exactions.

Second, under inclusionary housing policies, affordable housing is being provided “through the land use planning system,” to use the British expression. Affordable housing used to be produced primarily by the public sector or by social housing providers, on land acquired through either the market or the disposition of publicly owned property. That model has been radically transformed as a result of inclusionary housing programs. For example, in the United Kingdom today, the term planning and affordable housing is used extensively in government planning guidance. It refers to policies that either (1) use the
development permission system as a means of encouraging developers to include lower-cost units within market housing schemes; or (2) create a subsidy for housing development by granting development permission to “affordable housing” providers on sites that would not normally be released for housing, and which therefore have lower market value (Gallent 2000). The ways in which the provision of affordable housing and planning intersect vary among the countries in this study, but inclusionary housing, by its very nature, straddles the housing and planning fields and thus occupies a unique place in public policy.

Third, inclusionary housing is particularly important as a potential mechanism for land value recapture. This potential is not fully appreciated or understood in the United States for several reasons. The “incidence controversy”—the issue of who pays the costs of below-market units—remains unresolved. Land value recapture is rarely even addressed as an alternative approach to cover costs. Cost offsets such as density bonuses and reduced regulatory standards, many of which come at a cost to the public, are used widely to defuse local opposition and reduce the arguably imaginary costs of inclusionary housing to developers or market-price homebuyers. If the relationship of inclusionary housing and land value were better appreciated, it is possible that political opposition in the United States would diminish, and with it the perceived necessity for cost offsets.

Many Europeans hold a long-standing belief that increases in land value result largely from society’s efforts, and therefore do not belong to the landowner and that the increased value should be recaptured by the public sector. In Spain, for example, the recapture for public benefit of the land value increment created by public action has been enshrined in the nation’s constitution. There is little doubt among European planners and economists that requiring developers to pay for public facilities and/or affordable housing in ways that increase the cost of development will result in lower land prices. A typical formulation is found in the newsletter of a prominent British property law firm, which states unequivocally: “As inevitably, it falls to the landowner to fund these provisions, by reduction of the sale price, there is often lengthy and sometimes acrimonious discussion as to the need for and the amount of the provision” (Green 2004).
The extent to which this belief in the importance of land value recapture is reflected in public policy varies widely in the countries included in this study. A clear relationship exists between the way the effect of inclusionary housing on land values is understood and the underlying system of land use regulation. This, in turn, reflects the nature of each country’s property rights regime. It is important, then, to understand how the planning system in each country has evolved, especially in terms of its attempts at recapturing unearned increments in land values.

A related issue is the legal status of housing generally, and inclusionary housing in particular. Planning and housing systems operate within a framework of constitutionally protected rights, but such rights vary from country to country. While the constitutions of the seven countries studied all mention property rights in some fashion, those rights enjoy diverse levels of protection. The rights of ownership may not extend to development, while the right to housing forms part of only a few constitutions and may or may not be meaningful on the ground. The French experiment with giving its constitutional language meaning through the enactment of a law providing an enforceable (opposable) right to housing is unique, and still in its infancy.

In the United States, separate state legal systems, courts, and legislatures have addressed inclusionary housing in different ways, from all but requiring it in New Jersey and Massachusetts, to forbidding it outright in Oregon and Texas. There is no doubt that in Spain and England—and in Ireland after a 2000 supreme court decision—inclusionary housing passes constitutional muster. In Canada, however, questions remain as to its legality when individual cities enact inclusionary programs in the absence of legislation at the provincial level, where the power to regulate the property rights regime in that country resides.

In this paper, I will explain how political and ideological attitudes have affected the types of IH programs adopted in each country with a particular emphasis on the utilization of IH as land value recapture mechanism.
Politics, Ideology and IH

Alterman (2001: 37) in her edited volume on national planning systems, found that “surprisingly” national planning seems “to have become immune to the churning of political-ideological debates”. Not so for IH, a program that we have found to be highly politically charged, affecting IH debates and outcomes in most of the countries we have analyzed.

This is especially obvious in Ireland and the United States, two countries with a strong ideological commitment to the protection of private property. In Ireland IH legislation, Part V of the Planning and Development Act of 2000, was passed by a leftist government in the face of a looming housing affordability crisis. Developers objected sharply to Part V, warning as developers everywhere, that IH would lead to increased costs for market rate units and a reduction in the supply of housing. Although it was initially enacted intact, developer pressure led to extensive amendments only two years later that left Part V considerably weakened. Although Part V has had some impact, it has led to substantially less social and affordable housing than its supporters hoped, even at the height of the Irish property boom. With the current huge real estate crisis no development is occurring and therefore no IH is being produced.

In the United States, the predominance of market ideology has instituted a model of IH that is based on cost-offsets and incentives for developers. But even when cost-offsets and incentives are calculated to make IH economically neutral or even slightly profitable for the developers, they will oppose it nevertheless on ideological grounds, as another intrusion of government in the private housing market. With that kind of opposition, the passage and the characteristics of IH programs are contingent on several factors, most importantly the perception of the extent of the housing crisis and the strength of the affordable housing advocates on one side and development forces on the other. It is possible then, that even in the United States, a few progressive cities will pass IH without cost offsets and incentives.
Italy was the country where planners’ push for positive planning and land value recapture clashed most heavily with conservative forces and globally induced upheavals. Progressive planners have replaced the earlier dreams of public control of development land with the recognition that some of the development value should be appropriated by private landowners. They devised the *perequazione* approach for an equitable redistribution of planning benefits between the public and private sectors. But many cities and regions have moved further to the right, advocating more market friendly approaches. These differences are especially evident in the IH approaches of Florence and Milan. The center-left city government in Florence, in a style more reminiscent of the past, mandated rental housing in all development above a certain size, prompting the threat of a lawsuit on the part of the first developer burdened with the requirement. The outcome was negotiation between the city and the developer that resulted in a more flexible ordinance and the withdrawal of the lawsuit. About the same time, the Commune of Florence organized a symposium on land value recapture. All speakers asserted that the formation of the rendita cannot be eliminated or contrasted, but that through IH and competitions at least part of it can be recaptured by the public.

In Milan, with a center-right regime and an approach to planning based on flexibility and public-private partnerships that seem to benefit especially the private sector, the outcome has been disappointing. Non-market units provided in the many large-scale developments approved in the past decade are practically all for ownership, close to market in affordability and with resale controls easily overridden. More recent changes have introduced the requirement for social housing, but tied it to hefty density increases.

In Spain, it was a socialist government that passed 30% mandatory IH plus other measures that increase the potential for more betterment recapture and IH, and it is leftist local governments that pushed the political and economic limits to gain higher percentages of IH as in the case of Barcelona and Vigo.
The nationalization of development rights in the UK, which by now is far enough in the past to have become part of the planning consensus, probably makes IH less driven by government vs. market ideological struggles. The conflict perhaps is more along the lines of no-growth forces at the local level opposing government plans for additional housing. And if no market housing gets built, no Sec. 106 housing gets built either.

**Urban planning, land value recapture and IH**

During the period immediately after WW II planning followed highly centralized, top-down, command and control approaches based on the rational-comprehensive model of planning. This model implies an all-knowing, all-powerful governmental sector. Part and parcel of this approach was for the government to control development land and its value. Most important was the notion that some or all of the increases in land value resulting from government actions and expenditures should be recaptured for the public. Beginning in the 1970s, as the precepts of an all knowing interventionist state clashed with the reality of uncontrollable global forces driven by multinationals and international finance, it became clear that planning was a market-driven process, a “servant of the market” and that inflexible, detailed plans do not work in most real-life situations and are consequently either ignored or overridden (Cullingworth and Nadin 2002: 26).

**Models of planning and land value recapture**

This crisis of planning spurred a search for alternatives based on public-private partnerships, negotiation and flexibility in all the countries studied, with Spain the notable exception. IH, in its many varieties of public-private partnerships, is an outcome of this shift. It is also a form of land value recapture, or to use British terminology, of transferring planning gain or betterment, to the public. All the European countries presented in this volume have tried in different ways and at different time to recapture increases in land values resulting from governmental action and expenditures. A spur for those efforts was the prevention of inequity between property owners, a rather pernicious
outcome of planning decisions. The results have been quite disappointing. Can IH then, become an important instrument to recapture land values and smooth out the appropriation of development value among land owners? Under what circumstances can such a use of IH be made most effective and equitable? To answer those questions we will first summarize and categorize the different recapture approaches.

We distinguish four distinct models: 1) Countries with explicit recapture (Spain and the UK); 2) A country, Ireland, with explicit but limited recapture; 3) Countries where recapture is implicit or ambiguous (Italy, France and Canada) and 4) A country, the Unites States, where value recapture has not been part of the planning culture.

Spain and the UK. These two countries came to recapture from rather different directions. Efforts to recoup betterment in the UK have been many, most notably beginning with the 1947 Act and subsequent efforts to fix its problems. While the 1947 Act failed in this aspect, the nationalization of development rights remained, so that development rights rest with the state and not the property owner, the only country to have such a prerogative. The implications of such a system are many. We will mention the two most important for our purpose. First, local authorities’ land use designations in their development plans do not assign legal status to the properties involved and thus do not assign precise property values (with the opposite happening, as we shall see, in Spain). This happens only with the approval of a development plan. While that approval is generally based on the locality’s plan, it is not guarantee for approval. Second, such a planning system is based on a process of negotiation between the developer and the local authority, that can – at least theoretically – bargain from a position of strength for public amenities including, with Sec. 106, affordable housing. The negotiation process seems to have worked reasonably well both in producing affordable housing and recapturing land values. It is worth repeating what Sarah Monk explains in her chapter on England on how the recapture process is assumed to work in that country: “Section 106 aims to ensure the transfer of planning gain, or betterment, from the landowner to the local authority via the developer. Because the developer anticipates a major Section106 commitment, the price paid for the land is enhanced by the planning permission but only by the increased value.
less the anticipated cost of Section 106 agreements. While the market development value decreases, the cost is passed on entirely to the landowner who still receives a higher price for the land because of the planning permission.”

Spain, on the other hand, on the basis of its constitutional mandate and a sophisticated and complex planning system has been quite successful in recapturing for the public increased values resulting from general plan designations and creating equity among landowners. This happens through the repareclasacion process which calculates the equitable sharing of both the costs and benefits of development designations. Differently from Italy, where areas for public facilities were supposed to be secured through expropriations, in Spain it is the property owners in designated planning areas that provide the land, usually close to 50 percent of the overall comparto. These implementing mechanisms not only create equity among property owners and the eventual developer and provide the land to create the public city, but it also mandates a share in the plusvalias (5 to 15 percent of the profits) usually in the form of land – a betterment tax. The density allowed for the entire comparto is then concentrated on the remaining land and 30% of that square footage is to be dedicated to IH.

There are two important problems with the Spanish scheme. First, by assigning a percentage of profits resulting from development to the locality, it encourages growth and with it, corruption. Second, in assigning development rights at the time of plan designations to specific parcels, property values increase concomitantly, leading to one of the highest urban land values in Europe. While this bodes ill for housing costs, it also forces government to pay extremely high prices when needing to acquire land for city-wide or region-wide facilities. Hence the attempt on the part of the Zapatero socialist government to separate the jus aedificandi from the right to own land with the 2007 Ley del Suelo, attempt that, as we have seen in the Spain chapter, seems to have failed. The conservative government earlier attempt to open more land to development in the hope of lowering land costs backfired, as it provided fodder to the speculative madness of the 1997-2007 period.
An alternative to the liberalization of land markets to control costs is contemplated in the 2007 Ley del Suelo. It provides for the promotion of competitions among developers, acting as agentes urbanizadores, for the right to develop areas privately or publicly owned, chosen by local governments for immediate development. Presumably, one way developers would compete for designation will be by offering public benefits, including higher percentages of IH than required by law.

**Ireland.** With Part V, in the words of the Irish Supreme Court, “The owner may be required to cede some part of the enhanced value of the land deriving both from its zoning…and the grant of planning permission.” Such a sanction by the country’s highest court of collecting betterment might seem revolutionary in a country so attached to property rights and without a sophisticated planning tradition. But there are actually two precedents, both resulting from crisis situations, both unsuccessful. The first was the 1934 Town and Regional Planning Act that provided for a payment for betterment of three fourths of the increase in property values. However, as described in the Kerry Report, “as no planning scheme under the Act ever came into operation, no collection in respect of betterment was ever made. When the Act of 1934 was repealed by the planning Act, 1963, no similar provisions appeared in it.” Such a lesson “would be folly to ignore which is corroborated by the melancholy history of similar legislation in Britain” (Committee on the Price of Building Land 1971: 31). Second was the 1971 Kerry Report itself, amply described in the Ireland chapter. Although its recommendations were never implemented, it constituted an historical reference point that was tapped during the preparation of Part V legislation. Nevertheless, even with betterment recapture codified, the Irish tradition protective of property rights and the strength of the building industry influenced the 2002 IH legislation and subsequent amendments, making it considerable weaker than that of the UK and Spain.

**Italy.** After WW II Italy’s efforts to tackle betterment took two forms: 1) Paying less than market value for properties necessary for public facilities and public housing and; 2) Separating the *jus aedificandi* from the right to own property so that property owners had title to the existing use rights only, as in the UK. Such legislation was proposed and
reproposed, to be either neglected or trounced politically and constitutionally. A serious planning crisis ensued beginning in the 1970s, with general plans amended and sidestepped in favor of indiscriminate growth in many cities.

Eventually, Italian planners came to the somber acknowledgement that property had a right to share in the development value of land. But they do not want to fall in the Spanish trap that assigns value to land as a result of general plan approval. Instead, they want to create a two-phase planning process. With the first phase a strategic plan, the “piano strutturale” would indicate generalized land uses without assigning specific land uses to specific properties. Thus development rights would not receive legal status and values would not increase. They would be assigned with the five-year implementation plans, the “piano operativo.” At least in theory, the areas for development would then be chosen on the basis of benefits that would accrue to the city, including IH. To extract significant developers concessions (and hence recapture more betterment), including higher levels of IH, a few regions have passed legislation to allow concorsi (competitions), in which developers would compete for the right to develop (an approach similar to that of the agentes urbanizadores in Spain) on the basis of the number and quality of the amenities proposed. Such competitions would take place within an established regulatory framework establishing minimum requirements.

Much more promising and widespread is the perequazione. Inspired by the French Plafond légal de densité, a maximum density is spread over large similarly situated areas of a city, equitably distributing (minimum) property rights which are then concentrated on sub-areas, leaving the rest free for public facilities and affordable housing. Similar to the transfer of development rights, this is an elegant way for recapturing land values while ensuring equity among landowners and securing land for public facilities and affordable housing.

France’s attempt at a universal system of land value recapture was the enactment in 1975 of the Plafond légal de densité or PLD. Under the PLD, a maximum density of one square meter of development for each square meter of land, equivalent to a Floor Area
Ratio or FAR of 1.0 under United States practice was permitted on all properties located in urban areas, except in Paris, where the PLD was set at 1.5. To build at higher densities, the developer had to buy the development rights from the local administration. The PLD was intended to contain the excessive increases in land values in the central urban areas due to the high densities proposed under the local plans and to disincentivize high density developments through fiscal instruments that would have also “created substantive fiscal entries for local governments allowing the recapture of land value increases” (Renard 1999: 200 in Curti). The PLD, however, was an overly rigid system, which was soon modified to make it more flexible, and eventually eliminated. After 1983 cities with a population over 50,000 were allowed to increase it to a range between 1 and 2 and up to three in Paris. The PLD was made optional and the upper limit abolished in 1986, which practically ended its effective use. It was abolished entirely in 2000, although those municipalities that still had such regulations in place at that time were permitted to retain them. The PLD was widely seen as a disincentive to urban redevelopment, and a contributing factor to sprawl and the reduction of investment in the central areas of cities (Vitillo 2008). Today, the PLD is largely seen as a historical artifact of little relevance to present-day planning practice in France, which offers no explicit mechanism through which land value recapture takes place.

**United States.** When compared to European countries, the US is always presented as the country where property rights are protected the most and “the tradition of enterprise has always been uppermost (Hall 1999: 343). As a consequence, the idea of recapture of land values is not part of American planners’ lexicon. But at one time there was an understanding of the importance of the “financing of city planning” for producing the good city. As explained by Lawson Purdy at the Third National Conference on City Planning in 1911, the event and time associated with the birth of professionalized city planning in the U.S.:

> City planning is the art of so arranging streets and public places that privately owned land may put to its best use. When land is put to its best use the maximum land value is often one of the results. Land is the kind of property
that is increased in value by improvements in the city plan. Land, therefore, ought to pay the bill and can well afford to pay it. By taxation the price of land can be reduced, the opening of unnecessary street avoided, and the cost of government reduced. By assessment of property benefited, the cost of public improvements can be imposed on those who reap the financial reward that follows the improvement. By condemning more land than is necessary for widening of an old street, or the opening of a new street or park in a settled neighborhood, the expense may be reduced and plots subdivided in proper shape for immediate and suitable development to the great advantage of all. The method of making awards for land taken for public use may be so devised as to insure just awards in a short time. While this subject may be regarded as the financing of city planning, it is much more: it involves the best use by all the people of their common heritage.

As planning became a partner of the business community to make the American city more efficient and its legitimacy was established as a protector of property rights through zoning, that aspect of planning was lost.

However, it should be pointed out that, contrary to perception, regulation has come a long way from those early days. “Extreme” regulation of land, especially for environmental protection purposes, has been found constitutional in the US (Alterman 2001). And IH, as we have seen in the US chapter, has generally been construed as a land use regulation, not an exaction. Cost offsets and incentives might help IH pass legal muster, but they are not absolutely necessary. We have pointed out, for example, that in some progressive cities IH is constitutional even without cost offsets, working in effect, albeit without the rhetoric, as a land value recapture mechanism. Regulation then, while perhaps lessening its grip in European countries, is alive and well in the US, despite the presence of strong property rights movements, and forms the basis of IH.

But land value recapture has not received much traction. Some murmurs for the recapture of land values next to transit stations have been heard, as the push for high
density, mixed-use centers served by government-financed transit intensifies. IH could play that role as well. We have pointed out elsewhere that a few states in their enabling legislation or in mandating IH (New Jersey) have in fact tied IH to land use and zoning changes (Calavita and Mallach 2009). IH, we believe, is well positioned to become the mechanism to bring land value recapture back in the American planning discourse.

Canada. Despite notable differences between the United States and Canada in the course of their respective planning histories, there has been considerable convergence in practice, particularly in recent years. Although some provinces experimented with explicit land value recapture schemes in earlier years, these experiments are largely forgotten, and land value recapture plays little role in contemporary Canadian planning. This convergence is reflected in the severely limited extent that recapture is even recognized as playing a part in IH; although the Vancouver inclusionary program clearly relies on recapturing a share of the increment resulting from the rezoning of major parcels, the city avoids characterizing it as such, referring to the increment as a developer subsidy. The Montreal program, while voluntary and flexible, is based on a culture that emphasizes social integration which allows the city to bargain with developers from a position of strength when developers seek regulatory changes that enhance property values. The result is a “voluntary” form of land value recapture through IH.

In sum, IH is being utilized as a land value recapture mechanism explicitly in the UK, Ireland and Spain. It is implicit and ambiguous in Canada, France and the US. In Italy IH has been hailed in left-leaning cities as a tool to recapture land values, but in others it is just a mechanism – and not a very efficient one - to produce affordable housing

**IH, negotiation and economics or, how can land value recapture be made more efficient and equitable.**

IH is, ultimately, a negotiation-based process. Depending on the context and circumstances negotiations take place during the shaping of IH programs or, when flexibility and cost-offsets and incentives are provided, on how they are applied to
particular projects. They take place when localities wish to exceed minimum requirements. Or they take place routinely with each development, as in England. While these decisions are ultimately political, they have economic consequences. Requirements can go too far and make development economic infeasible; or not go far enough in recapturing a significant part on value increases for public benefits.

Negotiations then should be based on an analysis of the economic implications of various alternatives for developers, landowners and the public. In Spain, a country where the financial aspects of planning are quite sophisticated and at the forefront of the planning process, economic analysis are quite routine. Typically, planning departments lack the capability to perform or even verify economic analyses when provided by developers. As a result, in England for example, there have been charges that the negotiation process is stacked in favor of, especially large, developers. As the nature and processes of planning have changed with negotiation-based public-private partnerships becoming the norm, economic impact analyses should become the norm as well (Curti 2006).

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