IIP Opening Statement to Oireachtas Housing Committee – 01/06/2023.

Introduction

Irish Institutional Property (IIP) is the voice of institutionally financed investors and real estate providers with significant local and international backing in the Irish real estate market. The mission of IIP is to promote the development of a progressive world class real estate sector in Ireland, which benefits members, the economy and wider society. IIP members are backed by a diverse group of investors, including Irish and international pension funds, among others. Post the Global Financial Crisis (GFC) institutional capital has become a significant component of both the global and Irish real estate markets, providing stable long-term funding to enable sustained delivery of the required supply of critical infrastructure, housing, and workplaces. This capital has now largely re-structured and replaced the "highly leveraged" funding model of the past. These changes in the funding model were necessary to put Ireland on a par competitively with other OECD countries that recognises capital intensive activities such as housing and related real estate, need stable and more conservative capital structures to avoid the debt fuelled boom and busts of the past.

Since 2015 IIP members, have collectively invested c.€20bn in delivery of critical real estate in the Irish market as illustrated below:

- IIP members directly employ over 6,000 people.
- IIP members indirectly employ a further c.23,000 people.
- IIP tenant companies employ more than 36,000 people IIP members include five of the largest 20 companies on Euronext Dublin (formerly known as Irish Stock Exchange)
- IIP members are on target (post Covid) to deliver around 50% of the projected private market housing output in Ireland.
- Institutional investors are the major providers of debt funding to a significant majority of house builders and developers in Ireland that account for the balance of new housing output.

Basis for LVS

IIP members welcome the concept of capturing some of the value uplift in taking land from a lower use value to higher value and then using the revenue captured to fund the required infrastructure necessary to facilitate that higher use value.

However, there are a number of significant potential unintended consequences which may arise if the proposal was to be implemented as currently proposed. One key issue is the risk to the viability of apartment development. The Explanatory Memorandum notes that "it is evident that the benefit conferred by the zoning of land for residential development results in significant uplifts in land value". While this is true in some cases, as laid out in very stark economic terms in the Project Emerald report (see here)issued by the Department of Finance in April 23, it is very clear that in many situations by zoning land to high density apartment development it would create a negative land residual value. Imposing another tax on that already unviable situation would only make it worse and create a lot of very negative unintended consequences in the urban land market and further limit new housing supply.

It is critical that the LVS tax is structured to ensure that all the tax collected is ring-fenced to pay for and build all the infrastructure required for a particular project / area. Only when that land can be developed without a "funding gap" should any surplus funds be allocated to a wider county budget.

As drafted the proposal will:

- Not reduce housing costs in any way – but ultimately only increase the "tax wedge" in housing costs which is already one of the highest tax takes in Europe.
- By introducing the measure as a blunt "cliff edge scenario" it potentially leads to a hiatus in the land market. – There are many examples today of high-density sites that are already unviable (no land residual value) and now are at risk of an additional tax being imposed. The impact of this is already manifesting itself in the land market. A phasing in over a 5-6 year period at a growing percentage per annum, say 5,10,15% and so on would be preferable to avoid significant turmoil in the land market.
- Have detrimental implications for funding structures and investments made in recent years. Many, in particular higher density sites have already been delayed by judicial reviews and significant delays at ABP. As things stand there is no sign that this will change any time soon. It is imperative that the LVS tax reverts to the original proposal and the tax should apply only to newly zoned land for a long period. The so called transition arrangements will not be enough to avoid many investment write-downs. Recall currently that 65% of all apartment developments are being JR'd with an 88% success rate.
- This risk must be viewed in the context where around 80% of all funding for housing (including social and affordable) has to come from abroad – is this the right signal we want to send to this funding – initial soundings from IIP members is that, the statement of intention to impose an additional tax on land purchased – in good faith - in recent years will only increase funding costs and make even more projects less viable.
- The IIP is surprised that the initial proposal to have the LVS replace levies was scrapped. The market initially understood that the LVS would replace the S48 and 49 levies and the investment case and viability would be unchanged – but as proposed it is a retrospective tax on currently zoned land which will have significant unintended consequences.

Observations on UDZ

- The IIP welcomes the idea of properly planned areas, in particular with the full calculation of costs of infrastructure up front and the requirement for a funding scheme to be developed. As noted, it is essential that the LVS is used for this.
- However – we are concerned many of the "lessons learnt" from the very slow roll out of the SDZ's – where IIP members are the main actors – have not been addressed.
- The Explanatory Memorandum noted that *"evidence from designated SDZ's is that there has been a significant delay between the making of a Government Order and the*

preparation of the of the planning scheme, after which point there may be further delays associated with infrastructure planning and delivery. ***By this stage, it is often the case that changes to the adopted scheme are required*** *and this results in further delay"*

- IIP members who have been the main private sector and financial actors, alongside the public authorities bringing the major SDZ's to fruition. While a full blown UDZ might be a good idea for a "new town", it is critical that a less restrictive format similar to the SDRA in the Dublin City Council plan may be more appropriate in most cases – as long as the costing and infrastructure funding plan is also addressed. Even then a UDZ will need more flexibility in implementation to expedite delivery, one of the key obstacles that has hampered the roll out of SDZ's to date.

In summary

The UDZ has the potential to be a positive enhancement of the SDZ system. The Explanatory Memorandum has identified one of the key reasons SDZ's were slow to get started and in many cases are still stalled – the need for a funding plan. However, there are many other issues that do not work in SDZ's, in particular the need for additional flexibility – without the need to change the whole plan – to allow developers respond to constantly changing market and funding realities.

A facilitated engagement in a workshop between the Department and the main stakeholders in the major SDZ's on lessons learnt to date would be a good way to do this. IIP members who are the main players in this space would be happy to participate.

Other than very large developments – new towns – it may be that a less onerous UDZ similar to the SDRA process used by Dublin City Council is a more appropriate way to create coherent urban plans. Obviously, the proposal that a full plan for associated infrastructure would need to be added to the planning side is a good idea from this draft bill.

We have very significant concerns on the negative – we believe unintended consequences – of the LVS proposals as drafted. It is clear that the authors of this proposal were not familiar with the April '23 study – called Project Emerald - for the Department of Finance by KPMG. Reading the LVS proposals in conjunction with the Emerald report is very sobering and it is very clear that the LVS proposal will lead to many situations where a tax could be added to situations that already are not viable, putting projects even further in the red. The current proposal has the potential to disrupt and distort the land market and, in many instances, cause very significant financial distress to developers and investors in development land who have been subject to inordinate delays due to a systemic breakdown in the planning system – in particular for the higher density urban housing that this country needs both for social and environmental reasons.

The current LVS Proposal – which in its basic form theory should be a fair and reasonable idea – is very problematic - in particular departing from the previous proposal to have it replace development levies – it also seems totally disconnected from other government initiatives to deal with viability challenges such as the levy waiver and Croi Caoimhe and its application totally ignores the viability insights in the recent Project Emerald report.

Interestingly the Explanatory Memorandum states *“it is important to note that the analysis undertaken by Indecon is based on assumptions and an incomplete dataset given the lack of recorded data on land values.”*

It is essential that a major review of the LVS proposal is undertaken and that the Indecon report is released so that it can be analysed by the wider industry to identify any further potential unintended negative consequences in addition to those that are already very obvious to developers and funders of housing.

Additional Notes

Regulatory Uncertainty

- Large apartment developments can take 4-5 years to build. The investment commitment is made up front and investors need to know there will be no material changes to the assumptions they have made. Changes should only apply to developments started after the change as investors can price that in from the get-go. In recent years there have been a significant number of changes that undermine confidence of investors and developers to undertake large complex projects. The LVS proposal – applying retrospectively to current investments adds to this list. Recent changes that have impacted investors' confidence include:
  - Setting the rent cap at 2% - well below inflation
  - Restriction on debt in certain investment structures by the Central Bank of Ireland
  - An increase in the percentage of Part V units
  - Banning of Co-Living & BTR codes which are very successful in other jurisdictions on uninformed sentiment not any evidence of poor standards.
  - Introduction and withdrawal of Social Leasing initiative
  - The use of the HDNA process to "cap" available housing land – even key brownfield sites in urban locations.

Project Emerald

Published by the Department of Finance in April 2023.

https://www.gov.ie/en/publication/7a4b7-project-emerald-residential-funding-report/

The report shows that higher density apartment development remains unviable outside of Dublin and indeed highly challenged in Dublin (see tables below from the report).

The numbers illustrate that most sites have a negative land residual value, something the government is trying to overcome with Croí Cónaithe and the recent pause on development levies.

As most UDZ's are likely to be higher density apartment developments, either one of two things will happen. There will be long and protracted disputes as to what the tax should be with the state focused on collecting a tax and landowner and/or developer challenging. IIP members are of the view that 1) if a tax is imposed - which is a risk as we have no visibility on the Indecon report proposed calculated workings - it will further undermine viability and 2) if a valuation process endorses the view – as highlighted in the Department of Finance report - that there is no value uplift – no tax will be collected and the UDZ will – as happened with the SDZ's (until the arrival of the URDF) – be left without any infrastructure funding.

Referencing tables from the Project Emerald Report highlighting the current development costs for various forms of apartment development based on SCSI figures, prior to recent inflation.

It is very clear that the "Total Cost" is in many cases far in excess of what a units can be sold at in the market making the project viable. Even if the site cost is deduced, the saving is still not enough to make the project viable indicating that the land – in theory – has a negative land residual value.

The second table shows the numbers adjusted for the recent surge in inflation which has made viability even more challenging.

SCSI Apartment Categorisation

Apt Cat 1	Apt Cat 2	Apt Cat 3	Apt Cat 4
			
Suburban – Low Rise (3 storeys)	Suburban – Medium Rise (3 to 6 stories)	Urban – Medium Rise (5 to 8 storeys)	Urban – Medium Rise (9 to 15 storeys)

The composition of costs across each category is set out in Table 2 below

Table 2 – Composition of Construction Costs (SCSI as indexed for TPI)

2 bed Apartment - Composition of Cost	Apt Cat 1	Apt Cat 2	Apt Cat 3	Apt Cat 4	House
Construction	255,910	326,996	338,628	368,355	221,196
Sales & Marketing	7,718	9,923	11,025	12,128	9,446
Planning, Prof. Fees and Compliance	17,640	22,050	23,153	25,358	6,354
Part V Costs	5,843	5,843	5,843	5,843	5,960
Finance and Banking	31,019	40,067	49,114	50,406	21,891
Irish Water and Utiliy Connections	9,435	9,435	9,435	9,435	8,786
Contingency	12,925	16,802	16,802	18,095	13,096
	340,490	431,115	454,000	489,619	286,729
Development Levies	16,414	18,353	25,462	25,462	12,027
Site	36,700	53,700	74,700	74,700	55,523
	393,604	503,169	554,162	589,781	354,280
Developer Margin/Risk	59,041	75,475	83,124	88,467	53,142
	452,645	578,644	637,286	678,248	407,422
VAT	61,107	78,117	86,034	91,564	55,002
Total Cost	**513,752**	**656,761**	**723,320**	**769,812**	**462,423**

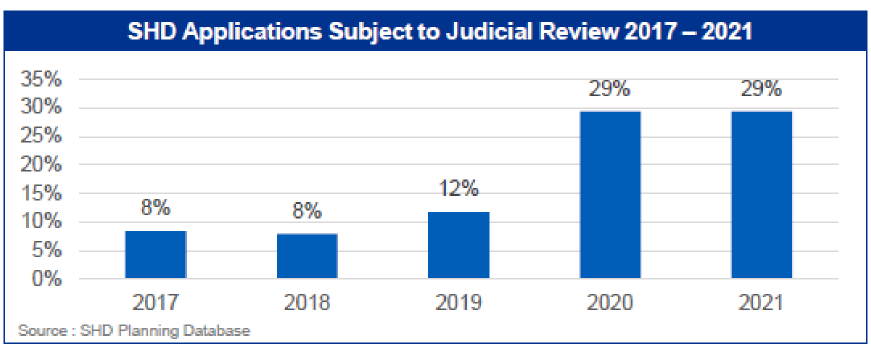
The costs figures noted include all costs including financing costs and the costs of equity (reflected as Development Risk). The increased cost of apartment development during 2021 and 2022 has served to substantially undermine the viability of apartment development. This is further evaluated on page 23

Table 3 – Viability of BTR Apartment Development Post Recent Inflation

Viability of PRS Apartment Development	Apt Cat 1	Apt Cat 2	Apt Cat 3	Apt Cat 4
Total Delivery Cost (incl. Dev. Margin/Risk)				
- 1 Bed	**310,509**	**396,943**	**437,171**	**465,271**
- 2 Bed	**513,752**	**656,761**	**723,320**	**769,812**
- 3 Bed	**621,019**	**793,887**	**874,342**	**930,542**
Monthly Rent				
- 1 Bed	1,500	1,650	1,800	2,000
- 2 Bed	2,000	2,200	2,600	2,800
- 3 Bed	2,200	2,400	2,700	3,000
Annual Net Rent (net of 20% Opex)				
- 1 Bed	14,400	15,840	17,280	19,200
- 2 Bed	19,200	21,120	24,960	26,880
- 3 Bed	21,120	23,040	25,920	28,800
Capital Value at 4% net yield				
- 1 Bed	344,630	379,092	413,555	459,506
- 2 Bed	459,506	505,457	597,358	643,308
- 3 Bed	505,457	551,407	620,333	689,259
Viability Gap (at 4% exit yield)				
- 1 Bed	34,120	-17,851	-23,616	-5,765
- 2 Bed	-54,246	-151,304	-125,962	-126,503
- 3 Bed	-115,562	-242,479	-254,009	-241,283

Impacts of Planning Uncertainty

- The last number of years has seen a surge in judicial reviews of higher density housing schemes. The introduction of the SHD system and the new national codes on Height and Density – has dramatically increased the number of apartment schemes that are stuck in court or have been overturned and must start again. In many cases developers and investors have had to wait for new Development Plans to be adopted to start again and even some of those plans are now being challenged in the courts.
- 30% of all (large 100+) residential schemes challenged in the courts. 65% of all higher density (apartment) schemes. 88% are quashed or withdrawn.
- Added to that systemic breakdown in a functioning planning system has been the well reported delays and restructuring at An Bord Pleanála



Outcome of Judicial Reviews for SHD Applications 2018 – 2021		
Status	**# of Decisions**	**% Share of Decisions**
Successful	31	70.4%
Withdrawn	8	18.2%
Refused	5	11.4%
Pending	50	N/A

- It is essential to sustain confidence by investors in the market, who bought land in good faith, before any LVS proposal is applied that they are allowed to complete thier developments without the imposition of a retrospective tax.
- This is critical in the context – as highlighted in the Project Emerald report – that Ireland will need to rely very heavily on foreign, mobile capital to build future housing stock. That includes a significant percentage of the planned social and affordable target.
- While the government is investing directly and via the use of ISIF funds – the vast majority of the funding for housing is from the private international markets – whose confidence we need to maintain as we have done for FDI investors with a strong commitment to a steady predictable tax regime. The LVS proposal as drafted completely undermines this as the proposed transition arrangements do not capture the reality of delays on the ground.

Other Delays:

- **In addition to the planning delays highlighted above – there are other issues delaying the start of development which may cause them to be unfairly caught by the transition arrangements:**
    - Sequential developments whereby we cannot apply for planning permission ahead of another landholding within a certain location,
    - Core numbers under the development plan or LAP do not allow for lodging a planning application,
    - Water, wastewater or road constraints, and;
    - Development land in conjunction with third parties where collaboration agreements are required.

Other Points:

- **Off-sets** - The proposal to allow off-sets to allow developers to provide land of build infrastructure is very positive and will lead to better value for money in the use of the LVS tax.

- **Phasing in**. As noted earlier, it is key that existing investments are not taxed retrospectively. However, to avoid a major "cliff edge scenario" we suggest that once the tax is imposed it is phased in at increments of 5% per annum until it reaches the 30%. This will help the land market remain functioning, avoid lengthy disputes and a potential overwhelming of valuation tribunal resources. It will also encourage landowners to move early and release more land. As currently drafted an overnight "cliff edge" will cause major disruption in the market and lead to significant levels of disputes.

- **UDZ.** The issue of SPPR's and National Planning Statements applying in UDZ's as they are enacted must be addressed. In some SDZ's ministerial guidelines issued 4-5 years ago have not yet been incorporated into the SDZ's despite official policy that they must be included. It is essential that these rules / guidelines apply in a UDZ as they do in any Development Plan as soon as they are adopted – without the need for a further adoption process.

- **Use of Levies -** Make sure there is no "funding gap" in a UDZ before any money is transferred out of it. The idea that some should be "shared" with the county could create a situation where the project is stuck with no funding for key infrastructure.

- **UDZ funding model** – It is important that the state develops some funding model to help liquidity issues in the early stages of a UDZ. There may be 5-6 landowners, but only one wants to develop early. That one LVS contribution may not be enough to fund the up-front infrastructure to open up the land. The state should consider lending to the UDZ until the other landowners start, who will than fund their share and pay down the state loan. This has been one of the challenges that has stalled SDZ roll -out.

- **Tax Wedge** increase. It is worth recapping on the significant number of taxes that have been imposed on development since the Kenny Report.
  - Capital gains tax (currently at 33%, but previously as high as 80% in this context),
  - VAT (currently 13.5%),
  - Development contributions (estimated at an average of €100 per square metre or 10k per unit),
  - The social and affordable obligation under Part V of the Planning Acts (20% of the existing use value),
  - Connection fees to Uisce Éireann (formerly Irish Water)
  - Other site activation measures, including the RZLT (at 3% of market value per annum)
  - VSL (at 7% of market value per annum)
  - Where relevant, archaeology fees now can run to 3-4k per unit.

- **Payment of the Charge**; the payment will form a condition on the grant of planning permission but there is no detail in the draft Bill on how the Charge is to be paid. We would propose that the charge be paid on a per unit basis prior to the closing of a home, similar to Section 48 Contributions. In addition, how the cost of deducting public infrastructure from the charge is calculated needs to be considered along with the definition of '*public infrastructure'* as well as clarification that the infrastructure costs are a deduction from the tax liability?

- **Exemption of Social & Affordable Developments**; we would recommend that in hybrid schemes that the percentage of Social & Affordable homes are exempt from the Charge.

It appears unfair that smaller schemes that are more likely to get support from LAs for an entire Social & Affordable scheme, of say less than one hundred units, would be exempt from the Charge.

- **Standardisation of Process**. It is important that adequate resources and training are put in place at LAs to manage this and there is a consistent code of practice for its implementation.
- **Mapping process**: the process of drafting the maps of land applicable for the Charge should have a consultation process similar to that of the RZLT mapping process.