



## OAK INVESTMENT MANAGEMENT GROUP



JULY (2) 2013

### Section 106 in UK Real Estate

*Colloquially, Section 106 refers to Section 106 of the Town and Country Planning Act 1990 (In Scotland it is Section 75 of the Town and Country Planning (Scotland) Act 1997). This started as a levy on development gain but now is a monstrous intrusion into the free market in UK real estate. It is the bane of developers' lives and should be considered one of the most arcane and one of the most unjust legal provisions in the UK.*

Conceived as a mechanism to encourage the development of affordable housing the Section 106 has done just the opposite of that. This provision has destroyed the free market for social housing by destroying free market supply to that market and people's incentives to deliver cheap housing for the poor; has restricted the development of housing to the mid-market in the UK; and has developed a cottage industry of dubious payments or political favours *in lieu* of what is a fundamentally unjust and arguably illegal (because it is arbitrary) transfer of economic resources from one sector to another.

Long after regulated tenancies have been abolished because of the detrimental effect to investment in real estate or wage controls lifted because of the dire consequences it has on incentives in the economy, developers are still required to pay a tax that is neither fixed or proportionate but is dependent on a supposed fixed rate of return deemed appropriate by the government or one of its agencies. There are few other asset classes (other than natural resources – which is hardly analogous) penalised so heavily beyond the capital gains taxes that are already in place for gain.

This is not only a 'theoretical' flaw but a very real and pragmatic one. In London, generally, developers can build up to nine apartments before they have to provide *on-site* affordable housing – but in many parts of the country this provision can be as low as three apartments. Where this is not appropriate even by this Act's sclerotic standards a payment is made to a housing association for the provision of off-site affordable housing. Worse still, the exact amount to be paid is determined by what is considered a required return by the government. The fact that twenty per cent is considered a just return for the margin between bricks, mortar and labour and the market price for the finished product neglects the time it might take to clear the apartments at that price and other embedded risk factors. Building involves many inter-dependent inputs and should one of these be delayed the 'ascertained' return will be destroyed. This is why return is best determined by the market.

This creates an unsustainable supply in the lower market (which is under-priced) and a restriction of supply in the mid-market (which is over-priced) and is thus a completely artificial market. Development in the UK is, as a result, a fraction of what it can and should be. We can only hope that the government sooner or later reconsiders what is empirically best for the provision of housing and returns to a market-based solution.