The Role of Property Tax Incentives in Urban Regeneration and Property Market Failure in Dublin

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Property tax incentives or selective waivers have been used extensively in Ireland in the last 25 years to stimulate property development and investment for urban regeneration. This paper investigates their prolonged use and examines their contributory role in the property crash and resulting financial crisis in 2008. Prolonged interventions can result in extensive distortion of property market operations. As a result, interventions aimed at revitalising a failing market become embedded in market processes to the extent that they may contribute to a more general subsequent market failure.

This paper examines the recent experience in the use of tax incentives in urban regeneration in Dublin during the period 1986–2011. The effects of the property- and area-based tax incentive schemes initiated under the Finance Act of 1986 and Urban Renewal Act of 1986 are examined. The paper provides an overview of the benefits, costs, and impacts of the incentives from an urban development market perspective.

The tax schemes are examined in terms of the rationale for their introduction and their effectiveness in operation from the public exchequer perspective. This examination is placed in the context of current debates on urban regeneration and the use of fiscal incentives in an international perspective. In order to gain insight into the specific performance of the incentives in relation to policy objectives, selected interviews were carried out to obtain the opinions of policy makers and planning interests.

Introduction

Privately led urban regeneration has been promoted in many cities worldwide to improve the use of public funds, increase devolution of central government responsibilities, enhance the functions delegated to the local level, and create public–private partnerships. Business improvement districts (BIDs) and city improvement districts (CIDs), in particular, have developed as models for revitalising commercial areas in declining inner-city areas as well as in high-to
low-income neighbourhoods (McGreal et al. 2002). City property development regeneration schemes have been linked to the evolution of an *urban entrepreneurialism* (McGuirk and MacLaran 2001) and the rise of neoliberal forms of governance as competition between cities in the global economy becomes greater than ever (Peyroux 2006).

Research confirms that selective tax waivers and other incentives for developers, investors, and residents can play a significant role in improving the physical and economic environment in cities (Adair, Berry, and McGreal 2003; Cadell, Falk, and King 2008; Williams 2008). However, research also suggests that tax-based measures need to operate within a clear planning, regulatory, and budgetary framework. It is also essential to recognise the different ways such measures may operate under different national and local taxation regimes, as well as their performance relative to national and local economies and the parallel functioning of local property markets, in determining whether the tax incentives have proven to be effective and financially beneficial. This paper suggests therefore that it is necessary to analyse the context for their introduction on the basis of the concept of market failure, the policy impacts of such interventions, and issues such as scope and duration of programmes, deadweight, displacement, opportunity cost, and multiplier effect.

Sustainable development and urban regeneration have become increasingly recognised as complementary goals (McGuirk 2000; Hemphill, McGreal, and Berry 2003; Evans 2007; McGill 2010). Since the late 1980s in Ireland, there has been an increasing government interest in the potential for tax-based measures to encourage and stimulate urban regeneration (Lloyd 2002).

Until that time, the policy framework for urban regeneration in other jurisdictions such as the United Kingdom was traditionally based on statutory and non-statutory land use planning initiatives supported by direct public expenditure and financial subsidies for specific geographical areas (McGreal et al. 2002; Thornton et al. 2007; Haran, Newell, and Adair 2011). Examples of these initiatives are urban development grants, urban regeneration grants, derelict land grants, and city grants. These tools were used to attract capital investment into inner-city locations and to stimulate the regeneration process (Adair, Berry, and McGreal 2003). Similar tools used in the United States took the form of subsidies designed to bridge the gap between the cost of development and the value of the scheme upon completion.

The clear objective of these grants was to attract private investment to supplement or replace public sector monies (Wernstedt et al. 2006; Singhal, Berry, and McGreal 2009). Singhal et al. (2009) believe the ability of certain urban areas and cities to gain access to investment varies significantly. Certain cities have a competitive advantage and are in a strong position to capture opportunities for growth and development.

The use of financial subsidies for specific geographical areas commenced in Ireland with the Urban Renewal Bill in 1982, which was not enacted, and the Urban Renewal Act, which was introduced in 1986. These measures had two principal aims: (1) the designation of physical areas for special incentives with the aim of revitalising those parts of the city that, in the absence of such intervention, were likely to remain derelict or undeveloped, and (2) the stimulation of investment in the construction industry and expansion of employment (Williams 2008).

During the period 1970–1990, the limitations of this type of approach were identified internationally as poor targeting of subsidies, that is, a focus on property owners and developers (Thornton et al. 2007) instead of on those occupiers and residents using the
space, leading to concerns about their effectiveness. Alternative approaches are needed to address the various complicated issues surrounding urban economic and community regeneration. As a result, additional focus is often placed on the use of broader fiscal incentives and interventions to encourage economic, physical, and social development.

**Policy Evolution in Ireland**

The genuine need to address the failing economy of Ireland in 1986 provided the stimulus for the Urban Renewal Act of that year, incorporating a range of property market incentives to initiate urban regeneration and development in selected areas of Irish inner cities. An unemployment rate of 17 percent and the chronic state of public finances encouraged policy makers to introduce innovative programmes to kick-start construction activity at long derelict sites in designated areas and to stimulate general housing development (Williams 1997, 2008). Barriers to achieving sustainable housing in the regeneration process are the lack of a shared vision for housing, inadequate building regulations, noncompliance with existing regulations, and a failure to recognise the need for social regeneration and limited resources (Winston 2009).

Because of lack of public finances in the 1980s (ESRI 1985), tax breaks were chosen as the primary means of incentivising property development and investment in city centre areas. In general, this involved the Exchequer sharing the risk of development by writing off future tax payments in lieu of costs incurred by those developing, investing in, and occupying qualifying developments.

Initially, land assets of public agencies were sold at discounted prices, and specialist regeneration agencies at innovative or flagship developments such as Temple Bar and Custom House Docks/Dublin Docklands Development Authority played a major role in facilitating the general regeneration process. Criticisms of the construction focus of the incentive schemes and the relative lower importance placed on social and economic improvements were balanced by the obvious successful physical redevelopment of designated areas and increased employment that followed.

The property-based tax incentives were first introduced under the Urban Renewal Act of 1986 and the Finance Act of 1986. Together with subsequent legislation, these laws allowed the government to designate renewal areas in Dublin and other urban areas, such as Cork, Limerick, Galway, and Waterford, for special tax incentives provision. Within these designated areas, incentives aimed at developers, investors, and occupiers were to apply for an initial period of 10 years.

**Rationale for Fiscal Incentives in a Changing Dublin Market Context**

**Introduction of Incentives for a Market in Need of Support: 1986–1994**

Following the failure of the Urban Renewal Bill in 1982, the Urban Renewal Act was introduced in 1986 with the following aims:

- Designation of areas for special incentives with the aim of revitalising those parts of the city that in the absence of such intervention were likely to remain derelict or undeveloped
- The stimulation of investment in the construction industry and expansion of employment.

The original aims of the programme were extremely broad, envisaging integrated economic development programmes, job creation, and other initiatives, but the serious state of public finances in the late 1980s and early 1990s militated against this approach. Instead, tax-related incentives for development and occupation of property dominated. The original package of incentives was
adapted to suit different areas and had the following aims:

- Tax allowances in respect of capital expenditures for construction or reconstruction of commercial buildings to be set off against income or corporation taxes
- A double rent allowance, which occupiers could set off against trading income for a period of 10 years, for new leases on commercial buildings
- Remission of rates for a 10-year period
- Income tax relief for owner-occupiers of residential units newly built or refurbished
- Tax relief for investors in rented residential property within specified size limits
- A reduced corporation tax rate of 10 percent for licensed companies involved in international financial services locating in the International Financial Services Centre (IFSC).

The adoption of an area-based approach placed the emphasis on physical renewal in the original schemes. Alternative approaches involving a more integrated approach were considered but not pursued because of limitations on resources and public finances and possible administrative complexities.

During this time brownfield redevelopment and waterfront revitalisation were significantly pursued in Irish cities, particularly Dublin, and this led to the regeneration of docklands areas (Curturi 2010). The Custom House Docks, a previously derelict docklands site, was the major flagship scheme of urban renewal in Dublin in the 1980s. It was the objective of a major integrated development with business, residential, and recreational functions. The creation of a new IFSC was added to this objective, and a single-purpose development agency, the Dublin Docklands Development Authority, was established with effective planning functions for the area under its administration. In the 1990s the second historic area of development was Temple Bar as a rejuvenated cultural, artistic, and entertainment quarter.

In order to assess any policy intervention, it is useful to consider the original policy parameters (Williams 2006):

- To designate areas in need of development without damaging surrounding areas
- To identify land uses to be promoted in such areas
- To quantify amounts of development that could take place
- To identify appropriate incentives
- To minimise cost to national exchequer.

Sustaining a Revived Market: 1994–2000

The altered economic circumstances of the late 1990s provide a significant statistical contrast to those at the initiation of the urban renewal scheme in 1986. From 1994 to 1999, real growth in the Irish gross national product (GNP) averaged 7.5 percent. Building and construction output rose rapidly, and unemployment fell to below 6 percent, the lowest level since the 1960s when there were labor shortages (ESRI 1994–1998). Emigration had ceased to be a problem, and immigration into Ireland, particularly in the Dublin region, was growing. Public finances were returned to a surplus situation, and inflation and interest rates were low. Over the period 1994–2000 the volume of construction output rose rapidly.

By 1994 urban renewal aided by a resurgent economy was proceeding successfully and the need for reform was evident. At this stage residential development incentives, which had been more widely available, were restricted to desig-
nated areas only, and measures to attract greater use of vacant or underutilised portions of buildings were introduced. A major official study of the urban regeneration schemes nationally was carried out in 1996 (DOELG 1996). At this stage more than IR£1.7 billion (US$2.84 billion) of development schemes had been generated, with approximately IR£1 billion (US$1.67 billion) of this development occurring in Dublin. (Note that the Irish pound was replaced with the Euro on January 1, 1999. However, since the data reported here are from earlier years, the Irish pound is used and not converted to the Euro.) The DOELG study and other independent research highlighted the success of the schemes in physical redevelopment of derelict areas and identified emerging problem areas in policy implementation.

Deadweight levels of projects refer to the extent to which the benefits of a tax incentive or subsidy are reduced or eliminated and relate the extent to which investments benefiting from the scheme would have occurred anyway. If investment would have proceeded without the incentive, then the tax revenue foregone by way of the tax relief represents an unnecessary cost to the Exchequer. Displacement and relocation of commercial users occur, and incentives to one project result in business being displaced from existing operators or providers of services.

Another concern was that conservation and refurbishment proved problematic because the structure of schemes favoured new development and single-use commercial developments over mixed-use development. In addition, the general pattern of development was sometimes viewed as piecemeal, and the absence of urban design and planning criteria led to poor-quality architecture and urban design. The longer term sustainability and coordination of development were regarded as having been more appropriately dealt with in the selected areas of Custom House Docks and Temple Bar than in general designated areas, and this model was preferred for future developments (DOELG 1996). The official estimate of the cost of tax allowances to the Exchequer was IR£367 to IR£461 million (US$617 to US$769 million) assuming deadweight of 25–50 percent and balancing such losses against additional tax revenues generated.

This set of estimates would appear to underestimate the direct cost of the scheme (Williams 2008) because of the following factors:

- The exclusion of infrastructural and administrative costs directly funded by public sources
- The treatment of valuation of public land assets
- Exclusion of the cost to local authorities of rate remissions.

In turn, it is also likely that the indirect benefits of the scheme may be underestimated because employment patterns were not clearly established in 1996 and numbers of workers in the IFSC were likely to be lower than later realised. Separating employment gains attributable to urban regeneration from those due to general economic growth is extremely unreliable. The positive aspects of growth for Dublin were the levels of economic confidence engendered by employment increases, significant inward investment, and a major growth in tourism. These development successes are balanced by the negative aspects of growth patterns and urban management issues such as housing affordability and major transportation and infrastructure deficiencies.

At this stage serious questions arose as to whether the incentives were in fact inflating an already overheating housing market. A variety of related tax incentives for investors in private rented property were amended to deflect investors and favour first-time buyers. After extensive lobbying, the government was con-
cerned that this was producing a housing supply downturn and by 2002 reversed these measures. In addition, following official reviews of urban regeneration by government-appointed consultants KPMG in 1996, moves were made to curtail the wasteful and negative aspects of these schemes. A more strategic and integrated approach to the awarding of incentive-type designations was introduced in the Urban Renewal Act of 1998 (www.environ.ie). Concerns about rising house prices in 1998 resulted in the temporary reduction of tax incentives for residential investors, but these were subsequently restored in later years as fears of curtailing the construction boom dominated official policy.

This policy shift in the approach to urban renewal was outlined in the revised programme of urban renewal that commenced in 2000. The introduction of a significantly amended approach to urban renewal in Dublin began with the 1998 Urban Renewal Guidelines. The intention to create a more coherent and holistic approach was represented in the introduction of a structured programme based upon Integrated Area Plans (IAPs) prepared for selected areas. These reports are prepared by local authorities for areas based on criteria established by an expert advisory panel to the Minister of the Environment. These plans are intended to be detailed area focus plans that identify the strengths and weaknesses of the districts involved, target those districts with the greatest need or potential for rejuvenation, and select sub-areas or key projects for special incentives. The creation and implementation of such plans were intended to include consultation with representative groups in the areas concerned. Fiscal incentives now formed part of the overall renewal strategy and were intended to be available only where proven barriers to development existed.

IAPs include broad issues such as urban design, sustainable land uses, education training, local economic development, environmental improvement, and traffic management. A major feature of the IAP scheme was the requirement for a specific monitoring and implementation strategy for each plan. Local authorities and authorised companies are required to monitor progress on a periodic basis. Public monitoring committees with cross-sectional community membership are required to examine physical, economic, and social benefits in an annual report. Following a selection procedure, a total of 49 IAPs received ministerial approval in 1999, including a number in the Dublin area. It is evident that a major location switch occurred—from city centre areas to adjacent and outlying areas.


From 2000 onward, government statements indicated aspirations to end the urban regeneration schemes because strong economic growth and relative full employment meant that large-scale financial subsidies and tax write-offs to sector interests were becoming increasingly difficult to justify. However, as property prices rose rapidly, generating supernormal profit levels by 2002, investors and financiers surged into property markets. In development and regeneration activities, the enormous potential returns available from trading in development land made the recapture of construction or borrowing costs seem a minor concern. An increasing range of existing and additional generous incentives and low taxation of property development activities assisted this trend. Government budgetary changes at this time and the use of offshore and alternative tax-based structures increased the financial attractiveness of the speculative property development market.

The demand for development activity in Ireland in this period was driven by several major factors: strong growth
in the general economy, high levels of inward investment particularly in the information technology (IT) sector, expansion of the services sector, and growth in tourism. Over the period 1990–2004, Ireland’s economic profile turned around completely, moving from one of the weaker economies of Northwest Europe to one of the strongest in terms of economic and employment growth. The Irish GNP was growing by 8 percent per annum by 2001, resulting in unemployment being reduced from 12 percent in 1996 to a low of 4 percent in 2000. From 2000 to 2004 continued economic and employment growth resulted in unemployment remaining below 5 percent for several years (ESRI 2000–2004).

Following several extensions after 2000, the Finance Act of 2004 extended the termination date for a number of property-based tax incentive schemes (from December 31, 2004, to July 31, 2006) subject to certain transitional requirements being met. A major lobbying issue for urban development interests in Ireland during this period was the expiry of urban renewal and property-based taxation schemes. The purpose of further extensions was “to facilitate the orderly completion of projects already in the pipeline” (Indecon 2006). The termination date of July 31, 2006, applied only to projects for which a valid application for full planning permission was received by the relevant local authority on or before December 31, 2004.

However, this termination date was again extended by the Minister for Finance Brian Cowen, as announced in the following statement as part of Budget 2005:

Because of the complex nature of this issue, the interaction of such reliefs with economic activity and the unintended consequences that untimely action may have for investment, I want to ensure that I take the time necessary to strike a careful and considered balance in what I do. (Department of Finance 2005)

A supervisory group of officials from the Department of Finance and the Office of the Revenue Commissioners was subsequently established in February 2005 to oversee the review. The review also involved external consultancy work on the evaluation of certain tax incentive schemes. The urban renewal incentive schemes were finally phased out by July 2008.


The final legislation for the expiry of tax-based incentive schemes was effected in 2006 with a phased termination of allowable expenditures until July 31, 2008. This delayed termination, however, contributed to a major surge in construction activity as projects were completed to take advantage of the incentives rather than match real demand, increasing the market oversupply and eventual collapse (Williams 2010).

From 2008 to 2011 Ireland’s favourable economic situation reversed. The country has been in recession since the second quarter of 2008. By December 2010, the unemployment rate for Ireland was more than 14 percent (Central Statistics Office 2010) and remains at this level in early 2012.

According to the Central Statistics Office, the country’s GDP shrank by 7.5 percent in the fourth quarter of 2008. Furthermore, a crisis situation faced Irish banking and its financial institutions with approximately €100 billion (US$131.4 billion) of toxic assets eroding balance sheets. The government established the National Asset Management Agency (NAMA) in response to the financial crisis and the deflation of the property market. NAMA essentially functions as a repository for the failed development finance sector, transferring property development loans from Irish banks in return for government bonds.

The primary responsibility of NAMA, as announced on September 16, 2009, was to improve the availability of credit in the Irish economy. The process has in-