



Irish Home Builders Association

Submission to the Department of Housing on the Residential Zoned Land Tax

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Prepared by
Deloitte.

Introduction

The IHBA represents hundreds of home builders of all sizes across Ireland, offering support and advice to members, liaising with relevant authorities and key stakeholders on the issues impacting home builders. The IHBA supports Irish home builders to deliver quality affordable homes to home buyers. The purpose of this submission, which has been crafted with the support of Deloitte, is to raise the concerns of our members of what are perceived to be the unintended impacts and consequences of the impending RZLT as currently legislated.

The RZLT was introduced as part of Finance Act 2021, with its stated aim being to increase housing supply by activating zoned, serviced residential development lands (including mixed-use lands) for housing. It also aims to incentivise landowners to activate existing planning permissions for housing. The new tax was introduced as part of *Housing for All*, the Government's housing plan to 2030.

The IHBA understands its members are operating under severe constraints in this housing crisis and action is required to increase the supply of residential property in Ireland. However, it is the considered opinion of the IHBA that the RZLT in its current guise will not achieve its stated aim and indeed could have the unintended short-term and long-term impact of further exacerbating the existing crisis.

We are living in uncertain times. Following on from Brexit, the pandemic and the war in Ukraine, we now see large scale cost inflation, materials and labour shortages, and significant viability issues particularly in relation to apartments while interest rates are going up significantly for the first time in a decade. On the ground, there are significant affordability challenges with rising input costs, as mentioned above, together with significant challenges securing planning permissions. There are currently a large number of units held up in An Bord Pleanála and others subjected to Judicial Review.

It is the view of the IHBA that while there is place in principle for a tax which achieves the aim of the RZLT, in order for such a tax to be effective all other aspects of the market need to be functioning correctly first. At the moment, we do not believe that to be the case.

We would welcome the opportunity to discuss our submission with you once you've had a chance to consider same. Please contact me should you have any queries in connection with same.



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The RZLT in practice

Principle of unfairness: The RZLT as structured currently will penalise home builders who are acting in good faith to develop sites within the scope of the tax. We have set out below an example of a home builder actively engaged in the planning and development process from 2024 onwards and who will ultimately suffer the same tax charge as a passive owner engaged in “land hoarding”.

Year	Event	RZLT charge
2021	Land zoned residential, serviced and with sufficient capacity for 750 apartments purchased for €13.5 million (assumed market value remains the same each year).	N/A
2022	Pre planning engagement with stakeholders. Land included as in scope for RZLT on maps published.	N/A
2023	Detailed design carried out by the developer	N/A
2024	Planning application submitted to the local authority for 750 units (full capacity)	RZLT charged at 3% of MV = €405,000
2025	Initial planning application denied. Home builder appeals decision but loses appeal.	RZLT charged at 3% of MV = €405,000
2026	Revised planning application submitted	RZLT charged at 3% = €405,000
2027	Planning granted. Judicial review taken against planning.	RZLT deferred for 2027
2028	Judicial review ongoing	RZLT deferred for 2028
2029	Planning approval overturned by judicial review	RZLT for 2027, 2028 & 2029 + accrued interest of c.8% p.a.= c. €1.3 million

The RZLT cost noted above is c. €2.5m. However, as the RZLT will either have had to be paid out of after tax profits (non deductible for tax purposes) or financed by a lender the actual cost of the RZLT is likely to be significantly higher (e.g. effective RZLT rate could be 4% or 5%). In the above example, there are any number of instances where the delays, and the ultimate failure to develop the land, is out of the hands of the home builder. In the end, the home builder having incurred significant non tax costs in efforts to progress matters will be in a worse position than the “land hoarder” who never did anything.

Key recommendation: A *bona fide* test to exclude owners (that are actively engaged in seeking to progress developments) from the scope of the RZLT should be drafted and form part of the RZLT legislation.

Other concerns identified with the RZLT in its current form

Other factors outside of the control of the home builder: In the absence of a *bona fide* test, home builders will be punished despite actively trying to develop land e.g. if a home builder developed 200 apartments over a number of years within the timeline of the planning permission granted thereby deferring the RZLT during that time which would otherwise have been due, there may be factors outside the control of a builder which prevent completion notices from being lodged e.g. there are currently significant delays being experienced in obtaining connections for developed homes from Irish Water/ESB etc. Such delays could result in the planning permission timeline expiring and deferred RZLT being triggered. Our members have identified many delays in the planning/development process (not just the appeals process opposite) which are outside of their control, such as: acquisition of a fire certificate, awaiting publication of a masterplan by local authorities, title issues etc.

Phased Development: A home builder may own an in scope site with capacity for 1,000 units. That home builder may only be allowed to develop this site on a phased basis (e.g. 200 units at a time). There are a number of reasons for this, including the planning regulator only permitting development of a certain number of units per year, planning permission timeline only allowing for phased development, lenders only willing to finance phased development, etc. While a deferral (which in itself makes a project inherently riskier) may be available for 20% of the land, the current legislation would tax the remaining 80% until that too is under development. It is contended that this will adversely impact viability and affordability of units subsequently developed on later portions of the site. One of our members specifically commented as follows:

“A developer will typically require a pipeline of say 5 years worth of land to enable a sustainable business. While building on today’s land we are typically planning and ensuring planning permissions are in place for 2-5 years down the line. This ‘land stock’ is an essential part of the process and taxing it will not encourage it to be built faster. We need this stock to plan our business and have a steady flow of what is our raw material (i.e. land).”

Crystallisation events: There are a number of instances where RZLT can be deferred by a home builder. The fact that a change in ownership of the site will crystallise a deferred RZLT liability (together with accrued interest) in certain cases is problematic practically for number of reasons e.g. a lender may require a home builder to transfer a site with planning permission to a new company within the same group for lender security reasons. In addition, certain sites may transfer from a builder to the end owner earlier on in the development process as a form of end user financing with the builder continuing to finish out the development following the transfer. In both cases, RZLT previously deferred may be triggered by such transfers with no mechanism for either the buyer or seller to reclaim RZLT where the site is subsequently fully developed. It is contended that any builder meeting the proposed *bona fide* test should be excluded from the scope of the tax rather than the deferral mechanism currently in place. This should also reduce inherent project risk which impacts financing and viability. Similarly, where the term of a planning permission runs out before development has completed, or development otherwise permanently ceases, deferred RZLT must be paid (again, with accrued interest). There is limited opportunity under the legislation for such a liability to be reduced provided a certain proportion of development has completed (such that certificates of completion have been lodged). While this may in theory allow for some relief in relation to housing developments, this will be of little assistance to those building apartments, as a certificate of completion would be unlikely to issue unless the development has completed in its entirety.

Viability: It is widely acknowledged, including in the latest Housing for All quarterly update, that there are serious viability issues with the development of apartments in particular. Imposing RZLT on a site which is not viable to develop will not result in additional housing being developed. The IHBA welcomes in this regard Housing for All’s commitment to propose new viability measures in Q1 2023 to activate stalled planning permissions and bring forward cost rental at scale.

Academic Commentary

Hughes, C., Sayce, S., Shepherd, E. and Wyatt, P. (2020): *Implementing a land value tax: considerations on moving from theory to practice*

A study published in 2020 by the University of Reading identified 6 jurisdictions that had introduced a land value tax (LVT). These were: South Africa, Estonia, Australia (Queensland), Denmark, New Zealand and Namibia. In Estonia, Namibia and South Africa the tax was introduced in the context of post-colonialism and radical political and economic change, while in Denmark, Australia and New Zealand the taxes were introduced based on economic theory in the late 19th and early 20th centuries. None of the taxes were primarily aimed at the development of land for residential use. According to the study:

“Economic theory suggests that a land value tax based on highest and best use would encourage the development of vacant or under-developed land because of the increased holding cost, thereby creating an incentive to sell the land or develop it. However, this only works in cases where land can be viably developed. Where land is economically not viable to develop, it follows that there is no value on which to levy a land value tax. Such land may require subsidy rather than taxation (Hughes et al. 2018). In the six countries reviewed, there was no firm evidence that LVT was a consistently effective tool for bringing land forward for development. Instead of taxation, more direct forms of regulatory control such as land use planning, development control and infrastructure investment are likely to be more effective.

That said, land value tax could potentially be effective in cases where there is evidence of speculative land banking by owners or land promoters who have obtained options to develop, or are holding land with a view to driving up values. However, this would also increase the tax liability of large housing developers who require several years’ worth of development land in various stages of the development process.

In England for example, the business models of larger housebuilders rely on such a pipeline due to the complexity and uncertainty involved in housing development (CW Economics, 2017). If the holding costs of several years’ worth of development land were to increase, this could affect development viability, or more probably, increase the use of options over land purchase. Furthermore, any resultant decline in the land value of assets held by development companies could have implications for company balance sheets and consequent borrowing capacity. Whilst these problems could be alleviated or, potentially, solved through sensitive transition arrangements, they illustrate how a land value tax is a potentially blunt instrument for encouraging the development of under-utilised land, and brings with it potential economic risks.”

Valuation concerns: RZLT is self-assessed such that each home builder would be required to apply their own valuation to a site. As noted above, it could be argued that if a site isn’t viable then it does not have any value which would suggest that the RZLT should be nil. However, as with all valuations this is open to interpretation. The concern for home builders is that a surcharge of up to 30% can arise where land is deemed to be undervalued for RZLT purposes. Thus, there is a need for clarity to be provided that where a site is not assessed as being viable to develop then the valuation for the purposes of the RZLT can be considered to be nil.

Prior Dept. of Finance Consultation

October 2015: *Report on the Outcome of Public Consultation on the Potential of Taxation Measures to Encourage Development of Zoned and Serviced Land*

A Public Consultation on an RZLT-type tax was initially launched in 2015, with numerous stakeholders then expressing similar concerns to those expressed in this submission. It is notable that the report included the following findings in its conclusion:

- *“No evidence has been presented that the hoarding of land to await its appreciation is a major issue preventing the development of that land.”*
- *“There are rather a range of limiting issues, of which land hoarding would only be one. These include difficulties in accessing finance, building standard requirements, planning requirements, and infrastructure deficits.”*
- *“It is the Minister’s determination that no new tax intended to encourage the development of residentially zoned and serviced land be introduced at this time.”*

Difficulties with understanding what’s changed: It is the view of the IHBA that, if anything, the limiting issues identified in 2015 have only been exacerbated by recent events including Brexit, the Covid-19 crisis, the war in Ukraine, cost inflation, supply and labour shortages, increased cost of funding etc.

While it is accepted that RZLT could activate some land being hoarded by those speculating as to land prices, the unintended consequences on market participants not engaged in this practice is disproportionate.

Our members build homes and it is the considered opinion of the IHBA that this new tax will simply create another barrier to the operation of viable businesses, and in turn, the supply of housing for the people of Ireland.

Current Market Challenges

In our view the current shortfall in the supply of housing has not been caused by land hoarding by home builders. Our members are in the business of building homes. However, they can only do so where a development is viable commercially. There are any number of challenges faced by the home building industry currently that are ultimately impacting on the viability on projects. We have summarised below some of the challenges faced by our members.

- **Construction Cost Inflation:** Wholesale prices for construction materials rose 14% in the year to June 2022 (17% to September 2022). From year end 2017 to June 2022 this figure is at 42%.
- **Judicial Review (“JR”) Timeline & Cost:** Developments that are subject to Judicial Review (“JR”) experience average waiting times of 60 weeks from initial planning application to court judgement. The Society of Chartered Surveyors Ireland estimates that the JR process adds between €8,000 and €12,000 to the cost of each new unit.
- **Concrete Levy:** The Society of Chartered Surveyors Ireland estimates that the concrete levy will add approximately €3,000 to €4,000 to the overall delivery costs of an average 3 bed-semi, the most common house type in Ireland.
- **Build to Rent:** The intended removal of the Build-to-Rent standards and the intention of Dublin City Council to specify in the draft City Development Plan for 2022-2028 that at least 40 per cent of complexes must meet the requirements of “standard build-to-sell apartments” will adversely impact viability. Industry sources have stated that axing the development standards would add to the cost of building homes in urban areas and will have an impact on delivery and investment in much needed housing.
- **Minimum Design Standards:** Research indicates Ireland’s Build to Sell standard is estimated to be approximately 11% bigger than the EU average. Our housing is also generally built in excess of the minimum Irish design standards. The minimum standard for a 3 bedroom apartment is 90 sq.m. The current 10 year average is 163.2 sq.m (130 sq.m in 2021). This requirement puts additional upwards pressure on the cost of development.
- **Commencements Trending Down:** From our research and on the basis of a 9-month lag from a grant of planning to commencement, the percentage conversion rate is 50% from Q1 and 63% from Q2. This is noticeably down on the previous three quarters’ figures of 70%, 72% and 73%, respectively. Latest Housing for All Quarterly Report notes, *“Ireland saw 27,417 new homes commenced in the year ending September 2022. This represents a 10% reduction on the previous 12 month period largely due to a surge of commencements immediately after Covid-19 lockdown restrictions to construction were removed. However, some slowing in commencements suggests impact of economic uncertainty during 2022.”* If viability of apartments in particular is not addressed we expect this trend to continue.
- **Pressure on the System:** There is a concern at the amount of time that is going to be taken up (by home builders, planning consultants and planning authorities) dealing with appeals regarding land incorrectly placed on the RZLT maps which could otherwise be used productively in engaging with planning applications.

**Housing for All 2022 Action Plan Update and Q3 Progress Report*

- **Real Estate Funding:**

Construction cost inflation has also been driven by factors such as pandemic related stoppages, depleted inventories, rising wages and Brexit-related transport issues. Energy prices have soared. Interest rates are rising. These cost pressures make homes costlier and slower to build. As such, those who finance and build face greater risks than they did one year ago.

RZLT is likely to impact leverage appetite as the lender needs to factor in an additional annual cost on a non income producing asset such as zoned land. The only other alternative source of funding this annual cost is equity, which is already a limiting factor in many residential development schemes. Developers that do not have adequate capital resources need to seek third party equity, which is becoming increasingly challenging given the factors such as:

- Yields continuing to widen;
- Land values expected to fall;
- Pricing expectations continuing to increase;
- The limited availability for speculative funding in the private rental sector; and
- A sharp decline in leverage appetite (the maximum leverage from alternative lenders on zoned land is c. 50% while traditional banks having no appetite for lending on zoned land).

The RZLT has the potential to further challenge viability and reduce the appetite of international funders to provide equity to Irish developers. This will reduce the pool of developers that have the ability to deliver housing in Ireland.

It has been noted by our members that if the RZLT results in the falling values of land held by home builders this could result in cash calls from lenders which could put home builders in financial distress.

- **Practical cost of planning delays**

For example, let’s assume:

- an average construction cost of €350,000 for a unit and 14% inflation on input costs.
- 31,000 units delayed (conservative estimate) by JR or awaiting ABP decision

This equates to construction value of 10.8 Billion with an inflationary increase of €1.5Billion per annum or €126 million per month or €4,000 per unit per month.

This only serves to emphasise the completely changed environment the industry finds itself today, especially when compared to the time when the RZLT was first envisaged. This will ultimately be a cost borne by the homebuyer at a time when affordability is a significant challenge. Buyers of new homes are already paying a significant amount towards infrastructural costs, water connections, VAT and other regulatory costs that purchasers of second hand homes simply do not have to pay.

Summary of key concerns and proposals

Concerns

- Economic environment has changed significantly since tax first considered in 2015 public consultation
 - Dramatic construction cost inflation
 - War/Covid impact on supply chains
 - Worldwide materials shortages e.g. copper
 - Reduced access to and increased cost of financing
- Impact on commencement expectations for next year
- Current RZLT legislation
 - does not take into account that where projects are not viable imposing an additional tax cost on owners will not change this
 - will tax those that are genuinely trying to progress developments and are being prevented due to circumstances outside of their control
 - will be frustrated in its goals of significantly increasing the number of residential units developed
 - will ultimately result in RZLT costs negatively impacting affordability for homeowners

Key Issues

Proposals

- Ensure the RZLT charge only arises at the point that barriers to commencement have been removed.
 - Should be excluded from RZLT charge if bona fide trying to progress the development (see earlier example)
 - Exclusion required rather than deferral for bona fide cases
- Address viability challenge
 - Option 1 – Postpone introduction of the RZLT for 3 years to allow current economic cycle to evolve
 - Option 2 – Introduce exclusion for non-viable projects or clarify that where projects are not viable valuations for RZLT purposes can be considered nil
 - Option 3 – Deal with viability
 - E.g. Target time limited reduction in the VAT rate applicable to residential developments and student housing
 - E.g. Allow a credit for RZLT paid against VAT arising on sale of residential property within a specific period
 - Others to be considered separately

“All agree in principle with the aim of the tax. However, in order for the tax to be effective all other aspects of the market need to be functioning correctly.”