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An tAcht um Thithe an Oireachtais
(Fiosrúcháin, Pribhléidí agus Nósanna Imeachta), 2013

REPORT of the Joint Committee of Inquiry into the Banking Crisis

Houses of the Oireachtas
(Inquiries, Privileges and Procedures) Act, 2013

Volume 1: Report
Volume 2: Inquiry Framework
Volume 3: Evidence

Dept. of Finance
DOF: Core Book 57

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Table of contents – by line of inquiry

R4: Appropriateness and effective utilisation of the Expert Advice

R4a: Appropriateness of expert advice sought, quality of analysis of the advice and how this advice was used

THEME: R4

Appropriateness and effective utilisation of the expert advice

LINE OF INQUIRY: R4a

Appropriateness of the expert advice sought, quality of analysis of the advice and how effectively this advice was used

Budget 2006:

Review of Tax Schemes

Volume II:

Goodbody Review of
Area-Based Tax Incentive Renewal Schemes

Department of Finance
February 2006

Introductory Note

A major review of existing tax incentive schemes was undertaken in 2005, on foot of the announcement by the Minister for Finance, Mr Brian Cowen T.D., to this effect in Budget 2005.

The review process involved internal reviews conducted by officials in the Department of Finance and the Office of the Revenue Commissioners, as well as reviews of certain schemes by external consultants. Goodbody Economic Consultants were retained in April 2005 to conduct a detailed review of area-based tax incentive renewal schemes.

Goodbody submitted their report on 4 November 2005. The full text of the Goodbody report is reproduced in this volume, which is Volume II of the series. The review of certain sectoral property-based tax incentive schemes, conducted by Indecon, is set out in Volume I. Volume III reproduces the finalised reports of the internal reviews.

Department of Finance
February 2006

Review of Area-Based Tax Incentive Renewal Schemes

Final Report

November 2005

Goodbody Economic Consultants in association with
Mazars and HKR
Ballsbridge Park, Ballsbridge, Dublin 4 • Tel: 353-1-6410482 • Fax: 353-1-6682388
www.goodbody.ie/consultants/ • e-mail – econsultants@goodbody.ie

Table of Contents

List of Tables

List of Figures

Executive Summary

General

The Minister for Finance announced in his Budget Statement of December 2004 that the Department of Finance and the Office of the Revenue Commissioners would undertake a detailed review of certain tax incentive schemes and tax exemptions in 2005.

As part of this process, the Department of Finance has commissioned a study of the area-based tax incentive schemes viz.

- The Rural Renewal Scheme;
- The Urban Renewal Scheme;
- The Town Renewal Scheme; and
- The Living over the Shop Scheme.

Goodbody Economic Consultants in association with Mazars and Horan Keogan Ryan were commissioned to undertake the study.

Objectives of the Review

The objectives of the review may be summarised as follows:

- To assess the costs and benefits of each scheme, taking account of dead-weight and displacement effects;
- To assess the costs to the Exchequer of the tax Incentives and the gross and net impact on Exchequer revenues;
- In particular, to assess the success of the schemes in the economic and social development and regeneration of designated areas;
- To identify successful and unsuccessful aspects of the schemes;
- To identify changes in the design of the schemes that would promote effectiveness and value for money; and
- To consider the extent to which alternative public expenditure measures could be used to achieve the same objectives.

Approach of the Consultants

The approach of the consultants to the assignment was based on the following elements:

- The derivation of a cost-benefit framework, within which the Urban and Town Renewal Schemes could be evaluated;
- Use of the Department of Environment, Heritage and Local Government databases, detailing expenditures on the Urban, Town and Living over the Shop Schemes;

- Development of basic data on the Rural Renewal Scheme through a series of surveys, as data on the Scheme were not available from official sources;
- Development and use of a model to assess the tax costs of the Schemes;
- Consultation with Departmental and local authority officials;
- Collection of relevant planning statistics from the local authorities
- A postal survey to elicit local authority planning officials views on the Schemes;
- Seven full case studies and two partial case studies of urban areas and towns benefiting from all four Schemes; and
- A review of similar and alternative schemes in operation abroad.

Cost to the Exchequer

It is estimated that the area-based tax incentive Schemes will cost the Exchequer €639m in tax forgone in present value terms in respect of developments undertaken to end of 2004.

By the end of July 2006, when the Schemes are due to expire, it is predicted that the costs to the Exchequer will have risen to €1,933m. Almost 74 per cent of these anticipated costs will arise in respect of the Urban Renewal Scheme.

The major impact on the Exchequer is yet to come, as even those developments completed by end 2004 will give rise to claims for tax relief for a considerable future period.

These tax costs are high relative to the outputs achieved. For example, the present value of tax costs represent up to 43 per cent of the building cost associated with developments undertaken as part of the Schemes.

The Rural Renewal Scheme

Th Rural Renewal Scheme has delivered a modest increase in housing output, which has improved the quality of the housing stock in the participating areas. Overall, it has had relatively little impact on industrial and commercial development and thus directly on economic activity. However, it has helped vitalise the towns of Longford and Leitrim, through both residential and commercial developments.

With regard to the housing output under the Scheme, it is evident that there is substantial dead-weight and a significant proportion of the output would have occurred in any event.

A key objective of the Scheme was to support a reversal of the population decline in the participating areas. There is evidence that much of the housing output has been taken up by existing residents, further increasing the dead weight associated with the Scheme. As a result, the Scheme has not represented value for money. This has been exacerbated by the tendency, on the part of a significant minority of participants to build relatively large houses.

It is now evident that the very substantial increase in housing output has now resulted in excess supply and that house prices are softening and rents have declined.

A positive feature of the Scheme has been the large number of participants, and thus a reasonably widespread distribution of the tax benefits. However, the Scheme, in common with the other area based incentive, has fundamentally adverse equity impacts.

The Urban Renewal Scheme

The Urban Renewal Scheme has been successfully implemented, and it is anticipated that by mid July 2006 a very high proportion of developments earmarked for the designated sites will have been completed. The structures put in place, including the Integrated Area Plans, have been vital in matching development to local needs and priorities. Areas where resources were applied to managing and marketing the Scheme were particularly successful.

The Scheme has had very positive impacts on dereliction and has been reasonably successful in improving urban design. With regard to economic impacts, the Scheme has enhanced housing outputs in the target areas. This housing has been taken up and there is no evidence of excess supply. Moreover, the Scheme had a strong emphasis on commercial development and has delivered significant benefits in this area.

The Scheme has been less successful in delivering social and community benefits, as significant funding for initiatives in this area was not raised. Because of the heavy involvement of residential investors in the Scheme and the increased supply of rental properties, concerns have arisen that there have been negative impacts on social integration. This has arisen because mental properties have often attracted a transient population, with excessive dependency on occupation by social welfare recipients.

While dead-weight continues to be an aspect of all such schemes, there is evidence that the Urban Scheme kick started developments in a number of areas, and was crucial in focusing developments on inner city locations, that developers might normally have eschewed.

While the Scheme has proved extremely valuable, its very success, together with the strength of the economy and the increase in private capital, has reduced the need for it going forward. Dead weight is now relatively high at the level of the individual project.

The tax benefits of the Scheme have accrued to relatively few higher income individuals. There has also been significant inflation of property prices as a result of the tax incentives and this has benefited a small number of landowners and developers. Thus, the Scheme has had strong negative income distributional effects, although this is to some extent inevitable when only a small number of sites are tax designated.

The Town Renewal Scheme

The Town Renewal Scheme has been less successfully implemented than the Urban Renewal scheme. A large number of developments at designated sites remain to be commenced. In a significant proportion of towns only a minority of developments have been completed by end of 2004. That said, some towns have benefited enormously from the Scheme.

Where progress has been poor, this is result largely of lack of interest on the part of developers and site owners. To some extent this lack of interest reflected a level of risk of investment in relatively small towns, which the tax incentives were insufficient to offset. It was also the result of the fact that in many towns the designations provided largely for refurbishment of existing commercial property and this proved less attractive to developers than new build.

There is some evidence that the Town Renewal Scheme was not as well managed as the Urban Scheme. Local authority resources were often spread too thinly across a number of towns. Either the allocation of greater managerial resources or a limit on the number of towns included in the Scheme would have produced better outcomes.

The impact of the Scheme has thus been relatively patchy. Where the Scheme was successfully implemented the impacts would have been on a par with those of the Urban scheme. This was not the case for a significant minority of towns.

Where successfully implemented, the Scheme, given its emphasis on refurbishment, had a strong impact on dereliction. Urban design issues featured less strongly than for the Urban Scheme, as did conservation. Because of the relatively low level of new build, economic impacts have not been to the fore. Community and social impacts were not really a feature of the Scheme, and there would not have been any real prospect of raising levies to fund initiatives in this area.

It must be recognised that there was substantial cross over between in terms of scale between areas designated under the Urban and Town Schemes. Larger towns in the Town scheme that had a relatively high level of designation for new build tended to derive similar economic benefits as did their counterparts in the Urban Scheme.

With regard to dead weight, it would appear that this was lower than for the Urban, as the higher risks in towns with lower populations made the tax incentives more crucial in the decision to develop a site.

Living over the Shop Scheme

The Living over the Shop Scheme, as with its predecessors, suffered from low levels of take up. This is a problem that is unlikely to be overcome, as the disruption to retail activities and the loss of storage space act as a deterrent to shopkeepers. Additionally, over the shop residences may not be very attractive to prospective tenants. Because of low take-up, the impacts of the Scheme on the urban environment has been limited. However, the Scheme has been more successful in some urban areas than others. The key factor appears to have been the application of resources to managing and marketing the Scheme.

Recommendations

It is recommended, subject to compliance with EU State Aids policies, that the expiry date for the current Schemes be extended to end 2007.

Thereafter, the Rural Renewal Scheme should not be continued. It is not regarded as cost-effective approach to the problems of rural decline, and is not a model that should be employed elsewhere in the country.

As the Living over the Shop Scheme has a narrow focus on fostering a living urban environment, it should be retained, despite the difficulties with take-up. It is recommended that the tax incentives be made available contingent on a commitment of resources by local authorities to managing the process.

With regard to the Urban and Town Renewal Schemes, the scale of economic activity and the availability of capital have reduced the need for such Schemes. That said, it is recommended that Government retain tax incentivisation as a tool of policy, should economic conditions require further action to regenerate urban areas.

If Government chooses to reintroduce area based tax incentivisation in the post 2007 period, then it is recommended that changes to the structure of the schemes be implemented to reduce the cost to the Exchequer and their inequitable effects.

These changes include:

- Targeting the schemes in areas or towns for which there is evidence of development activity , but where problem sites, such as old dock lands and industrial sites, are being neglected;
- Giving priority to urban areas identified as Gateways and Hubs in the National Spatial Strategy and to towns and cities that host RAPID areas;
- Ensuring that adequate resources are applied to the management of the Schemes;
- Incorporating structures to share experience and promote good practice
- Introducing measures to control abuse of the Schemes;
- Ensuring that designated sites have a prospect of being serviced;
- Establishing the Scheme for a sufficient duration to allow developers to respond;
- Increasing the level of owner-occupation in the housing output mix;
- In order to incentivise the latter, granting 100 per cent relief to owner-occupiers over ten years and restricting the investor relief to 50 per cent; and
- Improving the equity and cost effectiveness of the Schemes by allowing the relief in relation to a proportion of expenditure only.

1. Introduction

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1.4 Layout of the Report

The layout of the report is as follows.

Section 2 describes the background to the Schemes and the nature of the tax incentives offered,

Section 3 discusses the economic backdrop against which the Schemes operated and analyses the economic issues impinging on the Schemes and their evaluation, including the development of a cost-benefit framework.

Sections 4, 5, 6 and 7 present the reviews of the Rural, Urban, Town and Living over the Shop schemes respectively.

Section 8 discusses the future of the Schemes in light of European Union State Aids policies, and alternative schemes and approaches that are available.

Finally, Section 9 presents the conclusions and recommendations.

2. Background to the Schemes

2.1 Urban Renewal Scheme

The first Urban Renewal Scheme was introduced in 1986 to address the increasing problem of dereliction and decay affecting large parts of the inner city areas throughout the State. At that stage, many of these areas had sustained large population declines, as growth and development were increasingly concentrated in the suburbs. The core objective of the Scheme was to encourage urban renewal and redevelopment by promoting investment and reconstruction of buildings in designated areas.

The current Urban Renewal Scheme, which was put in place in 1998, followed a detailed review of the previous urban renewal schemes carried out by KPMG.[1] The study found that the schemes had been highly successful in attracting investment to designated areas. This conclusion was subsequently confirmed by an academic study, which compared the experience of tax based incentives in Dublin and Chicago.[2] It concluded that "tax incentives have played an important role and there is little doubt that the scale of physical renewal in Dublin would not have been achieved in their absence".

However, the KPMG study also found that some of the architectural/design elements had been of mixed quality, and the pattern of development was often piecemeal and not targeted at areas most in need. In addition, it was considered that the incentive schemes did not address issues central to the regeneration and sustainability of these areas, such as employment, the lack of public amenities, education and youth development. The KPMG review and the more recent academic study also highlighted issues such as dead weight, and the displacement of investment from non-designated areas.

The KPMG study led to several changes, when the 1998 scheme came to be designed viz.

- The adoption of a more structured approach to the process of designating areas for urban renewal;
- A focus on areas most in need of renewal; and
- A more selective approach to applying the various incentives.

For the new Urban Renewal Scheme, local authorities were requested to draw up Integrated Area Plans (IAPs) in respect of each urban area that they wished to include in the Scheme. Priority for selection was to be given to physically run down areas, which also suffered from high levels of social disadvantage. In order to minimise the resultant cost to the Exchequer, the plans also promoted the optimum use of existing infrastructure. A total of 78 Integrated Area Plans were submitted to the Minister for the Environment and Local Government. The Integrated Area Plans were assessed by a broad based Expert Advisory Panel set up by that Minister for the

[1] KPMG. Study on the Urban Renewal Schemes. Department of the Environment. 1996.
[2] S.McGreal at al. Tax-Based Mechanisms in Urban Generation: Dublin and Chicago Models. Urban Studies. Volume 39, No.10, 2002.

purpose of making recommendations in relation to the designation of areas. Work on assessing the Integrated Area Plans was completed in 1998. The Expert Panel recommended designation in respect of 49 of the 78 integrated area plans submitted. The designations cover a total of 43 cities and towns.

Unlike previous urban renewal schemes, a selective approach to the areas and the incentives available was adopted. In some instances, only one or two incentives apply in many small sub areas within individual Integrated Area plans and, in other cases, the incentives are often limited to residential tax incentives only. The Expert Panel recommended Section 23-type relief (Rented Residential) for new house construction in a very limited number of cases, for which it was considered absolutely necessary to achieve Integrated Area Plan objectives. A less restrictive approach was taken in respect of refurbishment of older buildings.

The residential elements of the Scheme were introduced from the 1st March 1999 and the Industrial/Commercial elements from the 1st July 1999.

2.2 Town Renewal Scheme

In 1999, The Minister for Housing and Urban Renewal announced a new Town Renewal Scheme. The Town Renewal Scheme focuses on the restoration, consolidation and revitalisation of the built fabric of smaller towns (towns with populations of between 500 and 6,000). The main objectives of the scheme are to counter the continuing trend for people moving out of towns, to make the town environment more attractive as a place to live, to restore older buildings and to help promote a wide range of commercial, leisure and social activities in towns. In recent years, many smaller towns and villages had begun to serve as dormitory or weekend centres with many vacant or under utilised upper floors and derelict sites. Tax incentives for a range of residential and commercial development were introduced on the same lines as for the Urban Renewal Scheme.

There were 226 towns potentially eligible to participate in the Scheme and one hundred of these were designated. The selection and designation process was similar to the process undertaken for the Urban Renewal Scheme. Local authorities were asked to submit a Town Renewal Plan to an Expert Advisory Panel before December 1999. This panel advised the Minister for the Environment and Local Government regarding the towns and sub areas within towns that were suitable for designation under the scheme. The areas and sub-areas designated for relief under the Scheme were announced by the Minister for the Environment and Local Government in late July 2000, and the residential elements of the Scheme were introduced with immediate effect. The commercial elements of the Scheme were introduced from 6thApril 2001, following agreement with the European Commission. Under the Scheme, capital allowances were made available to small and medium sized enterprises only.

2.3 Rural Renewal Scheme

This is a pilot initiative of rural renewal aimed at developing the Upper Shannon region. It extends to all of the counties of Leitrim and Longford as well as certain areas in counties Cavan, Roscommon and Sligo on a District Electoral Division basis.

The scheme has been in operation for rented residential projects since June 1998, for owner-occupied residential properties from the 6th April 1999 and for certain commercial and industrial projects since July 1999. The delay in introducing the business elements of the scheme was due to difficulties encountered in securing EU Commission approval. The Commission, in approving the scheme specified that investors active in certain sectors including the agricultural and financial services sector could not avail of the reliefs available under the scheme. The Commission also excluded property developers from claiming relief under the scheme.

2.4 Living Over the Shop Scheme

The KPMG study concluded that the Living Over the Shop Scheme, with the exception of Cork, had not been successful for several reasons such as security, legal issues, fire and building regulations and access problems. In order to ensure a greater measure of success, the new Scheme, which commenced in 2001, extended to streets outside the integrated areas designated under the Urban Renewal Scheme. The reliefs apply to specific lengths of streetscape, which were recommended by authorities in the five county borough areas and approved by a special panel of experts.

2.5 Nature of the Tax Reliefs

2.5.1 Tax Incentives Available

The incentives provided under the Urban, Town and Rural Renewal Schemes are as follows:

Industrial Buildings and Commercial Premises

Allowances can be claimed on the cost of construction or refurbishment of commercial buildings. An initial allowance of 50 per cent of expenditure may be claimed by both the owner-occupiers and lessors with an annual allowance of 4 per cent thereafter up to 100 per cent. Alternatively, an accelerated allowance of up to 50 per cent of expenditure may be claimed by owner-occupiers only with an annual allowance of 4 per cent thereafter up to 100 per cent.

Rented Residential Accommodation

Relief is granted against all rental income for the cost of construction (excluding site costs) of rented residential accommodation.

Relief is also granted against all rental income for the cost of conversion into rented residential accommodation of a building which had not previously been in use as a dwelling or the conversion into two or more houses, of a building which had not previously been used as a dwelling, or had been used as a single dwelling.

Relief is granted against all rental income for expenditure incurred on refurbishment of a building, which before and after refurbishment contains one or more residential units.

Owner Occupier Residential Accommodation

Owner-occupiers of residential accommodation may claim a deduction of 5 per cent per annum for 10 years in the case of construction expenditure and 10 per cent per annum for 10 years in the case of refurbishment expenditure.

The individual incurring the expenditure must be the first owner and occupier of the dwelling after the expenditure has been incurred and the dwelling must be the sole or main residence of the individual.

2.5.2 Allowable Expenditure

The qualifying expenditure on which tax relief can be claimed is the actual cost of construction, refurbishment or conversion work excluding the site costs of a property. Costs in relation to an individual's own labour do not qualify. Grants and other payments received directly or indirectly from the State, any board established by statute or any public or local authority are deducted in arriving at the amount of the expenditure, which qualifies for relief. Legal fees in respect of the purchase of a residential property, and stamp duty payable on such a purchase do not qualify for tax relief.

Where a newly constructed or refurbished property is purchased from a developer or a builder the value of the gross tax break to the purchaser is calculated as the price paid to developer or builder multiplied by the fraction A / (B + C),

Where:

A = Qualifying construction expenditure incurred in the relevant period

B = Total construction expenditure on that property

C = Expenditure on acquisition of the site.

In the case of refurbished properties, A and B represent the refurbishment costs with C being the costs of the building inclusive of the site before refurbishment.

Where the property is purchased from a person not carrying on the trade of a builder or is not a developer then the build costs will normally equal the gross tax relief as gross relief is the lower of:

- The direct cost of construction, excluding site costs and costs attributable to the purchase of the site, or
- The amount produced by the above formula.

In a property market with rising prices the direct construction costs will be the lower of the two (i.e. the formula will not apply).

2.5.3 Qualifying Periods

The qualifying period for the Schemes extends to 31st July 2006. In the case of the Urban and Town Renewal Schemes, this is the third extension of the qualifying period, with end-dates of 31st December 2002 and 31st December 2004 previously specified. With regard to the Urban Scheme, the July 2006 date applies to developments where the local authority has certified that 15 per cent of total expenditure has been incurred by 30th June 2003. For developments under the Town, Rural and Living over the Shop Schemes, to benefit from the extension of the qualifying period, an application to the planning authority must have been made before 31st December 2004.

3. Economic Issues

3.1 Economic Backdrop

3.1.1 General Overview

Since the introduction of the Schemes in 1999-2000 period, the economy has experienced strong rates of growth. This is indicated by levels of GDP, which increased in real terms from €76.3 billion in 1999 to €102.5 billion in 2004[3]. Despite the end of the Celtic Tiger growth era in 2000, GDP continued to grow strongly year-on-year, with preliminary figures for 2004 suggesting an annual growth rate of 4.9 per cent.

Another indicator of the strength in the economy is the rate of unemployment, which remained low over the period. In 2004, the average number of people unemployed stood at 86,825, compared to 95,125 in 1999, a fall of 8.7 per cent. Since 1999, the average unemployment rate for the country as a whole has remained steady, not exceeding 5.0 per cent.

Table 3.1 Annual Changes in GDP & Unemployment Rates: 1999 – 2004

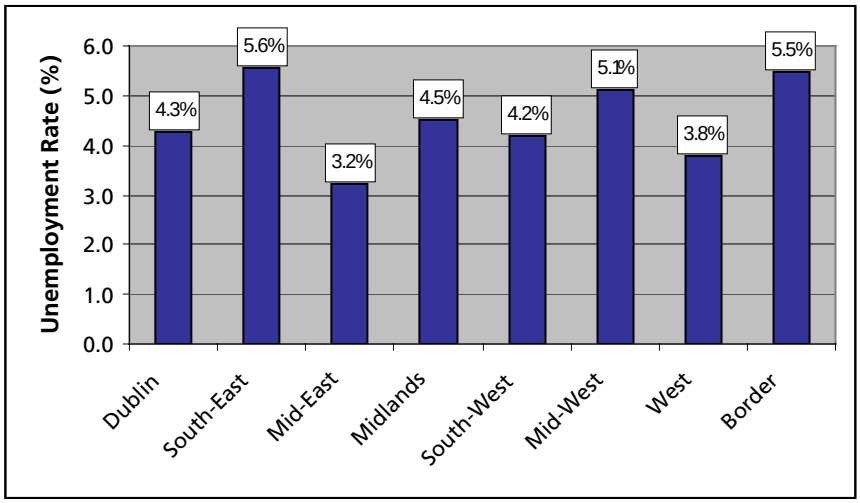
Year	Annual Change in GDP (%)	Average Rate of Unemployment (%)
1999	11.1	5.6
2000	9.9	4.3
2001	6.0	3.9
2002	6.1	4.4
2003	3.7	4.7
2004	4.9*	4.5

*Based on preliminary figures for 2004
Source: Central Statistics Office

Figure 3.1 below illustrates the average unemployment rate for each region in 2004. The Mid-East region had the lowest rate (3.2 per cent) followed by the West (3.8 per cent). At 5.6 per cent, the South-East region had the highest rate of unemployment in 2004. However, it is clear that unemployment rates are uniformly low across all regions.

[3] Constant 1995 prices

Figure 3.1: Average Rates of Unemployment by Region, 2004



Source: Central Statistics Office

The construction industry has been a particularly vibrant part of the economy over the last decade and has accounted for a good deal of the economic growth experienced. Output from the construction industry as a whole amounted to €6.4 billion in real terms in 1995. It increased at an average annual rate of 9.7 per cent to reach €10.1 billion in 1999. Over the next five-year period, output from the sector in real terms continued to grow at a more modest average rate of 4.2 per cent per annum to reach €13.3 billion in 2004[4].

When it is expressed as a proportion of GDP, total output from the construction industry accounted for 12.1 per cent in 1995 and the proportion increased steadily, with the industry accounting for 16.4 per cent of GDP in 1999. By 2004, it accounted for 19.3 per cent of GDP.

3.1.2 Construction Industry Output

The main impacts of the tax incentive schemes have been on residential, commercial and industrial development. These parts of the construction industry accounted for 7.8 per cent of GDP in 1995 and this proportion also increased steadily, with these elements of construction accounting for 10.9 per cent of GDP in 1999 and 13.9 per cent in 2004 respectively.

In Table 3.2 below, output for each of these sectors is aggregated for each of the two five-year periods, immediately preceding and over the course of the Schemes. Between 2000 and 2004, output from residential, industrial and commercial construction was 40.8 per cent higher than during the five-year period preceding the Schemes. Output generated by residential construction was 47.8 per cent higher and output generated by commercial construction was 38.5 per cent higher, whereas output from industrial construction had fallen and was 7.4 per cent lower.

[4] Source: Review of the Construction Industry and Outlook, Dept. of the Environment. Data referred to are constant 1995 prices.

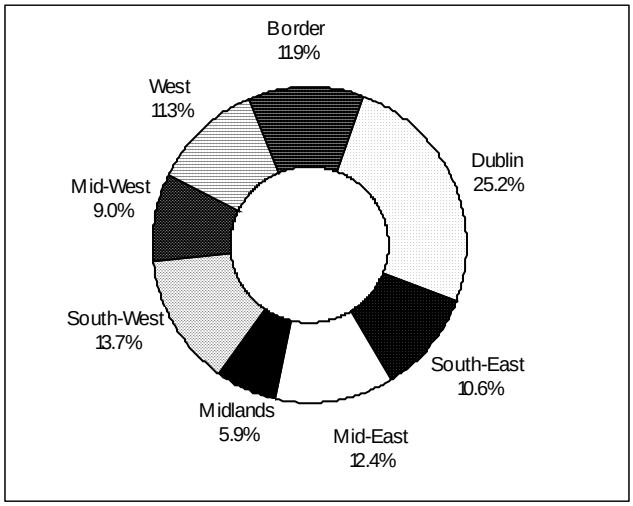
Table 3.2 Residential, Industrial and Commercial Building Output in Constant (1995) Prices: 1995-1999 & 2000-2004

Construction Sector	1995 – 1999 (€m)	2000 – 2004 (€ m)	% Change (€m)
Residential	20,540.6	30,360.2	47.8
Industrial	2,818.7	2,609.1	-7.4
Commercial	3,448.6	4,777.7	38.5
Total	**26,807.9**	**37,747.0**	**40.8**

Source: Department of the Environment, Heritage and Local Government. Review of the Construction Industry and Outlook (various issues).

Regional output data are available for 2003. Figures 3.2 to 3.4 illustrate the regional breakdown of output by each construction sector. Output from residential construction is more evenly distributed on a regional basis than that from the other two construction sectors. The greatest proportion of output from residential construction in 2003 was generated in the Dublin region. Each of the other regions generated between 9.0 and 13.7 per cent of it in monetary terms, except for the Midlands region, which generated only 5.9 per cent of total output from residential construction.

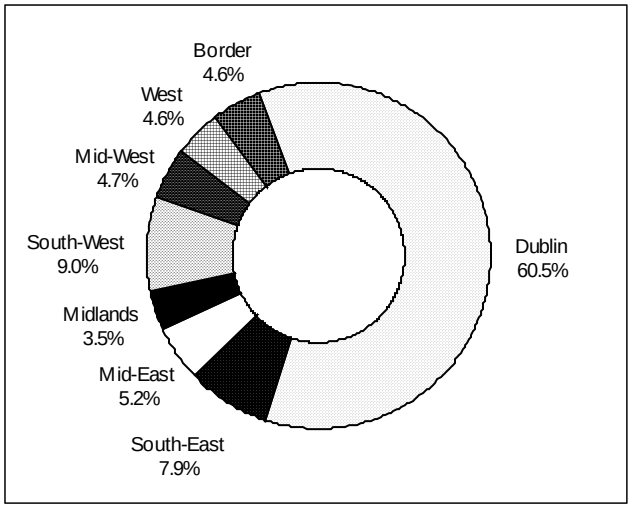
Figure 3.2: Regional Distribution of Output from Residential Construction, 2003



Source: Review of the Construction Industry and Outlook

The major share (60.5 per cent) of output from commercial construction was generated in the Dublin region, with each of the other regions producing, on average, 5.6 per cent of output in monetary terms.

Figure 3.3: Regional Distribution of Output from Commercial Construction, 2003



Source: Review of the Construction Industry and Outlook

3.1.3 Availability of Capital for Investment

As well as a need to meet demand, the construction industry has undoubtedly been driven by increased levels of private capital available for investment. Table 3.4 indicates the very substantial growth in the availability of private funds for investment. In nominal terms, funds available for capital formation amounted to an aggregate of over €114bn in the period 2000-2003, compared to €67bn in the previous four years, an increase of 70 per cent. There is thus now no shortage of funds seeking suitable investments.

Table 3.3: Private Capital Available for Investment: 1995 – 2003

Year	€m
1995	9,666
1996	11,540
1997	14,804
1998	18,699
1999	22,103
2000	26,140
2001	27,434
2002	29,098
2003	32,314

Note: There are no data available for 2004
Source: Central Statistics Office

3.1.4 Conclusions

During the period that the Tax Incentive Schemes have operated, the economy has experienced strong growth and low unemployment levels. The benefits have been felt throughout the country, as evidenced by low unemployment rates experienced across the regions.

The period of the Schemes has witnessed substantial output growth in building and construction. In the last five years, residential construction output has been 47.8 and commercial construction output 38.5 per cent above the level of the previous five years in real terms. Capital has become plentiful with funds available for investment some 70 per cent above the previous period.

The strong performance of the construction industry in the last five years and the increased availability of capital raise the issue of the need to continue to intervene in the market through the tax incentivisation of property development.

3.2 Economic Analysis of Property Based Tax Incentives

3.2.1 Introduction

Economic evaluation of the Schemes requires consideration of the nature of the benefits and costs to which they give rise. Government interventions in the property market must be based on the objective of improving market efficiency or addressing market inequities. Market inefficiency arises from market failures, while market inequity occurs where, left to itself, the market does not deliver an appropriate distribution of benefits. This Section of the report first discusses these issues and then considers how they can be incorporated into a formal cost-benefit evaluation of the Schemes.

3.2.2 Efficiency Benefits

Efficiency benefits arise where market failures are addressed. With regard to property, market failures are usually viewed as occurring for certain reasons:

- Certain locations may be high risk and property development at these locations will be hindered by the fact that no investor will wish to go first (pioneer risk);
- Where site assembly is required, similar considerations as well as high transaction costs may apply (co-ordination failure);
- There are risks in the sale of property that has low current value, as there is a risk to selling at a low price, when a much better offer may materialise in the future (asymmetric risks);
- Property development may have positive spillover benefits on a local area that the property developer cannot capture. These spillover effects arise because individual property developments may improve the physical image of the local environment and by increasing activity locally improve both the security and attractiveness of the area (neighbourhood effect).

However, it should be noted that these effects are more likely to be present at specific locations in urban areas than in rural areas. In urban areas, the availability of sites may be restricted, there is often a need to achieve scale in development, and the potential for spillover benefits is large. Thus, there are benefits associated with urban renewal in these areas.

Such market failures are the reason that Governments have intervened in the property market in the past, through urban renewal measures. An added reason is another form of non-property related market failure. This is where there is excess unemployment locally that the market is not eliminating. The employment demand created by the building industry on foot of the incentivisation of development or the creation of industrial or commercial activity in newly developed properties reduces such unemployment.

However, it should be noted that where Government intervenes in the market in the absence of market failures, there are real dangers that the benefits generated will not exceed the costs.

3.2.3 Equity Benefits

Governments intervene in the market in order to achieve a more equitable distribution of income or public services among certain groups in the population. Such policies are usually aimed at addressing the problems of social deprivation or ill-health and disability. Governments may also have spatial development aims such as maintaining or enhancing regional or local (rural) population levels, part of the motivation for which may be economic as well as social.

In implementing policies aimed at redistributing income either at the individual or spatial level, Governments have to take account of the possibility of adverse equity impacts. In the case of tax-based initiatives, this occurs where the general taxpayer, including those on lower incomes faces an increased tax burden as a result of tax forgone, whereas the scheme beneficiaries are those with higher incomes. This is an issue of real concern in relation to a number of tax incentive schemes at present, including the area-based schemes under review in this report.

3.2.4 Delivering Efficiency and Equity Benefits

Financial Returns to Development

Tax Incentives will not deliver efficiency and equity benefits unless economic agents, such as developers, are induced to engage in property development that they would otherwise have eschewed.

Perceived financial return is the primary factor influencing developer investment decisions and anticipated market demand is the major determinant of financial return. In areas where market demand is low, capital appreciation and growth in rental values will be low, and developers will look elsewhere for investment opportunities. In areas in need of renewal, there are risks that market demand for property will not materialise, so that first movers into the market bear high financial risks. Similarly, the costs of development may be exceptionally high, as sites may be awkward, relatively inaccessible, or subject to special conservation requirements. Tax incentives are a means of enhancing developer return from such sites and

encouraging their development. They may thus tip the balance in favour of development on such sites. It is important, however, to note that where anticipated market demand is very weak, even very substantial tax incentives will not be sufficient to encourage development.

Dead Weight and Displacement

Dead weight and displacement are two means by which an investment in a particular area does not have the desired impact on the local area, and the value for money of the incentives policy is reduced. Dead weight occurs where, in the absence of the incentives scheme, the investor would have invested in the designated area on some scale and at some time. Displacement occurs where, by investing in the area, activity is created, which displaces activities from other areas.

If there is zero or partial dead weight, then the investment has a beneficial impact on the area i.e. it has some measure of additionality for the area. However, it is important to know whether this benefit to the local area is also beneficial at the national level. If, in the absence of the scheme, the participant would have invested abroad, then there is both local and national additionality or benefit. If, on the other hand, the participant would simply have invested elsewhere in the country, then here is no net national additionality, simply a transfer of activity from one part of the State to the other. While such a transfer of activity is of benefit, in that the policy objectives underlying the scheme would have been achieved, it is obviously less beneficial than if there were also net additionality from a national viewpoint.

3.3 Cost-Benefit Framework

3.3.1 Overview

The terms of reference require the evaluation of the Schemes to be conducted in a cost-benefit framework. Cost-benefits of projects, programmes or policies usually consider a number of dimensions of the intervention viz.

- Effectiveness: the extent to which the intervention has delivered the anticipated benefits;
- Efficiency: the extent to which the benefits delivered are good value for the Government support provided; and
- Equity: the extent to which the benefits and costs have produced desirable outcomes in terms of the distribution of incomes and benefits.

With respect to effectiveness and efficiency, cost-benefit usually attempts to monetise these impacts and establish an economic rate of return. This requires imputing money values, where the market does not do so. Current guidelines on cost-benefit are set out by the Department of Finance.[5] These recognise that imputation of money values is not always possible and that a cost effectiveness approach, which compares quantified physical output measures to costs, should then

[5] Department of Finance. Guidelines for the Appraisal and Management of Capital Expenditure Proposals in the Public Sector. February 2005.

be employed. The Guidelines also indicate that multi-criteria analysis may also be employed where benefits cannot be quantified.

With regard to urban renewal, monetisation of market efficiency benefits arising from market failure is very difficult. For example, the neighbourhood effects of reduced crime and higher quality of life are difficult to monetise, because of the need both to link urban renewal actions with these effects and to ascribe monetary values to them. Also, many of the benefits arise from a redistribution of activity into the designated areas, and such redistribution cannot be valued in a way that facilitates measurement of economic rates of return, as a market value cannot be imputed.

Accordingly, the evaluation framework adopted here is to assess the effectiveness and equity impacts of the Schemes through a multi-criteria analysis, with efficiency impacts being assessed using cost effectiveness indicators. However, there is a difference between the Schemes in terms of their objectives, with the Urban and Town Schemes having a range of urban renewal objectives, while the Rural and LOTS schemes being more narrowly focussed. Accordingly, the cost-benefit framework is developed with the first two Schemes in mind and has more limited application to the latter two.

3.3.2 Effectiveness

This report analyses the effectiveness of the Schemes in terms of a number of benefit categories or criteria:

- Physical development benefits;
- Economic benefits; and
- Social and community benefits.

Physical development benefits are those related to the physical structure of the designated area. They may be further resolved into a number of dimensions as follows:

- Urban design: provision of civic spaces, delivering sustainable urban areas, and high quality building design;
- Dereliction: addressing problems with derelict and poor quality buildings;
- Conservation: conserving heritage buildings and archaeological sites;

Economic benefits comprise the employment impacts of construction activity as well as the ongoing impacts caused by housing development and population growth on the one hand and commercial/industrial development on the other.

Three elements of social and community benefit have been identified viz.

- Community linkage: using the proceeds of levies on developers to fund community projects;

- Employment and training of people from deprived areas; and
- Provision of social housing.

3.3.3 Equity Impacts

Analysis of the equity impacts of the Schemes requires consideration of two fundamental questions:

- To what extent are the benefits of the Schemes confined to a relatively few individuals; and
- To what extent are those individuals in the higher income and wealth groups.

Obviously, the more concentrated the group of scheme beneficiaries is and the higher their income and wealth status, the more inequitable the Scheme is.

With regard to the spread of benefits, a key issue is the extent to which the benefits of the scheme are garnered by those who supply the properties or those that purchase them. Where the properties are supplied by the building industry and some of the benefits of the scheme accrue to the industry, the greater the likelihood that there will be a concentration of Scheme benefits among relatively few individuals. This raises the question of the incidence of benefits. If developers have the capacity to raise prices, then some of the tax benefits will accrue to them. Appendix 1 discusses the conditions under which developers will tend to have some price setting power.

4. Review of the Rural Scheme

4.1 Introduction

The Pilot Rural Renewal Scheme was introduced with the aim of invigorating the Upper Shannon region. The scheme covers all of the counties of Leitrim and Longford as well as certain areas in counties Cavan, Roscommon and Sligo on a District Electoral Division basis. These areas were recognised as having suffered long term population decline and less than average economic growth. They were also regarded as lacking significant urban centres necessary to attract inward investment and generate economic growth. In an effort to address these problems, the Scheme was introduced both to encourage people to reside in the area and to promote new economic activity.

This section of the report begins in Section 4.2 with an analysis of the construction expenditure that has occurred under the Scheme to date and an estimate of the total expenditure up to the end of the Scheme in July 2006. In Section 4.3, the cost of the Scheme to the Exchequer in terms of tax foregone is presented. The overall outputs of the Scheme are evaluated in Section 4.4. Section 4.5 presents an analysis of the Scheme's costs and benefits. Conclusions and recommendations are contained in Section 4.6.

4.2 Overview of Expenditure

4.2.1 Introduction

This section of the report presents an estimate of allowable construction expenditure under the Scheme. Calculation of allowable expenditure is an essential first step to determining the tax cost of the Scheme, as well as representing the value of the Scheme outputs.

In contrast to the Urban and Town Renewal schemes, no data were routinely collected on construction expenditures under the Scheme. Moreover, the local authority planning development information systems were not readily amenable to analysis to determine even the number of developments that had taken place in areas designated under the RRS. Thus, estimating construction expenditure under the scheme presented a considerable challenge. Appendix 2 presents a brief account of the methodology by which expenditure was calculated. Essentially, the expenditure estimates with regard to the residential elements of the Scheme are based on applications for certificates of reasonable cost and compliance made to the Department of the Environment, Heritage and Local Government's (DOEHLG) Building Grants Section.

The estimates of expenditure for the period 1999-2004 presented below refer to allowable expenditure on foot of certificates issued in that period. At end 2004, approximately 50 per cent of applications under the Scheme made in that period had not been finalised and certificates had yet to be issued. In most of these cases, however, the bulk of the building work was already completed, so that the figures presented below are likely to be a significant underestimate of building activity under the Scheme in the period 1999-2004.

Late finalisation of applications would appear to be largely the result of applicants waiting until all ancillary works have been completed or until they have made adjustments to the works to ensure their compliance with the Scheme eligibility conditions.

4.2.2 Aggregate Allowable Scheme Expenditure 1999-2004

Expenditure under the Scheme on foot of finalised certificates is estimated at a total of €453m for the period 1999-2004. Table 4.1 profiles expenditure over time. No expenditure was recorded for 1999, as the Scheme only commenced in June 1998. After a slow start, expenditure rose rapidly from €24.6m in 2000 to a peak in the year 2002 at €107.5, which was the first extended date at which the Scheme was expected to cease. This level of expenditure was broadly maintained in 2003, before growing substantially to €134.8m in 2004, the year to which the Scheme was subsequently extended.

Table 4.1: Trend in Expenditure 2000-2004

Year	Expenditure €m	Rate of Growth (%)
2000	24.6	-
2001	81.0	+229.3
2002	107.5	+32.7
2003	105.4	-2.1
2004	134.8	+27.9
Total	**453.4**	

Source: Goodbody Economic Consultants Estimate

4.2.3 Profile of Expenditure by County 1999-2004

Table 4.2 sets out the aggregate expenditure under the Scheme in the period 2000-2004. Of the total of €453.4m, Longford and Leitrim account for similar levels of expenditure at €131.4m and €137.3m or approximately 30 per cent each of the total. The dominance of these two counties is not surprising given that the whole of each county was designated under the Scheme. Roscommon, although only partly designated, is also a major contributor to expenditure at €94.7m or 20.9 per cent of the total.

Table 4.2: Profile of Aggregate Expenditure by County (2000-2004)

County	Expenditure €m	Proportion of Total (%)
Cavan	36.9	8.1
Leitrim	131.4	29.0
Longford	137.3	30.3
Roscommon	94.7	20.9
Sligo	53.0	11.7
All	**453.4**	**100.0**

Source: Goodbody Economic Consultants Estimate

4.2.4 Profile of Expenditure by Type of Sector and Type of Build

Of the total of €453.4m, €398.5m (88.1 per cent) was in respect of residential developments and €54.4m (11.9 per cent) related to commercial/industrial developments. The bulk of expenditure was on new-build. Developments that were solely new-build or that contained an element of new-build accounted for €436.5m or 96.3 per cent of total expenditure. Expenditure on developments that were purely refurbishment was at very low levels, for both residential and commercial/industrial activity. This is the result of both a small number of developments that were purely refurbishment, and a low average expenditure per development.

Table 4.3: Profile of Scheme Expenditure by Sector and Type of Build (€m) 1999-2004

Type of Build	Sector		
	Residential €m	Commercial/ Industrial €m	Total €m
New Build Only	382.6	31.8	414.4
Refurbishment or Conversion Only	12.1	4.4	16.5
Combination of New Build and Refurbishment/Conversion	3.8	18.6	22.4
Total	**398.5**	**54.8**	**453.3**

Source: Goodbody Economic Consultants Estimate

4.2.5 Predicting Future Scheme Expenditure

Developments, in respect of which a planning application was made before end December 2004, are eligible to participate in the Scheme, provided that planning and other requirements are met. Expenditures, in respect of such developments, in the period up to July 2006 are eligible for tax relief.

An estimate of total expenditure under the Scheme must take account of expenditure arising from;

- The backlog in finalising applications for certificates already made under the Scheme; and

- The certificates that will be issued on foot of applications made in the period remaining to July 2006.

With regard to the backlog of applications, it was assumed that these would give rise to expenditure levels pro-rata with those arising from finalised applications. With regard to expenditure on foot of future applications, it was necessary to predict the number of applications in the remaining period up to July 2006

Table 4.4 compares the number of planning applications in the designated areas of each county for 2003 and 2004, with the exception of Roscommon for which no data were received at the time of writing. It is evident that very large increases in the number of planning applications submitted took place as people sought to ensure that they could avail of the Scheme. The average increase was 78 per cent. Data available for 2005 indicate that the number of applications for certificates under the Scheme has risen in line with the increase in planning applications. In predicting applications to July 2006, it was assumed that this high rate of applications would continue.

Table 4.4: Comparison of Planning Applications in Scheme Areas 2003–2004

County	2003	2004	Increase (%)
Longford	714	1,401	96
Sligo	412	684	66
Cavan	543	1,264	132
Leitrim	1,414	2,147	52
Average	**771**	**1,374**	**78**

Source: Local Authorities

However, because only expenditure incurred before July 2006 is allowable under the Scheme, it is evident that expenditure on foot of some applications will not be eligible, as it will take place outside the Scheme eligibility period. In making predictions, it was assumed that 90 per cent of expenditure under applications between September 2005 and July 2006 would prove to be allowable.

It is predicted that the Scheme will give rise to an estimated €1,072.5m of allowable expenditure, of which €453.3m has already been incurred of foot of certificates issued in the period up to end 2004.

Table 4.5: Predicted Total Scheme Expenditure

Period in which Certificates Issued	Predicted Expenditure €m
1999-2004	453.3
2005+	619.2
All	**1072.5**

Source: Goodbody Economic Consultants Estimate

4.2.6 Conclusions

Allowable expenditure under the Scheme is estimated at total of €453m for the period 1999-2004. After a slow start, expenditure rose rapidly from € 24.6m in 2000 to €134.8m in 2004. There is a significant backlog in finalising applications, so that this is a significant underestimate of actual building activity in the period.

Of the total of €453.4m, Longford and Leitrim account for similar levels of expenditure. Roscommon, although only partly designated, is also a major contributor to expenditure at €94.7m or 20.9 per cent of the total.

Of the total of €453.4m, €398.5m (88.1 per cent) was in respect of residential developments and €54.4m (11.9 per cent) related to commercial/industrial development.

The bulk of expenditure was on new-build. Developments that were solely new-build or that contained an element of new-build accounted for €436.5m or 96.3 per cent of total expenditure.

Very large increases in planning applications took place in 2004 as people sought to ensure that they could avail of the scheme. The average increase in planning applications was 78 per cent on that year. Taking account of these applications, the predicted allowable expenditure under the Scheme is estimated at €1,072.5m.

4.3 Analysis of Tax Costs

4.3.1 Introduction

This section provides an analysis of the tax forgone arising from the Rural Renewal Scheme. It begins with and analysis of the tax forgone associated with residential projects and then presents a similar analysis for commercial developments. A more detailed methodology is presented in Appendix 3. It should be noted that the process described below considers the tax costs that will be incurred in respect of developments that take place up to July 2006. A separate estimate for the anticipated tax costs associated with developments that were completed by end 2004 is also provided. As not all tax reliefs are taken immediately but are taken over a period of years, tax costs will also arise in future years, even in respect of completed developments. Thus, there is a need to present not only the nominal costs to the Exchequer but also the present value of these costs.

4.3.2 Tax Forgone on Residential Properties

The following information is required to calculate tax costs:

- The number of housing units arising (by sub-category of housing type);
- Average build costs (by sub-category);
- Average sale price (by sub-category);
- Average site costs (by sub-category); and
- The tax payers' marginal tax rate (by sub-category).

Step 1: Estimating Residential Units by Type

It is anticipated that 10,596 residential units will benefit from the Scheme by the end of July 2006. These residential units must then be split into the four sub-categories of eligible residential reliefs as the tax reliefs available differs slightly between each (as do the assumptions made in estimating tax forgone). On the basis that 60 per cent of housing under the scheme is classified as owner occupier, owner occupied units are put at 6,358 with investors accounting for the balance of 4,238.[6] This split between owner occupier and investors is further broken down between new builds and refurbishments/conversions on the observed 95 per cent: 5 per cent mix. For example,

- Owner occupier new builds is calculated by multiplying 6,358 by 95 per cent to give 6,040 units; and
- Investor new build units is worked out by multiplying 4,238 by 95 per cent to give 4,026 units.

[6] See Section 4.4 for derivation of this figure.

Further details are given in Table 4.6. The rate of tax relief available and the time over which the tax relief may be exhausted varies within the residential category[7]; hence housing units are divided into sub-categories.

Step 2: Average Build Cost

Average build cost is calculated by dividing total estimated build costs over the life of the scheme by the number of units expected to be developed up to July 2006 to give €94,499. Average build costs for refurbishments/conversions is calculated in the same way at €21,345.

Step 3: Average Sale/Purchase Price and Site Cost

The average price is calculated in two ways, depending on the type of residential housing concerned:

- For owner occupied new builds, DOEHLG data on new house and apartment prices are used and weighted by the proportion of housing output delivered each year as shown in Table 4.6. This produces an average purchase price of €195,830 per unit;

- For investor new builds the same process was adopted plus a premium of €15,000 was added based on observations from the Irish Auctioneers and Valuers Institute's most recent annual survey of members. This produces an average purchase price of €210,830.

Owing to the low average build cost per refurbishment/conversion a view was taken that these projects were undertaken by existing property owners and therefore purchase price and site costs were not estimated, as in these cases the gross tax relief arising is set at build costs.

For new builds, site costs are set at 65 per cent of build cost, again based on observations from the Irish Auctioneers and Valuers Institute and the Irish Home Builders Association (please see Appendix 3 for more details).

The results from applying these steps and assumptions are given in Table 4.6.

[7] Owner occupiers of new build residential units are entitled to 50% of gross relief at 5% p.a. over 10 years whereas owner occupiers of refurbished units are entitled to 100% gross relief at 10% p.a. over 10 years. Residential investors get 100% gross relief with no time frame attached.

Table 4.6: Unit Data Used in Estimating Tax Forgone on Residential Rural Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
No. of Units	6,040	318	4,026	212	10,596
Share of Units	57.0%	3.0%	38.0%	2.0%	100.0%
Avg .Build Cost	€94,499	€21,345	€94,499	€21,345	
Assumed Price	€195,830	-	€210,830	-	
Site Cost (65% of build cost)	€61,424	-	€61,424	-	

Step 4: Gross Tax Forgone

Based on Dept. of Environment, Heritage and Local Government's housing data the share of units built directly by individuals is 30 per cent, with 70 per cent assumed to be build by builders/developers. In the case of own account projects gross relief equals build costs, whereas the formula (see Appendix 3) applies to units purchased from builders/developers.

As noted, it is assumed that refurbishment projects are undertaken by existing building owners and therefore the formula is not applied. Instead, the gross tax relief equals build cost.

Applying this mix to the data in the table above gives €1,158.6m gross tax relief arising in Table 4.7.

Step 5: Net Tax Forgone before Discounting

The second last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief attached to each project. To do this the following enabling assumptions, as fully explained in Appendix 3, were made:

- For owner occupied projects two marginal rates could apply: 20 per cent or 42 per cent. It is assumed that 30 per cent of owner occupiers have a marginal tax rate of 20 per cent. The remaining owner occupiers are assumed to pay tax at a marginal rate of 42 per cent.

- It is assumed that all investors pay a marginal rate of 47 (the higher rate plus PRSI and levies) per cent in year one and 42 per cent thereafter.

Following all the steps detailed above gives Table 4.7, transforming the €1,158.6m gross tax relief to net tax relief of €328.6m.

Table 4.7: Undiscounted Tax Forgone on Residential Rural Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
Unit Gross Tax Relief via formula	€118,685	-	€127,776	-	
Unit Gross Tax Relief at Cost	€94,499	€21,345	€94,499	€21,345	
All Units - Gross Tax Relief	€672,999,668	€6,785,288	€474,289,500	€4,523,525	€1,158,597,982
Net Tax Cost at Standard Marginal Rate	€20,189,990	€407,117	-	-	
Net Tax Cost at Higher Marginal Rate	€98,930,951	€1,994,875	€205,130,209	€1,956,425	
Total Net Tax Forgone	€119,120,941	€2,401,992	€205,130,209	€1,956,425	€328,609,567

Step 6: The NPV of Net Tax Forgone

The last step in arriving at net tax forgone is to calculate present values, this is done by taking a 5 per cent discount rate to reflect that the relief is a fixed values but it has to be exhausted over a period of years, reducing its value today. The Scheme's rules state that owner-occupiers must take the relief over ten years. Investors do not operate to this time constraint and in practice tend to consume the tax relief over a much shorter period, believed to be 4 years.

Table 4.8: Discounted Tax Forgone on Residential Rural Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
Undiscounted Tax Forgone	€119,120,941	€2,401,992	€205,130,209	€1,956,425	€328,609,567
Annual Undiscounted Tax Forgone	€11,912,094	€240,199	€51,282,552	€489,106	€63,923,952
Discount Rate	5%	5%	5%	5%	
Time Period (in years)	10	10	4	4	
NPV of Tax Forgone	€91,982,033	€1,854,755	€181,845,392	€1,734,346	€277,416,526
NPV of Tax Forgone per Unit	€15,230	€5,835	€45,162	€8,184	€26,181

The total tax forgone for residential projects is put at €277.4m, of which:

- Investor new builds accounts for €181.8m (65.6 per cent);
- Owner occupied new builds accounts for €92m (33.2 per cent);
- Owner occupied refurbishment/conversions accounts for €1.9m (0.7 per cent); and
- Investor refurbishment/conversions accounts for €1.7m (0.6 per cent).

In all, the discounted tax forgone represents 29 per cent of the build cost associated with these projects and 23.9 per cent of the gross tax relief arising.

Looking at individual units the tables shows that the overall NPV of tax forgone per unit is €26,181. This is a large degree of variability in this figure with the NPV of tax forgone per owner occupier refurbished unit running at €5,835 as against €45,162 per investor new build unit. This large difference is driven by the original build costs, the fact that all investors are assumed to be high rate tax payers, and timing issues, with investors exhausting the 100 per cent relief over a shorter time period.

4.3.3 Tax Forgone on Commercial Properties

In calculating tax forgone, each step in the process is explained in less detail as the steps involved are very similar to the residential Scheme and the reader can refer to Appendix 3. Data on commercial projects were not disaggregated into different types of commercial buildings such as office, retail, industrial etc. as the tax relief attaching to commercial buildings does not change with use or ownership. Again, data are required on the number of units, build costs, site costs and purchase price.

Step 1: Estimating Units

The total number of units expected under the Scheme to July 2006 is converted into commercial units by applying a multiplier of 1.2 commercial units per development (sourced from the case studies). This yields an estimated 344 units over the life of the Rural Renewal Scheme.

Step 2: Average Build Cost

Average build cost is calculated by dividing total estimated build costs over the life of the scheme by the number of units expected to be developed up to July 2006 to give €371,317.

As tax relief is available at 100 per cent for new builds and refurbishments there is no need to further disaggregate commercial projects.

Step 3: Average Selling/Purchase Price and Site Cost

Based on observations, the average price of a commercial unit in the area covered by the Rural Scheme is €600,000 and site costs are set at 50 per cent of build cost. This combination of build costs, site costs and selling price allows for a reasonable profit margin for the vendor.

Step 4: Gross Tax Forgone

The analysis allows for three broad types of commercial projects:

- Those purchased from builders/developers to which the gross formula is applied in establishing gross tax forgone (as detailed in Appendix 3);
- Those developed by individuals who occupy the unit for which only the build cost can qualify for relief;
- Lastly, those purchased from a person other than a builder/developer where the value of the gross tax break to the individual is the lower of:
  - The direct cost of construction, excluding site costs and costs attributable to the purchase of the site, or;
  - The amount produced by the formula;

  In a property market with rising prices the construction costs will be the lower of the two (i.e. the formula will not apply).

We have assumed that commercial projects are split 70 per cent: 30 per cent between those purchased from builders/developers and others. This produces a gross tax forgone of €134.6m.

Step 5: Net Tax Forgone

The last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief. It is assumed that a marginal tax rate of 47 per cent applies to 90 per cent all of these projects as they are owned by individual and the remaining 10 per cent are owned by companies with a marginal tax rate of 12.5 per cent.

Table 4.9 shows the results. Before discounting, €58.6m of tax forgone is associated with these projects.

Table 4.9: Tax Forgone on Commercial Rural Renewal Scheme Projects

	Commercial
No. of Units	344
Average Build Cost	€371,317
Sale Price per Unit	€600,000
Site Costs (50% of build cost)	€185,658
Unit Gross Tax Relief via formula	€400,000
Unit Gross Tax Relief at cost	€371,317
Total Gross Tax Cost	€134,639,880
Net Tax Cost at 47%	€56,952,669
Net Tax Cost at 12.5%	€1,682,999
Net Tax Cost	€58,635,668
Discount Rate	5%
Time Period (in years)	14
NPV	€48,312,244
NPV of Tax Forgone per Unit	€140,443

The net present value of tax forgone is determined by discounting at 5 per cent over 14 years. This gives a net present value of tax forgone of €48.3m which represents 37.8 per cent of build costs. On a unit basis, the NPV of tax forgone works out at €140,443 per unit.

4.3.4 Tax Forgone on by Development Status

This section presents an analysis of the tax cost of residential and commercial projects by the development status of the projects.

Residential Units

Table 4.10 gives the development status of residential units. Given that 4,532 units were delivered up to 2004 and 10,596 are to be delivered over the life of the scheme, projects yet to be delivered were divided equally into those in planning and those in progress.

The NPV of tax forgone per sub-category of residential unit multiplied by units in each development status grouping gives the NPV of tax forgone by development status. Of the €277.4m of residential tax costs, €118.7m is associated with projects which are complete and €158.7m is due to projects yet to be completed.

Commercial Units

Table 4.11 repeats the analysis for commercial units, with the timing of commercial units assumed to match the delivery of residential units.

Table 4.10: The Development Status of Residential Rural Renewal Scheme Projects and Tax Costs

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
NPV of Tax Forgone per Unit	€15,230	€5,835	€45,162	€8,184	€26,181
Number of Units by Development Status					
- Completed	2,584	136	1,723	91	4,534
- Work in Progress	1,728	91	1,152	61	3,031
- In Planning	1,728	91	1,152	61	3,031
Totals	6,040	318	4,026	212	10,596
NPV of Tax Forgone by Development Status					
- Completed	€39,358,866	€793,645	€77,811,156	€742,122	€118,705,788
- Work in Progress	€26,311,584	€530,555	€52,017,118	€496,112	€79,355,369
- In Planning	€26,311,584	€530,555	€52,017,118	€496,112	€79,355,369
Totals	€91,982,033	€1,854,755	€181,845,392	€1,734,346	€277,416,526
Share	33.2%	0.7%	65.5%	0.6%	100.0%

Table 4.11: The Development Status of Commercial Rural Renewal Scheme Projects and Tax Costs

	Commercial
NPV of Tax Forgone per Unit	€140,443
Number of Units by Development Status	
- Completed	147
- Work in Progress	98
- In Planning	99
Total	344
NPV of Tax Forgone by Development Status	
- Completed	€20,645,058
- Work in Progress	€13,763,372
- In Planning	€13,903,814
Total	€48,312,244

4.3.5 Overview

In conclusion, the NPV of all tax forgone associated with Scheme up to July 2006 is estimated at €325.7m, of which residential projects account for €277.4m or 85.2 per cent and commercial projects account for €48.3m or 14.8 per cent. With regard to developments completed by end 2004, the tax cost is estimated to be €139.3m.

Table 4.12: Overview of Present Values of Predicted Scheme Tax Foregone

	Residential (€m)	Commercial (€m)	Total (€m)
Predicted Tax Cost to Mid July 2006	277.4	48.3	325.7
Tax Cost Incurred to end 2004	118.7	20.6	139.3

4.4 Scheme Outputs

4.4.1 Introduction

This Section of the report summarises the main outputs of the Scheme, such as the number of developments and housing units. The data presented are estimates, which were constructed from the data on certificates issued and from the results of the Goodbody survey of files held by the Building Grants Section of the Department of the Environment and Local Government, to which reference was made in Section 4.2. See Appendix 2 for an overview of the methodology.

The data thus refer to developments in respect of which a final certificate has been issued. As indicated in Section 4.2, there were a significant number of applications awaiting finalisation at end 2004.

4.4.2 Developments under the Scheme

4.4.2.1 Aggregate Developments under the Scheme

Table 4.13 presents an estimate of the total number of developments under the Scheme, distinguishing between residential and industrial/commercial. An estimated 1,876 developments were completed in the period 1999-2004. Of these, 1,753 or 93.4 per cent were residential in nature.

Table 4.13: Number of Developments by Year and Sector, 2000-2004

Year	Residential	Commercial/ Industrial	Total
2000	97	6	103
2001	312	23	335
2002	414	28	442
2003	406	29	435
2004	524	37	561
Total	**1,753**	**123**	**1,876**

Source: Goodbody Economic Consultants Estimate

4.4.2.2 Developments by County

Of the total of 1,876 developments, the largest number was in Leitrim and Longford, with an estimated 544 and 572 developments respectively. These account for just under 60 per cent of all developments to date. Roscommon was the next largest with an estimated 388 developments (20.7 per cent of the total).

Table 4.14: Profile of Aggregate Developments by County (2000-2004)

County	Developments	Proportion of Total
	No.	(%)
Cavan	152	8.1
Leitrim	544	29.0
Longford	572	30.5
Roscommon	388	20.7
Sligo	220	11.7
All	**1,876**	**100.0**

Source: Goodbody Economic Consultants Estimate

4.4.2.3 Profile of Developments by Type of Sector and Type of Build

The vast majority of developments, 1,561 (83.2 per cent) were new-build only, with 1,650 developments (88.0 per cent) having at least some element of new build. Only 226 developments were estimated to be refurbishment or conversions. The dominance of new-build applied to both residential and commercial/industrial developments.

Table 4.15: Profile of Developments by Sector and Type of Build 1999-2004

Type of Build	Sector		
	Residential	Commercial/ Industrial	Total
New Build Only	1,490	71	1,561
Refurbishment or Conversion Only	216	10	226
Combination of New Build and Refurbishment/Conversion	47	42	89
Total	**1,753**	**123**	**1,876**

Source: Goodbody Economic Consultants Estimate

4.4.3 Housing Output of the Scheme

From the above, it may be seen that residential developments have dominated the Scheme output and that the vast bulk of these were in respect of new-build. These new-build developments were divided approximately equally between single and multiple housing units, so that on average there were some 2.6 units per residential development. Table 4.16 profiles the estimated new housing unit completions under the Scheme, based on finalised certificates.

A total of 4,320 housing units were completed in the Scheme area in the period 1999-2004. As might be expected the distribution of output by year and county mirrors that for Scheme expenditure and number of developments. The Table also compares the Scheme housing output to the total of private house completions in the counties designated. This shows that the proportion of all new private houses that benefited under the Scheme peaked at 29.1 per cent in 2002, and averaged 23.3 per cent over the Scheme period to date. In interpreting this Table, it should be noted that in the case of Roscommon, Cavan and Sligo, the total of private dwellings refers to the county as a whole, whereas the Scheme output refers only to the parts of those counties which were designated.

Longford and Leitrim were fully designated under the Scheme. Examination of these counties indicated that the Scheme completions peaked at 55 per cent in the case of Longford (2004) and 54 per cent for Leitrim (2003).

Table 4.16: Housing Units Developed under the Scheme by Year and County

County	2000	2001	2002	2003	2004	Total
Cavan	4	64	91	94	93	347
Leitrim	83	305	262	367	245	1,261
Longford	76	216	300	241	476	1,310
Roscommon	42	126	214	195	318	895
Sligo	32	63	155	109	148	507
Total Scheme	237	774	1,023	1,006	1,280	4,320
Total Private Housing Unit Completions	2,555	3,116	3,510	3,908	5,417	18,506
Scheme as Proportion of Total Private Completions	9.3	24.8	29.1	25.7	23.6	23.3

Sources: Goodbody Economic Consultants Estimate and DOEHLG Housing Statistics

In the case of Longford and Leitrim, it may reasonably be asked why the vast bulk of housing completions are not falling under the Scheme. It is clear, as mentioned in Section 4.2 that a significant number of people have built houses but have yet to finalise their applications and therefore do not appear in our estimates. It is thus recognised that the housing calculated outputs are likely to be under-estimates. There are other reasons why output under the Scheme may fall short of total output viz.

- Some residents may be ignorant of the Scheme;
- Some persons building houses may not apply, as they consider the development ineligible, as they do not intend to either owner occupy the house or let it (e.g. holiday homes);
- Some housing developments may be ruled out because they are above the maximum floor area permitted, although it is difficult to see this as a major contributor, as the maximum limits are relatively generous; and
- A final reason, which local planning officials mentioned, was that when the Scheme is brought to the attention of some house owners, they indicate that they do not wish to avail of it, for fear of coming to the notice of the Revenue Commissioners.

It is possible to make an alternative estimate of housing output under the Scheme on the basis that the applications made but not finalised represent houses that are occupied. Based on this assumption, estimated housing output under the Scheme

rises to 5,700 for the period up to end 2004, representing 30 per cent of all housing output in the Scheme counties. In the case of the fully designated counties of Longford and Leitrim, these data suggest that approximately two-thirds of housing completions are benefiting from the Scheme.

4.4.4 House Tenancy

Housing completed under the Scheme could be occupied by owners or be let. Based on the survey of DOEHLG files and the case study, it is estimated that some 60 per cent of the units became owner occupied, with 40 per cent rented. Based on the same sources and interviews with local planning officials, it is obvious that the occupants are diverse and vary from location to location. They include:

- Sons, daughters and other relatives of the site owners;
- Young people using the opportunity move out of home;
- Migrant workers attracted to job opportunities in the area (Longford and Carrick-on-Shannon);
- Asylum seekers (Longford); and
- Dublin and East Region families seeking lower accommodation costs and a better life style.

It may be noted that not all of the housing output would have supported a population increase, but rather facilitated existing residents in setting up independent homes.

4.4.5 Predicted Housing Output

Making the same set of assumptions as were made in respect of predictions of expenditure, it is possible to make a prediction of the number of additional housing units that may be built up to the end of the Scheme in 2006. Table 5.5 sets out the results. The overall prediction is that the Scheme, when it terminates, will have contributed 10,596 housing units to the Scheme areas.

Table 4.17: Predicted Scheme Housing Outputs

Period in which Certificates Issued	No. of Housing Units
1999-2004	4,320
2005-2006	6,276
All	10,596

Source: Goodbody Economic Consultants Estimate

4.4.6 Conclusions

An estimated 1,876 developments were completed under the Rural Renewal Scheme in the period 1999-2004. Of these, 1,753 or 93.4 per cent were residential in nature, and 6.4 per cent commercial/industrial.

Of the total of 1,876 developments, the largest number was in Leitrim and Longford, with an estimated 544 and 572 developments respectively. These account for just under 60 per cent of all developments to date. Roscommon was the next largest with an estimated 388 developments (20.7 per cent of the total).

The vast majority of developments, 1,561 (83.2 per cent) were new-build only, with 1,650 developments (88.0 per cent) having at least some element of new build. The dominance of new-build applied to both residential and commercial/industrial developments.

A total of 4,320 housing units were completed in the Scheme area and benefited from tax relief in the period 1999-2004. Houses that benefited under the Scheme accounted for 29.1 per cent of all new private houses in 2002, and averaged 23.3 per cent over the Scheme period to date.

A significant number of people have built houses but have yet to seek the appropriate certificates and therefore do not appear in the above estimate. Taking these into account, estimated housing output under the Scheme rises to 5,700 for the period up to end 2004, representing 30 per cent of all housing output in the Scheme counties.

In the case of the fully designated counties of Longford and Leitrim, these data suggest that approximately two-thirds of housing completions are benefiting from the Scheme.

4.5 Impact of the Scheme

4.5.1 Introduction

This Section of the report considers the impact of the Scheme. It commences with a discussion of the nature of Scheme impacts. This focuses on the distinction between impacts that improve the efficiency and effectiveness of the economy on the one hand, and on other hand, aspects of Government policy that related to the distribution of income, both at the individual and spatial levels. A prerequisite to determining the impact of the Scheme is the identification of whether it had effects over and above those that would have occurred in its absence. i.e. whether a degree of additionality occurred. If additionality was limited and there was substantial dead weight in the Scheme effects, then the benefits of the Scheme would have been small. Having examined this issue, the economy and distributive impacts of the Scheme are then assessed.

4.5.2 Nature of Scheme Impacts

4.5.2.1 Introduction

The Rural Renewal Scheme represents a Government market intervention in that it results in the subsidisation of certain economic activities. In this instance, the tax reliefs available represent a subsidy to certain types of property development. Such interventions are normally justified on the basis of market failure or for the purpose of achieving a more equitable distribution of income or economic activity than would result from the operation of the market.

4.5.2.2 Market Failure and Economic Effectiveness and Efficiency

Market failure may occur for a variety of reasons, which have been identified in Section 2. However, they are more likely to be present at specific locations in urban areas. In such areas, the availability of sites may be restricted, there is often a need to achieve scale in development, and the potential for spillover benefits is large. Thus, there are benefits associated with urban regeneration in these areas.

In the context of the Rural Renewal Scheme, therefore, these market failures are likely to be present to a significant degree only in the principal towns such as Longford and Carrick-on-Shannon.

4.5.2.3 Distribution Benefits

Governments interfere in the market in order to achieve a more equitable distribution of income or public services among certain groups in the population. Such policies are usually aimed at addressing the problems of social deprivation or ill-health and disability. Governments may also have spatial development aims such as maintaining or enhancing regional or local (rural) population levels, part of the motivation for which may be economic as well as social. As indicated in Section 2, a prime motivation for introducing the Rural Renewal Scheme was to address the depopulation of the areas designated under the Scheme.

Finally, in implementing policies aimed at redistributing income either at the individual or spatial level, Governments have to take account of the possibility of adverse equity impacts. In the case of tax-based initiatives, such as the Rural Renewal Scheme, this occurs where the general taxpayer, including those on lower incomes faces an increased tax burden as a result of tax forgone, whereas the Scheme beneficiaries are those with higher incomes. This is an issue of real concern in relation to a number of tax incentive schemes at present, including the Rural Renewal Scheme.

4.5.3 Additionality and Dead Weight

Section 4.5 indicated that a large number of properties have benefited under the Scheme to-date. However, the impact of the Scheme is determined by the extent to which these developments are additional or to the absence of dead weight.

Table 4.18 depicts the ratio of housing output in the Scheme counties to that of other BMW counties in aggregate. This shows that during the 1990s, this ratio was remarkably stable at 21 to 22 per cent. However, following the first impacts of the Scheme in 2000, the ratio rose sharply. Moreover, there is a correlation between the years in which the Scheme output was high and those in which the ratio was high. This suggests that the Scheme was successful in increasing housing output in the participating counties.

It also suggests a methodology for measuring dead-weight. As the ratio of output in the Scheme counties to that of the rest of the BMW region was constant during the 1990s, one means of predicting what would have occurred in the absence of the Scheme would be to assume that the ratio would have been maintained, and to predict total housing output in the Scheme counties on this basis. This approach to predicting the "do-nothing" outputs has the benefit of taking account of the effect of general economy-wide increase in economic activity and population levels that would have occurred in any event. The aggregate housing output for the Scheme counties was predicted to be 15,454 on this basis (See Table 4.19).

Table 4.18: Housing Output in the Scheme Counties and the Remainder of the BMW Region

Year	Housing Output RRS Counties	Housing Output Other BMW Counties	Output in RRS Counties as a Proportion	Scheme Housing Output
	No.	No.	(%)	No.
1994	1,070	4,855	22.0	
1995	1,216	5,466	22.2	
1996	1,520	6,890	22.1	
1997	1,654	7,966	20.8	
1998	1,965	9,274	21.2	
1999	2,411	10,620	22.7	
2000	2,555	12,280	20.8	237
2001	3,116	13,556	23.0	774
2002	3,510	12,273	28.6	1023
2003	3,908	15,482	24.7	1006
2004	5,417	16,681	32.1	1280

Sources: Goodbody Economic Consultants Estimate and DOEHLG Housing Statistics

Table 4.19: Measuring Dead Weight

Measure	Aggregate Number of Houses 2000-2004
Predicted Housing Output in Scheme Counties (A)	15,454
Actual Housing Output in Scheme Counties (B)	18,506
Additional Unanticipated Output in Scheme Counties (C=B-A)	3,052
Housing Output Under the Scheme (D)	5,700
Dead weight Output (E=D-C)	2,648
Dead Weight (%) (E/D)	46.4

Source: Goodbody Economic Consultants Estimate

This aggregate predicted output may be compared with the actual output that occurred (18,506), to measure the scale of unanticipated output. The unanticipated output is estimated at 3,052. However, housing outputs under the Scheme were in excess of this number at 5,700,[8] indicating that a dead weight output of 2,648 or 46.4 per cent occurred. This is a minimum estimate of the dead-weight, as it effectively assumes that all of the unanticipated increase was due to the Scheme.

While all measurements of dead-weight are subject to error, the above measurement suggests that the Scheme was successful in stimulating housing output, but that there were very substantial dead-weight losses.

A similar calculation was not possible in respect of the commercial/industrial developments under the Scheme. In the discussion below, a similar level of dead weight as for housing is assumed.

4.5.4 Benefits arising from Market Failures

4.5.4.1 Urban Regeneration Benefits

Section 4.5.2.2 indicated that property-related market failure type benefits were more likely to occur in urban areas. An analysis of the situation in Carrick-on-Shannon revealed that almost 1,000 housing units have been constructed in the town and its environs during the course of the Scheme to date. As the total housing output to date is 5,700, and output in Longford has also been considerable, it is clear a large share of development (c.40 per cent) has taken place in the major urban areas.

[8] It is considered that the higher estimate of output under the Scheme is more accurate.

The case study of Carrick-on-Shannon revealed that the Scheme has contributed significantly to the development of the town (See the Box below). Prior to its introduction, there would have been a lack of confidence in the town, which inhibited local development. The advent of MBNA, together with the introduction of the Scheme, overcame this barrier. There were also synergies between the two events in that the housing output under the Scheme provided accommodation for MBNA workers. However, the mix of developments under the Scheme is a cause for concern with too little in the way of commercial/industrial development and in-fill development and an emerging over-supply of housing. This, together with the scale of current development indicates that the Scheme has fulfilled its purpose in respect of the town.

Information with regard to Longford indicates a somewhat similar story, with the Scheme being a significant factor in the animation of the town. The increased residential output here has provided accommodation for both a migrant workforce for local manufacturing plants and for State supported asylum seekers. Again, there is some concern that there may prove to have been over-provision of housing in the medium term.

A common feature of both towns is that the Scheme did not operate within a dedicated area planning structure, with designation of specific areas or sites where market failure was evident. This has reduced the benefits of the Scheme in combating such market failures.

Outside of these major urban areas, property-based market failure would not have been a factor to a significant degree. As it is estimated that approximately 55 per cent of housing development occurred outside these areas, the specific benefits arising from addressing property market failures were absent from much of the Scheme.

4.5.4.2 Employment Creation

The Scheme contributed to employment demand in two ways viz. through increased:

- Building activity in the area; and
- Employment in commercial and industrial enterprises.

The €453m spent within the Scheme in the period 2000-2004 would have given rise to significant demand for labour in the building industry. However, as dead weight is estimated to have been a minimum of 46 per cent, only €243m would have created additional demand. Based on the average employment content in building and construction[9], this level of spend would have created a demand for over 1,300 person years of direct employment during the period 2000 to 2004, or an average annual demand for 260 workers. Income tax and PRSI receipts would have totalled just under €15m.

[9] See: CSO. 2002 Census of Building and Construction

These impacts only occur during the construction phase of the Scheme. More lasting economic impacts could occur through the expansion and refurbishment of industrial and commercial premises. Only an estimated 123 industrial and commercial premises were developed under the Scheme. Assuming, a similar level of dead weight as for housing indicates an additional 66 premises. It is by no means the case that all of these would have given rise to increased employment demand: some developments were undoubtedly replacements or refurbishments without expansion. The indications, therefore, are that the economic benefits arising from this source are not substantial.

The scale of these developments is unknown, so that an estimate of employment demand is not possible. However, given the small number of developments and the likelihood that their scale is small, employment demand is unlikely to be significant. The fact that additional employment demand was created does not imply that economic benefits occurred. This would occur only if the shadow price for labour was below the market price. If unemployment levels are low, then shadow and market prices are close, and the impact of the additional employment demand will be simply to drive up wages, as firms compete for limited labour resources. The unemployment rates for the Scheme area has been 5 per cent or lower. Such low levels of unemployment have led the IDA to assume that the shadow price for labour is a maximum of some 90 per cent of the market price outside the Dublin area. This in turn implies that for each increase in employment demand of 100, only 10 additional jobs are created for unemployed people. Thus, on this basis, employment demand on foot of the Scheme does not contribute substantially to economic welfare.[10]

[10] One impact of the Scheme on the building sector was that, as a result of the increased activity, local builders found employment locally rather than having to seek work in the East Region market.

Case Study: Carrick-on-Shannon

Carrick-on-Shannon is the county town and administrative centre of Co. Leitrim. It is strategically located on the Dublin to Sligo road (N4) and is serviced by rail. Leitrim is one of the poorest counties in the country and has suffered from a declining population in recent decades – a trend which has only started to change in the last number of years. There are two large employers in the town: Masonite and MBNA. Masonite has been established in Carrick-on-Shannon for almost 10 years and employs 320 people. MBNA opened its offices in Carrick-on-Shannon in July 2001 and employs 1,100 people.

In the years prior to the introduction of the Rural Renewal Scheme there was no commercial development undertaken in the town, and only a limited amount of residential development (approximately 30 to 40 houses).

The developments carried out in Carrick-on-Shannon have been mostly residential. The level of commercial development has been very low apart from a few significant projects such as the Landmark Court and Central Park. The Landmark Court development provided a number of new business and retail outlets which have helped to develop a new street on the waterfront. The Central Park development will accommodate 65,000 square feet of retail and commercial premises. Almost all of the development which has taken place under the scheme has been new build with very little refurbishment projects carried out.

Since the introduction of the scheme at least 960 residential units have been built in Carrick-on-Shannon. Approximately 25 per cent of these units are apartments despite concerns that there was no market for this type of accommodation in the town. Of the total residential units developed, approximately 70 per cent are owner-occupied with 30 per cent rented. Most of the apartment developments have been sold to investors, though in recent years owner-occupiers have been a stronger segment of the market. The tax incentives available have made houses in Carrick-on-Shannon more affordable with the result that young single people now make up a large segment of buyers.

The increased supply of houses has led to increased quality as competition for buyers intensifies. As a result, the quality of housing outputs is quite high, however there are a number of developments which are considered to be of poor quality. In the earlier years of the scheme there was no area plan for Carrick-on-Shannon with which planning applications were to be aligned and so a number of developments have been located on greenfield sites outside the town centre.

The huge number of residential units which have been developed in Carrick-on-Shannon have led to an over-supply of accommodation. In the past number of years, rents have dropped by 50 per cent and tenant-hopping has become a prominent feature of the rental market.

It is estimated that the vacancy rate for residential property in Carrick-on-Shannon is approximately 30 per cent. Given this high level of vacancies and the attraction of the town as a tourist destination, it is possible that a proportion of these residential units are being used as holiday homes, or have been bought by persons who have yet to occupy them.

The Local Authority has benefited from the Rural Renewal scheme through increased income from Developer Contributions and Commercial Rates. There has been an estimated 25 per cent increase in Commercial Rates since the introduction of the scheme. Other direct benefits of the scheme are proceeds from the sale of Local Authority owned lands. Two sites have been sold in Carrick-on-Shannon for approximately €2 million. The Local Authority has also been able to fund a new Leisure Centre in the town as a PPP joint venture.

Overall, the Rural Renewal Scheme has had a very positive effect on Carrick-on-Shannon and is credited with having given a psychological boost to the town. While some level of development is likely to have taken place in any event, it would certainly have been to a much lesser extent in the absence of the scheme. The housing output accruing from the scheme has accommodated a significant increase in the population in recent years. This increased population has stimulated the local economy through increased spending. However, there have been some negative outcomes from the scheme such as instances of poor quality housing developments. Also, the huge increase in the housing developments has led to over-supply in the housing market. The high levels of vacant apartments have also given rise to concerns over the future use of these properties. Low maintenance and dereliction may become an issue.

As there was no initial requirement under the Rural Renewal Scheme for an Integrated Area Plan to be produced, developments carried out in the early years of the scheme were not subject to any framework or standards in relation to the overall development of the area. In 2004 a Local Area Plan was developed for Carrick-on-Shannon to establish a framework for the development of the town. Planning applications submitted following the introduction of this plan had to comply with the standards set out therein.

Given the high level of residential development that has taken place in Carrick-on-Shannon, relative to the size and population of the town, it would seem that the Rural Renewal Scheme does not need to be continued in this area. The scheme has provided the town with the necessary boost to invigorate the economy and attract the larger population needed to expand and develop the town into the future.

4.5.4.3 Overview

The overall conclusion is that as some 40 per cent of activity under the Scheme was concentrated in the major urban areas, property-related urban regeneration benefits occurred. Our case study and analyses have suggested that the Scheme has played a role in creating such benefits. While, the Scheme has created demand for additional employment, the economic benefits have not been significant due to the low levels of unemployment in the Scheme counties.

4.5.5 Population and Housing Benefits

4.5.5.1 Population Change and Housing Outputs

The prime aim of the Scheme was to help reverse the declining population trend in the designated counties by encouraging an adequate supply of housing and facilitating an expansion of commercial and industrial output. It is clear from the analysis of Section 4.5, that the Scheme failed to engender much permanent economic activity arising from commercial and industrial development.

The contribution to housing supply was more pronounced. Taking account of dead weight, the Scheme contributed 3,052 additional housing units in the period 2000 to 2004. While the average occupancy of these units is not known the evidence of the Carrick-on-Shannon case study is that a significant proportion was taken by single persons. At an average occupancy of two persons, a total of some 6,000 persons may have been catered for.

There are no data on county populations for intercensal periods. The Census data for 1991, 1996 and 2002 are presented in Table 6.3. In 1996, shortly before the Scheme commenced, the population of the Scheme area had declined by 2.5 per cent compared to 1991, whereas other counties in the BMW region were experiencing population growth. By 2002, the decline in the Scheme area had been reversed, with all Scheme counties experiencing population growth, which amounted to 2.6 per cent or 2,917 persons for the Scheme area as a whole. By 2002, a minimum of 2,135 housing units had been certified under the Scheme, more than sufficient to cater for this population increase.

Table 4.20: Population Growth in BMW Region 1991- 2002

County	Population 1991	% Change	Population 1996	% Change	Population 2002
Leitrim	25,301	-1.0%	25,057	3.0	25,799
Longford	31,496	-4.2%	30,166	3.0	31,068
Sligo	14,593	-1.6%	14,365	2.8	14,769
Roscommon	32,573	-2.6%	31,723	0.6	31,926
Cavan	13,029	-2.5%	12,708	5.2	13,374
Total	**116,992**	**-2.5%**	**114,019**	**2.6**	**116,936**
BMW	**733,899**	**2.1%**	**749,227**	**8.5**	**812,807**
State	**3,525,719**	**2.8%**	**3,626,087**	**8.0**	**3,917,203**

This indicates the presence of another form of dead weight, as it suggests that a significant proportion of the additional housing units were occupied by existing residents of the area. That is, that the additional housing encouraged additional household formation through young people setting up independent homes before they would otherwise have done so. Thus, a significant but unquantifiable element of housing output under the Scheme was not available to support population growth. As against this, it could be argued that the increased availability to young people of housing at lower cost will encourage them to remain in their local areas, leading to a retention of the existing population.

However, on balance the comparison of housing provision and population growth suggests that while the aim of the Scheme of reversing population decline has been achieved, a significant proportion of the Scheme output did not contribute to that aim.

4.5.5.2 Value for Money

Given the two types of dead weight, there will be concerns over whether the Scheme constitutes value for money. Three indicators are presented below for residential and commercial units:

- The tax costs per additional unit;
- The present value of tax costs per additional unit;
- The ratio of the present value of tax costs to new build costs.

At €31,427 per housing unit, the cost to the Exchequer is substantial. On average, it constitutes 16 per cent of the typical house price of €200,000. If dead weight losses are considered, the tax cost per housing unit rises to €59,300. By any measure, this is a very high price for the Exchequer to pay for incentivising housing development in the Scheme area. The implication is that the Scheme has proved to be an extremely expensive means of encouraging population growth. The NPV of tax costs account for 29 per cent of residential build costs incurred by those developing new housing. By way of comparison these figures are very similar to the tax costs arising under TRS but less that those associated with URS.

The table also gives efficiency indicators for commercial units; however these are not directly comparable with the other incentive schemes which measure commercial floor space, not units. At 37.8 per cent the NPV of tax costs to commercial build costs is quite high, but similar to the ratio observed for other schemes.

The tax costs of the Scheme will not be offset to a significant degree by either direct income tax and PRSI payments by the construction industry or developer contributions. Taken together, these amount to less than 5 per cent of build costs.

Table 4.21: Efficiency Indicators

Item	Value
Tax cost per housing unit (€)	31,427
Present value of tax costs per housing unit (€)	26,181
Ratio of discounted tax cost to build costs	29.0
Tax cost per commercial unit (€)	170,452
Present value per commercial unit (€)	140,443
Ratio of discounted tax cost to commercial build costs	37.8

4.5.5.3 Housing Quality

The census of 1991 and 2002 provide information on the proportion of houses in each county which are lacking basic amenities such as central heating and water supply. In the BMW region, Longford and Leitrim were shown as having the highest percentage of dwellings which are without basic amenities, and the highest percentage of houses built pre 1940. According to the 2002 Census, the number of houses in Leitrim with no piped water was 3.7 times the national average as can be seen from Table 4.20. Given the high number of residential units developed in the designated area, a further benefit of the scheme would be the extent to which it improved the quality of the housing stock in the designated area.

Table 4.22: Percentage of Private Dwellings Lacking Basic Amenities in BMW Area

Area	*% of private dwellings* No Central Heating	No Piped Water	No Sewerage Facility	Built Pre 1940
Leitrim	17.60	1.27	*2.27*	34.08
Longford	18.14	0.95	1.29	26.58
BMW Average	15.01	0.71	1.04	23.85
National	13.00	0.34	0.55	21.98

Source: Census 2002, Central Statistics Office

4.5.6 Equity Impacts

4.5.6.1 Introduction

Analysis of the equity impacts of the scheme requires consideration of two fundamental questions:

- To what extent are the benefits of the Scheme confined to a relatively few individuals; and
- To what extent are those individuals in the higher income and wealth groups.

Obviously, the more concentrated the group of scheme beneficiaries is and the higher their income and wealth status, the more inequitable the Scheme is.

4.5.6.2 Incidence of Benefits

If there are few tax-designated sites, then supply is relatively fixed, and the pressure of demand for these few sites will raise their price and thus the price of the property (see Appendix 1). While relatively few sites were designated under the Urban and Town Renewal Schemes, this was not true of the Rural Scheme. The whole of the counties of Leitrim and Longford and significant parts of Cavan, Roscommon and Sligo were designated. Therefore, site availability would not have been a factor in inhibiting supply. With regard to the availability of building resources, these were undoubtedly in short supply generally throughout the period of the Scheme, which was characterised throughout the country by rapidly rising house prices. However, the case study and information gathering conducted for this study indicates that this effect may have been mitigated somewhat in the Rural Scheme area. This is because there is evidence that some builders who were resident in but who formerly worked outside the Scheme area, concentrated their activities locally once the Scheme got underway. Thus, while supply side constraints undoubtedly raised prices during the period of the Scheme, there is no reason to believe that this was particularly pronounced in the Scheme area.

The incidence of the Scheme benefits is determined not only by supply side conditions, but also by demand side. If demand is very sensitive to price, then the capacity of builder/developers to raise prices is limited, as potential purchasers will be deterred by the price increases. Again, the fact that large areas were tax designated would have tended to increase the price elasticity of demand. Purchasers seeking properties in a particular townland or urban area would have a choice of locations, both within and without that area.

The conclusion is that because of the large areas that were designated under the Scheme and the availability of local building resources, it would not have particularly added to price inflation, over and above that which would have occurred because of the strong housing demand that existed throughout the country generally.

Over and Under Supply

New house building under the Scheme comprised both construction for owner-occupation by the site owner and speculative house building. When speculative house building takes place, speculative builders base their decisions as to the levels of output to provide on the demand they anticipate may arise in the future. If they get this decision wrong, then they provide too little or too much housing output, leading to either a softening or hardening of house prices. Thus, it may be seen that the incidence of benefits under the scheme also depends on the behaviour of speculative builders in anticipating the market. Professional builders would have a wealth of experience in judging the market and therefore may avoid oversupplying the market. However, over 80 per cent of residential developments under the scheme were single units, and there is supporting evidence that a proportion of these were built speculatively by site owners uninvolved in the building trade for subsequent sale. This would have tended to increase the scope for speculative over supply of the market.

4.5.6.3 Price and Cost Trends in the Market

The above analysis suggests that the fact that the Scheme applied over a wide area, the availability of local building resources, and the potential of some speculative building to oversupply the market indicates that it would not necessarily have added to house and price inflation, over and above that which would have occurred in any event because of general market conditions. The implications are that a significant element of the tax gain would have accrued to house owners or renters.

If this is not the case, then it would be expected that, building costs, house prices and rental values in the Rural Renewal Scheme area would have risen strongly by comparison with other areas. With regard to building costs, there is no evidence that these were particularly high. It is estimated that the average cost of house building under the Scheme was approximately €70 per square foot. The Institute of Auctioneers and Valuers provide indicative estimates of house building costs for insurance purposes. These costs include the costs of demolition of existing properties, as well as full professional fees. Currently, the IAAVI estimate these costs at approximately €110 per square foot in rural areas.

With regard to house prices, there are no data that refer to the Scheme area as a whole. However price data are available for the counties of Leitrim and Longford. In the period, 1996 to 2004, the price of private houses in these two counties increased by 197 per cent and 184 per cent. This was considerably lower than the increase for the State as a whole, or, more relevantly, the other BMW counties at 206 per cent. During the period 1999-2004, house prices in these two counties declined from being the 6th and 13th cheapest in the BMW region to being the cheapest and second cheapest. Thus, there is clear evidence of a relative decline in house prices in the two counties that received countywide designation under the Scheme.

Table 4.23: House Price Inflation, 1996-2003

Area	Average Prices 1996	Average Prices 2004
Leitrim	66,077	196,800
Longford	67,986	193,106
BMW Average	70,249	215,588

Source: Irish Permanent Building Society/ESRI Surveys

There are no equivalent data on rental values. However, the Case study of Carrick-on-Shannon revealed that rental values have declined by 50 per cent in the last two years. This may be compared with an equivalent of minus 1 per cent nationally. [11]

[11] As indicated by the CSO Rental Value Index component of the Consumer Price Index

Thus, the overall conclusion is that building costs under the Scheme have not been excessive and that house prices and rents have tended to soften relative to areas outside the Scheme. This, in turn indicates that individual owner-occupiers and investors have benefited from the Scheme to a large degree, in that they have not faced excessive costs or prices for properties constructed or purchased. There is evidence also, that renters are benefiting from lower rents. Finally, the fact that 82 per cent of developments constructed were single dwellings suggests that small builders were very active in delivering the increased housing output.

4.5.6.4 Owner-Occupiers and Investors Benefits: Equity Implications

As with all tax-based schemes, only those with taxable incomes stand to benefit. Moreover, with regard to income tax relief, those taxpayers on higher incomes and paying taxes at the higher tax rate stand to gain most from the Scheme. Additionally, investors seeking Section 23-type relief have other rental income against which they claim relief, implying significant wealth. The Scheme thus favours those on higher incomes and therefore has, in this fundamental sense, negative equity impacts.

This view is reinforced by an analysis of the scale of once-off houses developed under the scheme. Table 4.24 shows that houses were divided almost equally between those that were less than 150 square metres (1614 square feet) and those that were above. Some 13 per cent of houses were in excess of 200 square metres (2,152 square feet) indicating that a sizeable minority of beneficiaries of the scheme had the necessary funding for very large dwellings.

Table 4.24: Distribution of One-off Housing Units by Floor Area

Floor Area (m^2)	% of Total
50 - 100	6.6
100 - 150	44.9
150 - 200	35.2
200-210	13.3
Total	**100.0**

Source: Goodbody Economic Consultants Survey

Having said that, the Scheme differs from the Urban and Town Renewal Schemes in that it does not focus on particular designated sites. Rather, developments within the whole of Longford and Leitrim counties, and in significant tracts of Sligo, Roscommon and Cavan are eligible. Thus, the development opportunities under the Scheme are available to a wide range of land and property owners. This is evident in the large number of individual developments under the Scheme. During the period 1999-2004, there were an estimated 1,876 individual developments under the scheme. Moreover, in respect of the 1,744 residential developments, 82.3 per cent related to a single housing unit development (see Table 4.25)

Table 4.25: Distribution of Housing Developments by Number of Units

Number of Units	Proportion of Total Developments %
1 Unit	82.3
2 - 5 Units	6.3
5 - 10 Units	5.0
10 - 20 Units	3.3
20 + Units	3.0
Total	**100.0**

Source: Goodbody Economic Consultants Survey

4.5.6.5 Overview of Equity Impacts

The overall view of the equity aspects of the Scheme is as follows:

- Owner-occupiers and investors were significant beneficiaries under the Scheme;
- While builder-developers also benefited from the scheme, there is no evidence that they did so to an inordinate degree;
- Because of the large proportion of one-off housing under the Scheme, it is likely that small-scale builders benefited from the additional business that the Scheme brought;
- There is some evidence that the Scheme lead to a moderation of house price increases and low rents, which would be to the benefit of house purchasers and renters generally.
- Thus, the benefits of the Scheme would have been spread widely among owner-occupiers, investors and builders. However, as the Scheme was tax based, it would have fundamental inequitable effects, as the tax benefits were available only to those with taxable incomes. Moreover, those with the highest income had the capacity to benefit most from the Scheme by building relatively large houses.

4.5.7 Compatibility of the Scheme with Planning Policies

The 1997 policy document "Sustainable Development: A Strategy for Ireland" set out a strategic policy framework to deliver sustainable development. The Strategy indicated that there should be a presumption against urban generated one-off housing in rural areas adjacent to towns. The National Spatial Strategy (NSS) indicated that subject to adherence to good planning practice, rural generated housing needs should be accommodated where they arise. The NSS approach was elaborated in the guidelines for rural housing – "Sustainable Rural Housing:

Guidelines for Planning Authorities" issued by the Department of Environment Heritage and Local government. These provided that:

- People who are part of the rural community should be facilitated by the planning system in all rural areas, including those under strong urban based pressures; and
- Anyone wishing to build a house in rural areas suffering persistent and substantial population decline will be accommodated.

As indicated above, there were 1,753 residential developments under the Scheme. 87.8 per cent of these or 1,539 developments related to new build. Of these, 82.3 per cent or 1,260 were one-off developments. As the total housing output under the Scheme was 4,320 in the period 1999-2004, one-off housing units represented 29.2 per cent of the total. Thus, it is clear, that while significant, one-off housing output did not dominate. With regard to the geographic distribution of housing, it is estimated that 40 per cent of this took place in the major urban areas. However, developments in rural areas would not necessarily run counter to good planning, in light of rural housing guidelines acceptance of rural housing in areas of population decline.

A separate aspect of housing development does give rise to concern. Although difficult to quantify, it is evident that some housing development, particularly in Longford gave rise to long distance commuting to the Greater Dublin area, with negative sustainable development impacts.

4.6 Conclusions and Recommendations

4.6.1 Scheme Expenditure

Expenditure under the Scheme is estimated at total of €453m for the period 1999-2004. After a slow start, expenditure rose rapidly from € 24.6m in 2000 to €218.2m in 2004.

Of the total of €453.4m, Longford and Leitrim account for similar levels of expenditure at €130 to €140m. Roscommon, although only partly designated, is also a major contributor to expenditure at €94.7m or 20.9 per cent of the total.

Of the total of €453.4m, €398.5m (88.1 per cent) was in respect of residential developments and €54.4m (11.9 per cent) related to commercial/industrial developments.

The bulk of expenditure was on new-build. Developments that were solely new-build or that contained an element of new-build accounted for €436.5m or 96.3 per cent of total expenditure.

Very large increases in planning applications took place in 2004 as people sought to ensure that they could avail of the scheme. The average increase in planning applications was 78 per cent on that year.

Taking account of these applications, the predicted total construction expenditure on foot of the Scheme is put at €1,072m.

4.6.2 Tax Costs of the Scheme

It is estimated that the total tax forgone arising from the Scheme up to its end date of July 2006 will be €326m in present value terms.

Of the total tax costs, residential developments will account for €277mm in present value terms or 85 per cent and commercial developments for €48m or 15 per cent.

New housing will account for €274m of the tax costs, with refurbishment a very small element at €3m.

Of the new housing residential tax relief, it is estimated that the investor will account for €181m (67 per cent) and the owner-occupier for €92m (33 per cent).

4.6.3 Scheme Outputs

An estimated 1,876 developments were completed under the Rural Renewal Scheme in the period 1999-2004. Of these, 1,753 or 93.4 per cent were residential in nature, and 6.4 per cent commercial/industrial.

Of the total of 1,876 developments, the largest number was in Leitrim and Longford, with an estimated 544 and 572 developments respectively. These account for just under 60 per cent of all developments to date. Roscommon was the next largest with an estimated 388 developments (20.7 per cent of the total).

The vast majority of developments, 1,561 (83.2 per cent) were new-build only, with 1,650 developments (88.0) having at least some element of new build. The dominance of new-build applied to both residential and commercial/industrial developments.

A total of 4,320 housing units were completed in the Scheme area and benefited from tax relief in the period 1999-2004. Houses that benefited under the Scheme accounted for 29.1 per cent of all new private houses in 2002, and averaged 23.3 per cent over the Scheme period to date.

A significant number of people have built houses but have yet to seek the appropriate certificates and therefore do not appear in the above estimate. Taking these into account, the estimated housing output under the Scheme rises to 5,700 for the period up to end 2004, representing 30 per cent of all housing output in the Scheme counties.

In the case of the fully designated counties of Longford and Leitrim, these data suggest that approximately two-thirds of housing completions are benefiting from the Scheme.

4.6.4 Scheme Impacts

A significant proportion of the Scheme output would have occurred without the tax incentives. This dead-weight element is estimated at a minimum of 46 per cent, and reduces substantially the benefits of the Scheme.

Some 40 per cent of activity under the Scheme was concentrated in the major urban areas of Longford and Carrick-on-Shannon. A common feature of both towns is that the Scheme did not operate within a dedicated area planning structure, with designation of specific areas or sites where market failure was evident. This reduced the urban regeneration benefits of the Scheme, as developments sometimes occurred on unsuitable or less than optimum sites.

Outside of these major urban areas, property-based market failure would not have been a factor to a significant degree. As it is estimated that approximately 60 per cent of housing development occurred outside these areas, benefits derived from addressing property–based market failures were absent from much of the Scheme.

The direct contribution of the Scheme to increasing economic demand was small, as commercial and industrial developments under the Scheme were few in number.

While, the Scheme has created demand for additional employment in the building industry, the economic benefits have not been significant due to the low levels of unemployment in the Scheme counties.

Significant housing output occurred under the Scheme. However, a substantial proportion of this output was taken up by existing residents. That is, that the additional housing encouraged additional household formation through young people setting up independent homes. Thus, a significant but unquantifiable element of housing output under the Scheme was not available to support population growth. While the aim of the Scheme viz. that of reversing population decline has been achieved, a significant proportion of the Scheme output did not contribute to that aim.

While many residential developments were modest, almost one in seven had a floor area in excess of 200 square metres, indicating that some house owners used the tax incentives to build or purchase very large dwellings.

Taking account of dead weight, at €59,300 per housing unit, the cost to the Exchequer is very substantial. By any measure, this is a very high price for the Exchequer to pay for incentivising housing development in the Scheme area. The implication is that the Scheme has proved to be an extremely expensive means of encouraging population growth. In present value terms, tax costs account for 29 per cent of build costs incurred by those developing new housing.

The tax costs of the Scheme are not offset to a significant degree by either direct income tax and PRSI payments by the construction industry or developer contributions. Taken together, these amount to less than 5 per cent of build costs.

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There is clear evidence of an over-supply of housing in the Scheme area. House prices have fallen relative to other areas in the BMW. There is also evidence in some locations of high vacancy rates and rapidly falling rents.

The benefits of the Scheme would have been spread relatively widely among owner-occupiers, investors and builders. However, as the Scheme was tax based, it has fundamental inequitable effects, as the tax benefits were available only to those with taxable incomes. Moreover, as indicated above, those with the highest incomes had the capacity to benefit most from the Scheme by building relatively large houses. A positive aspect of the Scheme is that the majority of residential beneficiaries are estimated to have been owner-occupiers.

4.6.5 Conclusions and Recommendations

In summary, the Scheme:

- Had little direct impact on economic activity, except in the major urban areas;
- Had a modest impact on housing output, due to the high level of dead-weight;
- Resulted in higher quality housing output, but largely to the benefit of existing residents;
- Led in some cases to the construction of excessively large dwellings;
- Was poor value for money as the tax costs per housing unit were very high;
- Has now resulted in an excess supply of housing in the Scheme area.

Based on these conclusions, it is recommended that the Scheme should not be renewed after its current expiry date. Moreover, it is not considered to be a useful model for the regeneration of other areas of the country. The urban regeneration benefits achieved by the Scheme would be better delivered through targeted town renewal schemes.

5. Review of the Urban Renewal Scheme

5.1 Introduction

This Section of the Report presents a review of the Urban Renewal Scheme. It begins with an analysis of expenditure under the Scheme in Section 5.2. That analysis is used to estimate the tax costs of the Scheme in Section 5.3. Sections 5.4 and 5.5 assess the Scheme outputs and impacts. Conclusions are presented in Section 5.6.

5.2 Scheme Expenditure 1999-2004

5.2.1 Aggregate Scheme Expenditure

Expenditure under the Scheme is estimated at total of €1,281m for the period 1999-2004. There are no comprehensive data available to indicate the trend in expenditure over this period. As many of the projects are large and would take a considerable period of planning, it is likely that the bulk of expenditure has been towards the end of the period.[12] There is support for this view from an analysis of applications for certificates of compliance issued in respect of the residential aspects of the Scheme. These relate to numbers of completed residential projects. Table 5.1 below shows that 45.8 per cent of the residential projects completed by end 2004, were completed in that year.

Table 5.1: Number of Completed Residential Projects under the Urban Renewal Scheme, 1999 –2004

Year	Number	Proportion (%)
1999	0	0.0
2000	15	6.3
2001	30	12.6
2002	40	16.8
2003	44	18.5
2004	109	45.8
Total	**238**	**100.0**

Source: DOEHLG

[12] A frequent comment made during the course of the case studies was that the decision to extend residential investor (Section 23) type tax relief to sites that previously only had owner occupied relief effectively kick started the Scheme in certain areas.

5.2.2 Profile of Expenditure by Urban Area 1999-2004

Of the total of €1,281m, expenditure, over half occurred in the Dublin area, with Limerick the next most important at 12 per cent. Of County Boroughs, Waterford and Cork also had high expenditure levels at 7.6 per cent and 3.6 per cent respectively. Locations outside the major urban areas accounted for 19.2 per cent of the total with Kildare and Drogheda being prominent locations for expenditure.

Table 5.2: Estimated Expenditure by Urban Area 1999-2004 (€m)

Location	Expenditure (€m)	Proportion (%)
Major Urban Areas Of which:	1,034.3	80.8
Dublin	711.6	55.6
Cork	46.7	3.6
Limerick	158.7	12.4
Waterford	98.3	7.6
Galway	19.0	1.5
Other Urban Areas	246.4	19.2
Total	**1,280.7**	**100.0**

Source: DOEHLG
Note: Dublin refers to the area of the four local authorities; figures are an underestimate due to missing data in respect of O'Connell Street

5.2.3 Profile of Expenditure by Type of Sector and Type of Build

Of the total of €1,281m, €612.5m (47.6 per cent) was in respect of residential activity and €670.8 m (52.1 per cent) related to commercial/industrial activity.

The bulk of expenditure was on new-build, which accounted for €1,199.2m or 93.2 per cent of total expenditure. Expenditure on refurbishment was low. However, this reflects a low average expenditure on a significant number of developments that had a refurbishment element.

5.2.4 Profile of Expenditure by Project Type

The Urban Renewal Scheme consists of relatively large projects that often comprise both residential and non-residential elements as well as a mix of new-build and refurbishment or conversion.

Newbuild projects in total accounted for €1,149m or 89.7 per cent of all expenditure. Of these, newbuild projects that are a mix of both residential and commercial/industrial development have incurred the greatest expenditure (€601.1m or 46.9 per cent of the total), as they tend to be larger in number and size. Projects

that are pure refurbishment or a mix of newbuild and refurbishment accounted for only €121.2m or 9.5 per cent of the total.

Table 5.3: Estimated Expenditure by Type of Project 1999-2004 (€m)

Project Type	Newbuild Only (€ m)	Refurbishment Only (€ m)	Mix Newbuild & Refurb. (€ m)	Not Stated (€m)	Total (€m)
Commercial/ Industrial only	274.1	28.1	28.0	-	330.2
Residential Only	274.1	22.4	10.3	-	306.8
Mix Res. & Comm./Ind.	601.1	7.1	25.3	-	633.5
Not Stated	-	-	-	10.8	10.8
Total	**1,149.3**	**57.6**	**63.6**	**10.8**	**1,281.3**

5.2.5 Conclusions

Expenditure under the Scheme is estimated at total of €1,281m for the period 1999-2004. Of the total expenditure, over half occurred in the Dublin area, with Limerick the next most important at 12 per cent.

Of the total of €1,281m, €612.5m (47.6 per cent) was in respect of residential activity and €670.8 m (52.1 per cent) related to commercial/industrial activity.

The bulk of expenditure was on new-build, which accounted for €1,199.2m or 93.2 per cent of total expenditure. Expenditure on refurbishment was low. However, this reflects a low average expenditure on a significant number of developments that had a refurbishment element.

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5.3 Analysis of Tax Costs

5.3.1 Introduction

This section provides an analysis of the tax forgone arising from the urban renewal scheme. We begin with residential projects and then present an analysis of the tax forgone associated with commercial developments (with more detailed material relegated to Appendix 3).

The DOEHLG database was the primary source of information on the Scheme expenditure. However, this needed to be adjusted to exclude some elements of expenditure for the following reasons:

- General exclusions arising when a project in the database did not take place and will not take place;
- Timing exclusions arising when only a portion of a project will take place within the scheme's qualifying timeframe;
- Commercial/Residential exclusions arising when either a commercial or a residential element of a mixed use project is excluded, as the site on which that project took place only qualifies for relief for one type of use (not both); and
- Other exclusions arising when a particular commercial or residential sub-categorisation of use is ineligible for tax relief, in which case only the affected cost is excluded and the remaining costs are unaffected as they still qualify for relief.

Allowing for exclusions gives a net qualifying cost for each project. Just as costs were adjusted for exclusions so were the number of residential units and the commercial floor space arising. The next effect of this process was to take €709m out of the URS database for the period up to the end of the Scheme in 2006.

Information on exclusions was sourced from individual local authorities either by the DOEHLG or by the Review team with an emphasis placed on areas with a lot of activity under the schemes and also on large projects in other areas. For example, for all Scheme projects in planning with a build costs over €5m, the relevant local authority was contacted for further details. This process was assisted by an analysis of all projects against the relevant statutory instrument giving effect to the renewal schemes to highlights those with sub-components in conflict with the relevant designation.

5.3.2 Tax Forgone on Residential Properties

Step 1: Estimating Housing Units by Type

The total number of units expected under the scheme to July 2006 is estimated at some 15,538 units based on the housing output stated in the database provided by the DOEHLG. This includes projects known to be completed, developments currently in progress and an assumed delivery of 75 per cent of projects still in the planning phase.

It is necessary to split these 15,538 housing units into the four sub-categories of eligible residential reliefs as the tax breaks available differs between each sub-category (as detailed in Appendix 3). The disaggregation was based on the use mix ratio indicated in the database.

The same method was used to apportion build costs.

Step 2: Average Build Cost

The average build cost per sub-category of residential type was calculated across all completed, in progress and in planning projects. This calculation produced a very high build cost for new build units (€155,878 per owner occupier unit and €192,065 per investor units); giving rise to a situation that when site costs were factored in new builds appeared to be unprofitable. This problem is very likely due the fact that the database appears to include site costs in with build costs for projects seeking to comply with the 15 per cent requirement.

This problem was overcome by taking the data from completed projects and applying an average build cost based on these. The completed projects would then have excluded the site costs in obtaining the relevant certification, as it was the base for calculating development levies. These 'completed averages' were then adjusted for construction inflation to give the figures presented in Table 5.4. The need for an inflation adjustment arose due to the fact that most of the activity under the scheme is taking place towards the end of its life cycle.

Step 3: Average Sale/Purchase Price and Site Cost

Data is required for the purchase price or sale price and site cost in estimating gross tax relief in situations were units are purchased from a builder or developer. In cases of own account developments undertaken by existing owners, the gross value of the tax cost is set at the build cost allowing for a builder's margin.

The average selling price per unit was calculated based on Dept. of Environment, Heritage and Local Government data on new apartment prices weighted to reflect:

- The location mix between Dublin, the cities of Cork, Galway, Limerick and Waterford and the smaller urban areas and the number of units expected to arise in each of the three location groups;

- The timing of activity under the scheme, which is loaded towards the end of the Scheme's timeframe.

The above gave a selling price per unit of €266,657. Investor properties were then given a price premium of €50,000 per unit to reflect the additional prices the vendors can get for these properties. This premium is based on comments in the IAVI's most recent survey of members.

Site costs are set at 70 per cent of build cost, based on observations from the IAVI and the Irish Home Builders Association (see Appendix 3 for more details). In the case of refurbishments an additional €60,000 is added to site costs as in these cases eligible site costs include the building occupying the site.

The results from applying these steps and assumptions are given in Table 5.4, with a total build cost of €1,804m.

Table 5.4: Unit Data Used in Estimating Tax Forgone on Residential Urban Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
No. of Units Arising at 75% Completion of Projects in Planning	4,363	2,018	7,053	2,104	15,538
Database Average Build Cost per Unit	€155,878	€40,080	€192,925	€54,549	
Inflation Adjusted Average Build Cost per Completed Unit	€143,544	€31,109	€143,544	€48,828	
Gross Inflation Adjusted Build Costs	€626,277.9m	€62,768. 2m	€1,012,441.4m	€102,727.6m	€1,804,215m
Assumed Price per Unit	€266,657	€266,657	€316,657	€316,657	
Site Cost (set at 70% of build cost)	€100,481	€160,481	€100,481	€160,481	

Step 4: Gross Tax Forgone

The Department of Environment, Heritage and Local Government data information suggested a scheme mix of 70 per cent builder/developer constructed and 30 per cent other for new builds. The mix for refurbishments was put at 20 per cent builder/developer and 80 per cent other to account for the likelihood that many of these projects are undertaken by existing property owners.

Applying this mix to the data in the table above gives the gross tax relief arising, which is put at €2,071.3m in Table 5.5. Allowing for purchase price in situations where units are purchased from a builder/developer drives the gross value of the tax relief above build costs.

Step 5: Net Tax Forgone before Discounting

The second last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief attached to each unit. To do this the following enabling assumptions, as fully explained in Appendix 3, were made:

- For owner occupied projects two marginal rates could apply: 20 per cent or 42 per cent. It is assumed that 10 per cent[13] of owner occupiers have a marginal tax rate of 20 per cent. The remaining owner occupiers are assumed to pay tax at a marginal rate of 42 per cent.

- It is assumed that all investors pay a marginal rate of 47 per cent (the higher rate plus PRSI and levies) in year one and 42 per cent thereafter.

Following all the steps detailed above gives Table 5.5.

Table 5.5: Undiscounted Tax Forgone on Residential Projects in the Urban Scheme

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
Unit Gross Tax Relief via formula	€156,857	€43,298	186,269	€73,870	
Unit Gross Tax Relief at Cost	€143,544	€31,109	€143,544	€48,828	
All Units - Gross Tax Relief	€666,937,765	€67,686,799	€1,223,384,921	€113,264,838	€2,071,274,323
Net Tax Cost at Standard Marginal Rate	€6,669,378	€1,353,736	-	-	
Net Tax Cost at Higher Marginal Rate	€126,051,238	€25,585,610	€529,113,978	€48,987,043	
Total Net Tax Forgone	€132,720,615	€26,939,346	€529,113,978	€48,987,043	€737,760,982

Table 5.5 shows that before discounting the net tax cost associated with Urban Renewal Scheme residential units is €737.8m, as against a gross tax relief of €2,071.3m.

Step 6: The NPV of Net Tax Forgone

The last step in arriving at net tax forgone is to calculate present values, by taking a 5 per cent discount rate to reflect that the relief is a fixed values but it has to be exhausted over a period of years, reducing its value today.

As per the scheme's rules owner occupiers must take the relief over 10 years. Again, investors do not operate to this time constraint and tend to consume the tax relief over a much shorter period, believed to be 4 years.

[13] This is lower than the 30% assumption for RRS and TRS as the average price of a residential unit under this scheme is higher which means that standard rate tax payers are less likely to purchase such units.

Combining the 5 per cent discount rate and 10 and 4 years periods gives the present values shown in Table 5.6.

Table 5.6: Discounted Tax Forgone on Residential Urban Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
Undiscounted Tax Forgone	€132,720,615	€26,939,346	€529,113,978	€48,987,043	€737,760,982
Time Period (in years)	10	10	4	4	
Discount Rate	5%	5%	5%	5%	
NPV of Tax Forgone	€102,483,341	€20,801,849	€469,052,994	€43,426,407	€635,764,592
NPV of Tax Forgone per Unit	€23,489	€10,310	€66,502	€20,641	€40,917

The total discounted tax forgone for residential projects is put at €635.8m, of which:

- Investor new builds accounts for €469.1m (73.8 per cent);
- Investor refurbishment accounts for €43.4m (6.8 per cent);
- Owner occupied new builds accounts for €102.5m (16.1 per cent); and
- Owner occupied refurbishment/conversions accounts for €20.6m (3.3 per cent).

In all, the discounted tax forgone represents 35.2 per cent of the build cost associated with these projects and 30.7 per cent of the gross tax relief arising.

Looking at individual units, the table shows that the NPV tax cost per unit, regardless of type, is €40,917. The highest tax cost per unit is associated with investor new builds, followed by investor refurbishments. The tax cost per unit for owner-occupier new builds and refurbishments are less than half those associated with similar investor held proprieties.

5.3.3 Tax Forgone on Commercial Properties

In calculating tax forgone each step in the process is explained in less detail as the steps involved are very similar to the residential scheme. Data on commercial projects was not disaggregated into different types of commercial buildings such as office, retail, industrial etc. as the same rates of capital allowances apply to each category.

Step 1: Estimating Square Metres

The database did not record data on the number of commercial units associated with each development but did give good data on a square metre for each project.

In arriving at a calculation of the area given to commercial use for a mixed use project the total floor space was multiplied by the percentage of the project stated in the database to be commercial. Once this was repeated for all projects in the Scheme database, the total commercial floor space was determined. As with the residential analysis, an adjustment was made by assuming that 75 per cent of projects still in planning will be completed by July 2006. Those in progress are assumed to be fully completed by July 2006. This gives 1,580,416 square metres of commercial space arising under Scheme.

Commercial build costs were calculated using the same methodology.

Step 2: Average Build Cost

On average build costs per square metre was arrived at by dividing total estimated commercial build costs over the life of the scheme by the floor space expected to be developed up to July 2006. This gave an average build cost of €1,355 per square metre. Again, we repeated the calculation using data on completed project only as completion costs are more likely to better capture true costs. This gave an average build cost of €1,230 per square metre allowing for inflation.

Multiplying total floor space arising by €1,230 per square metre gives an indicative build cost of €1,943.7m.

Step 3: Average Sale/Purchase Price and Site Cost

Data on rental rates and yields per square metre was used to establish the average price per square metre of commercial space under Urban Renewal Scheme. This data was weighted to reflect location and timing. This resultant average price per square metre was €2,474

Site costs are set at 70 per cent of build cost giving €861 per square metre.

Step 4: Gross Tax Forgone

For new build projects the gross tax forgone is calculated by applying the formula which yields a value of €1,455 per square metre and €1,230 per square metre in situations where the property is build directly or acquired from a non-builder/non-speculator.

We have assumed that commercial projects are split 70 per cent: 30 per cent between those purchased from builders/developers and others. This produces a gross tax forgone of €2,193m.

Step 5: Net Tax Forgone

The second last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief. It is assumed that a marginal tax rate of 47 per cent applies to 90 per cent all of these developments as they are owned by individual and the remaining 10 per cent are owned by companies with a marginal tax rate of 12.5 per cent. Table 5.7 shows the results. Before discounting, €955m of tax forgone is associated with commercial projects, which represents 43.6 per cent of the gross tax costs.

Table 5.7: Undiscounted Tax Forgone on Commercial Urban Scheme Projects

	Commercial
Floor Space in Sq Metres at 75% Completion of Projects in Planning	1,580,416
Average Sq. Metre Build Cost (All Projects)	€1,355
Inflation Adjusted Sq. Metre Build Costs for Completions	€1,230
Total Inflation Adjusted Build Costs	€1,943,737,071
Sale Price per Sq. Metre	€2,474
Site Costs per Sq. Metre (70% of build costs)	€861
Sq. Metre Gross Tax Relief via formula	€1,455
Sq. Metre Gross Tax Relief at cost	€1,230
Total Gross Tax Cost	€2,192,974,114
Net Tax Cost at 47%	€927,628,050
Net Tax Cost at 12.5%	€27,412,176
Total Net Tax Cost	€955,040,227

The net present value of tax forgone is determined by discounting at 5 per cent over 14 years. This gives a net present value of tax forgone of €786.9m which represents 40.5 per cent of build costs and 35.9 per cent of gross tax relief. On a unit basis, the NPV of tax forgone works out at €498 per square metre.

Table 5.8: Discounted Tax Forgone on Commercial Urban Renewal Scheme Projects

	Commercial
Undiscounted Tax Forgone	€955,040,227
Discount Rate	5%
Time Period (in years)	14
NPV of Net Tax Forgone	€786,895,383
NPV of Net Tax Forgone per Sq. Metre	€498

5.3.4 Tax Forgone on by Development Status

This section presents an analysis of residential and commercial projects by the development status of the projects. As per the Department's database projects are either completed, in progress or still in planning.

Residential Units

Table 5.9 gives the development status of residential units. Of the 15,538 residential units arising, 4,057 (26.2 per cent) were delivered, 8,561 (55.1 per cent) are in progress and the remainder are in planning.

Table 5.9: The Development Status of Residential Urban Scheme Projects and Tax Costs

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
NPV of Tax Forgone per Unit	€23,489	€10,310	€66,502	€20,641	€40,917
Number of Units by Development Status					
- Completed	1,139	527	1,841	549	4,057
- Work in Progress	2,404	1,112	3,886	1,159	8,561
- In Planning	820	379	1,325	395	2,920
Totals	4,363	2,018	7,053	2,104	15,538
NPV of Tax Forgone by Development Status					
- Completed	€26,755,772	€5,430,829	€122,457,708	€11,337,521	€165,981,830
- Work in Progress	€56,468,102	€11,461,774	€258,447,196	€23,927,857	€350,304,929
- In Planning	€19,259,467	€3,909,245	€88,148,091	€8,161,029	€119,477,832
Totals	€102,483,341	€20,801,849	€469,052,994	€43,426,407	€635,764,592
Share	16.1%	3.3%	73.8%	6.8%	100.0%

The NPV of tax forgone per sub-category of residential unit multiplied by units in each development status grouping gives the NPV of tax forgone by development status. Of the €635.8m of residential tax costs, €166m is associated with units which are complete, €350.3m is attributed to those in progress and €119m is related to units in planning.

Commercial Space

Table 5.10 repeats the analysis for commercial space.

Table 5.10: The Development Status of Commercial Urban Scheme Developments and Tax Costs

NPV of Tax Forgone per Sq. Metre	€498	
Sq. Metres by Development Status		
- Completed	542,654	
- Work in Progress	705,246	
- In Planning	332,515	
Total	1,580,416	
NPV of Tax Forgone by Development Status		Share
- Completed	€270,189,655	34.3%
- Work in Progress	€351,144,977	44.6%
- In Planning	€165,560,751	21.0%
Total	€786,895,383	100.0%

Of the €786.98m of tax costs, 34.3 per cent is associated with completed projects, 44.6 per cent is linked to work in progress and projects still to start account for 21 per cent.

5.3.5 Overview

In conclusion, the present value of all tax forgone associated with Scheme up to July 2006 is estimated at €1,422.7m, of which residential projects account for €635.7m or 44 per cent and commercial projects account for €787m or 56 per cent. With regard to developments completed by end 2004, the tax cost is estimated to be €436.2m.

Table 5.11: Overview of Present Values of Predicted Scheme Tax Foregone

	Residential (€m)	Commercial (€m)	Total (€m)
Predicted Tax Cost to Mid July 2006	635.8	787.0	1,422.7
Tax Cost Incurred to end 2004	166.0	270.2	436.3

Source: Consultants' Estimates

5.4 Scheme Outputs

5.4.1 Introduction

This Section of the report summarises the main outputs of the Scheme, such as the number of developments and housing units. The data presented are based on the DOEHLG database and the Survey of Local Authorities. This survey elicited responses from nineteen of the twenty-nine local authorities, representing 32 of the 49 IAPs.

5.4.2 Developments under the Scheme

Under the Urban Renewal Scheme, a total of 49 Integrated Area Plans were approved across 23 counties. Within these plans there are a total of 1,015 projects, of which 426 or 42 per cent were completed by the end of 2004. A further 237 are at work-in-progress stage, making a total of two-thirds of all projects that were substantially advanced or complete by end 2004.

Table 5.12: Distribution of Projects by Status

Development Status	Number of Projects	Proportion (%)
Completed	426	42.0
Planning or Preplanning Stage	349	34.4
Work in Progress	237	23.3
Not Stated	3	0.3
Total	**1,015**	**100.0**

The database for the Urban Renewal Scheme showed that the vast majority (78.7 per cent) of developments have been granted planning permission. At the end of 2004, fewer than 8 per cent are awaiting planning permission and 6.3 per cent have been granted exemptions. It is evident, therefore, that the vast bulk of developments will be completed by mid 2006.

5.4.3 Developments by Urban Area

Of the total of 426 developments, the largest number was in Dublin, with 94 developments or 22.1 per cent of the total. The major urban areas accounted for 43.0 per cent of the total. As we have seen in Section 5.2 the major urban areas, including Dublin accounted for a higher proportion of total expenditure, reflecting the large average projects size in these areas.

The survey of local authorities revealed a high level of satisfaction on the part of local authority officials with progress under the Scheme. More than three-quarters

(76.7 per cent) indicated that they were satisfied with progress under the Scheme (see Table 5.6).

Of the 32 IAPs, for which the local authorities expressed an opinion, eight were identified as having performed poorly. [14]

Table 5.13: Number of Developments Completed by Urban Area 1999-2004

Location	Number	Proportion (%)
Major Urban Areas Of which:	183	43.0
Dublin	94	22.1
Cork	37	8.7
Limerick	23	5.4
Waterford	23	5.4
Galway	6	1.4
Other Urban Areas	243	57.0
Total	**426**	**100.0**

Source: Derived from DOEHLG Database

Table 5.14:Distribution of Local Authorities by Satisfaction with Progress of the Scheme

Level of Satisfaction with Scheme	Proportion of Respondents (%)
Very satisfied	23.8
Satisfied	42.9
Neither satisfied nor dissatisfied	19.0
Dissatisfied	14.3
Very dissatisfied	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

[14] These were Passage West, Buncrana, Dun Laoghaire, Tuam, Newcastle West, Dundalk, Birr, and the City docks area of Cork.

5.4.4 Reasons for Lack of Progress

Where progress was poor, a number of reasons were identified as follows:

- Lack of interest on part of developers, builders or owner-occupiers;
- Tax incentives available were not appropriate;
- Property in hands of elderly and other people not interested in developing it;
- Failure of land/property owners to reach agreement;
- Disputes over legal title to land or property;
- Failure to acquire planning permission;
- Lack of local authority services; and
- Poor marketing of the Scheme

Lack of interest on the part of developers was the most prevalent reason, followed by legal disputes and failure of landowners to agree.

5.4.5 Profile of Developments by Type of Sector and Type of Build

Developments are either new build, refurbishment or a combination of both. Similarly, they can be residential, industrial/commercial or a mixture of both. Table 5.12 indicates the number of developments that fall into each of the new categories. This shows that 167 or 39.2 per cent of developments involve commercial/industrial development only, 122 or 28.7 per cent involve residential development only and 125 or 29.3 per cent are a combination of both. Over half (223 developments) are newbuild developments, 32.8 per cent are refurbishment and 12.0 per cent are a combination of both. With a number of developments having more than one use or type of build, the greatest number of completed developments (86) are a combination of Residential and Commercial/Industrial and are newbuild developments. A further 85 developments fall into the commercial/industrial-refurbishment category, followed by the residential-newbuild category (80 developments).

This shows that there was significant activity under the Scheme in refurbishment projects, although the average expenditure on them was, as one would expect, relatively low. Similarly, the Scheme has had good mix of developments, with a strong focus on commercial/industrial developments, and was not dominated by residential developments.

Table 5.15: Completed Projects by Use and Type of Build

	Newbuild	Refurbishment	Mix Newbuild & Refurb.	Not Stated	Total
Commercial/ Industrial	57	85	25	-	167
Residential	80	37	5	-	122
Mix Res. & Comm./Ind.	86	18	21	-	125
Not Stated	-	-	-	12	12
Total	**223**	**140**	**51**	**12**	**426**

Source: Derived from DOEHLG Database

5.4.6 Scale of Developments

When all completed projects are analysed by scale of cost of development, 40.4 per cent have estimated costs of €500,000 or less. Just over 40 per cent have estimated costs of over €1 million, with 7.7 per cent having costs of over €10 million.

Table 5.16: Estimated Cost of Completed Developments

Est. Cost of Development (€)	No. Projects	As % of all Projects
<= €100,000	63	14.8
€100,001 – €500,000	109	25.6
€500,001 – €1,000,000	55	12.9
€1,000,001 – €3,000,000	84	19.7
€3,000,001 – €10,000,000	55	12.9
€10,000,001 – €20,000,000	21	4.9
> €20,000,000	12	2.8
Not Stated	27	6.3
Total	**426**	**100.0**

Source: Derived from DOEHLG Database

5.4.7 Conclusions

The Urban Renewal Scheme has been successfully implemented, with 426 developments completed by end 2004. It is anticipated that the vast bulk of all 1,015 developments will be completed by the time the Scheme ends in July 2006. Local authorities are generally very satisfied with progress in implementing the Scheme.

Dublin has highest number of completed projects at 94 or 22 per cent of the total. The major urban areas account for 44 per cent of all projects.

For areas where progress has been poor, the major reasons are lack of interest on the part of developers or site owners, together with legal and other problems associated with site assembly. Lack of local authority services and poor marketing of the Scheme were also cited as reasons for lack of progress.

The Scheme has provided a good mix of developments to date. Residential developments have not dominated the Scheme, with developments comprising commercial/industrial elements being somewhat in the majority.

Similarly, while newbuild developments have formed the larger part of the total, developments involving refurbishment have been substantial in number.

In terms of scale, the Scheme has also produced a good mix. Almost half of all developments were less than €0.5m, with only a minority (7.7 per cent) of very large developments over €10m.

5.5 Impact of the Scheme

5.5.1 Introduction

This Section of the Report identifies the impacts of the Scheme and evaluates them using the framework outlined in Section 2. The analysis draws on the DOEHLG database, the Survey of Local Authorities and the case studies to provide an overview of Scheme impacts. It begins with an analysis of Scheme effectiveness, followed by consideration of efficiency and equity impacts. Urban case studies were undertaken in the HARP, Limerick, Monaghan, and Athy IAPs. More limited data were also collected from Tallaght and Ballymun IAPs.

5.5.2 Scheme Effectiveness: Physical Development Benefits

5.5.2.1 Dereliction

The refurbishment or replacement of degraded, underused or derelict properties was a major focus of the IAPs prepared for the Scheme. This is reflected in the strong element of refurbishment and also the focus on commercial/industrial in individual scheme designations.

For example, in Athy, the major emphasis of designation was on back land sites showing a high level of dereliction, canal side properties made up of disused warehouses and industrial building, and a prominent area of dereliction close the historic White's Castle environment. As a result, the major focus of the IAP was on refurbishment and commercial/industrial developments.

The concentration of IAPs on refurbishment and commercial/industrial developments resulted in a substantial impact on dereliction. This is supported by the fact that 191 or 45 per cent of the completed developments under the Scheme had a refurbishment content. In addition, 292 developments (or 67 per cent) had a commercial/industrial component. The positive impact on dereliction showed through in the case studies. For example, it is estimated that in Limerick City, there were eight hectares of derelict property within the IAP area in 1992, which has been reduced to 2 hectares currently.

The survey of Local authorities also indicated significant impacts in this area. Table 5.17 shows that 95 per cent of local officials surveyed indicated agreed or strongly agreed with the view that there were positive impacts on dereliction. The overall conclusion is that the Scheme performed strongly in this area.

Table 5.17: Local Authority Views on Dereliction Impact

The scheme has contributed to a reduction in the degree of dereliction in the area	Proportion of Respondents %
Strongly agree	47.4
Agree	47.4
Neither agree nor disagree	0.0
Disagree	5.2
Strongly disagree	0.0
Total	**100.0**

Source: Goodbody survey of Local Authorities

5.5.2.2 Urban Design

The case studies undertaken included a number where urban design issues were central to the IAP. For example, in the HARP area in Dublin, the encouragement of good urban design was identified as a key objective, with the development of formal and informal civic spaces, a mixed-use strategy and high quality architecture, all being highlighted. The view within Dublin City Council is that the scheme has been generally successful in delivering on these objectives.

With regard to Tallaght, because of past developments, the town centre had developed in a form that facilitated vehicle access, with extensive car parking around commercial sites. There was thus a need to develop coherent streetscapes and pedestrian friendly routes, as part of the development of an integrated town centre with a distinct urban character. This necessitated the introduction of a greater mix of uses allied to "back of footpath" development and provision of off-street car parks. Thus, a central element of the plan was the development of a new pedestrian environment.

South Dublin County Council are broadly satisfied that the scheme is delivering on the majority of their objectives, though there are still outstanding elements of the urban framework to be completed. There have been difficulties in achieving certain urban design objectives where such planning aspirations are not sustainable by the commercial return that developers might achieve on the sites in question.

Anecdotal evidence from Waterford City Council suggests a reasonable degree of satisfaction with the nature and level of development, which has been achieved. Urban design issues were also to the fore in many other IAPs, but not always on the scale evident in the major urban centres such as Dublin and Tallaght.

Notwithstanding some instances where the objectives of IAPs have not been fully achieved, the general conclusion with regard to this impact is that the Scheme has been reasonably successful in delivering urban design benefits.

Issues of the design quality of tax designated development has arisen in certain instances, whereby it has been suggested that quality of design and build may have suffered due to timescale and programme constrains imposed by the deadlines inherent in the legislation. It is not possible to support this hypotheses as the myriad factors which come into play in the design and construction of developments are such that it is not possible to confirm that, where tax driven development has been criticised for being of poor quality, the relevant issues are attributable exclusively to tax-related issues.

In contrast, it is arguable that the introduction of the IAP process has generally served to improve the quality of the design in urban terms, as it has by its very nature encouraged a more integrated approach to development than was previously the case with development in general.

There is a general consensus at local authority level that tax incentive-led development has been broadly successful in terms of the extent and nature of physical development, which has been achieved over the last 20 years. This is particularly the case in situations where market forces would not have supported development or, in certain instances, where the pace of development would have been significantly slower in the absence of tax incentives.

5.5.2.3 Conservation

The emphasis on conservation varied from one IAP to another depending on the extent of the architectural heritage in various areas. In three of the four case studies – Limerick, HARP and Athy, conservation of buildings was a major objective of the plan. With regard to the Tallaght, preservation of the historic area was a prime objective. These objectives reflected the conservation objectives embodied in the Development Plans produced by the particular local authorities, which in turn generally reflected the relevant conservation aspects of the Local Government Planning and Development Act 1999.

Issues of building conservation within IAPs typically focussed on:

- Promoting the rehabilitation and renovation and reuse of existing buildings; and

- Ensuring that all new developments were acceptable from an architectural heritage viewpoint where the context so demanded

The achievement of conservation objectives is made difficult by the fact that owners and developers are reluctant to incur the perceived high costs associated with the refurbishment of listed buildings, particularly in instances where there may be alternative developments of lesser risk available to developers. The protracted planning process associated with the development of listed buildings has been cited in several instances as a disincentive to development. This has been a major reason why projects have not commenced on tax designated sites in Henrietta Street, Bow Street, and North King Street in the HARP area.

In Limerick, designation is credited with assisting in the conservation and preservation of a number of listed Georgian buildings. Almost all of the refurbishment under the scheme has taken place in the Georgian area of the city, restoring buildings considered to be under threat and enhancing Limerick's Georgian heritage. Out of the 12 designated conservation sites, four were redeveloped and enhanced and another site is in progress. However, it is questionable whether development will take place on the remaining sites.

These examples highlight the difficulties in conserving buildings and the fact that tax designation can help overcome the cost penalties associated with the development of protected buildings. However, it is also the case that in some instances, tax designation fails to provide a sufficient motivation to developers. This is reflected in the views of local authorities, when they were canvassed on this subject. While 50 per cent of respondents agreed or strongly agreed with the view that the Scheme has contributed to conservation, a very substantial 38.9 per cent were doubtful and 11 per cent believed the impact was negative. (see Table 5.15). On balance, therefore, the Scheme is viewed as having a moderately positive impact on conservation.

Table 5.18: Local Authority Views on Conservation Impact

The scheme has contributed to the preservation of the natural architectural and archaeological heritage in the area	**Proportion of Respondents (%)**
Strongly agree	5.6
Agree	44.4
Neither agree nor disagree	38.9
Disagree	11.1
Strongly disagree	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

Case Study: Limerick

As stated in the Limerick Centre IAP, its purpose is "to give effect to the goals of the city development plan which are to promote the economic and community development in Limerick". The IAP process was viewed as an opportunity to consolidate the various promotional, renewal, conservation and community development actions engaged in over the previous 20 years such as the transition from dereliction in Charlottes Quay

The Council chose to focus the IAP, geographically, on the centre of Limerick City as it was, and still is, the largest single employment and business centre in the Mid-West. It should also be pointed out that Limerick City Council took a very targeted approach to the IAP. They opted to put forward specific sites for designation, rather than seeking designation on a blanket basis for certain locations.

The 51 projects in Limerick City expected to be delivered by July 2006 have a total estimated build cost of €330m or an average build cost of €6.5m, these development are fully private sector led and do not arise from local authority/central government actions or assistance. Most of the projects have been of mixed-use variety comprising residential/commercial developments. New builds account for 95% of activity with refurbishment accounting for the balance.

It was clear from the consultations that the Council's officials saw Limerick city centre's designation as successful for a number of reasons. This view was reinforce by the March 2005 Urban Renewal Progress Report which stated that "consequent to the designation Limerick City has taken on a completely new image as one of the leading European riverside cities with the city focusing its new face towards the River Shannon".

Some of this success is attributed to past work in stimulating development and building on lessons learned. In the 1980s Limerick was a city in decline and in need of development. The Council and Shannon Development came together to simulate development through creating focus, sharing ideas and building a vision for the city centre. At a practical level the Council engaged in site assembly, via CPOs where necessary, to establish title, installed essential infrastructure and packaged development projects.

A number of factors were sighted as facilitating the progress made under Urban Renewal Scheme, these include:

- The tightly focused and targeted approach adopted in drafting the IAP, as opposed to the blanket designation approach favoured in other city centre IAPs. This forced developers wishing to avail of the scheme to developed sites viewed by the Council as most in need of improvement;

- Well serviced sites. Only sites capable of being developed, to the Council's knowledge, were put forward for approval;

  The high level of Council supplied essential services. Owing to experience gained from previous designations the Council knew where past service constraints to development were and how to address them, hence these constraints were address before the roll out of the Urban Renewal Scheme and these did not hinder development;

- Lessons learned from previous tax designation status. Again, past experience was applied to ensure that constraints to development did not bite, e.g. the Northern Relief Road;

- Site assembly was not viewed as a constraint. In fact, under previous tax designation schemes the Council helped packaged sites for development to animate the local property development market; and

- The general economic boom experience in Ireland since 1997 also spurred property development within the IAP zone.

The property developers and estate agents consulted were of the opinion that the development of Limerick would not have taken place on the scale that it did but for its tax designation status, not just the Urban Renewal Scheme but previous schemes as well. The common conclusion was that designation in the 1980s "kick-started" Limerick by showing what could be done and generating confidence. Subsequent designations ensured that progress was maintained and allowed critical mass to build. For example, tax designation status is credited with providing a substantial increase in commercial multi-storey car parks facilities which meet the growing demand for short-term and long-term off-street parking in the city.

5.5.3 Scheme Effectiveness: Economic Benefits

5.5.3.1 Construction Employment

The €1,281m expenditure of the Scheme in the period 2000-2004 would have given rise to significant demand for labour in the building industry. Based on the average employment content in building and construction[15], this level of spend would have created a demand for approximately 7,000 person years of direct employment during the period 2000 to 2004, or an average annual demand for 1,400 workers. Income tax, Employers PRSI and Employees PRSI payments to the Exchequer would have been of the order of €47m, €20m and €11m, making €78m in total.

As for the Rural Renewal Scheme, the fact that additional employment demand and Exchequer payments were created does not imply that economic benefits occurred. Given that, as depicted in Section 2, national and regional unemployment rates were very low throughout the scheme period, very little of this increased employment would have been drawn from the ranks of the unemployed, so that the net impact on unemployment levels and Exchequer receipts would have been minimal.

5.5.3.2 Housing Development and Population Growth

An additional 4,527 housing units were developed with the aid of the Urban Renewal Scheme in the period to end 2004. Table 5.16 presents a breakdown by urban area. Dublin accounted for half of all housing units, and output was dominated by the major urban areas.

[15] See: CSO. 2002 Census of Building and Construction

Table 5.19: Number of Housing Units Completed by Urban Area 2000-2004

Location	Number	Proportion (%)
Major Urban Areas		
Of which:	3,657	80.8
Dublin	2,191	48.4
Cork	142	3.1
Limerick	669	14.8
Waterford	493	10.9
Galway	162	3.5
Other Urban Areas	870	19.2
Total	**4,527**	**100.0**

Source: Derived from DOEHLG Database

A total of over 300,000 new housing units as a whole were constructed in the State in the same period. However, the impact of the Scheme is not principally in adding to total housing output but with creating additional housing in the designated areas. From this point of view, the Scheme was relatively successful, a view which is also held by local authority officials. Two thirds of the latter were of the view that the Scheme contributed to housing supply in the IAP area (see Table 5.17). However, there is a sizeable minority who disagree, reflecting perhaps the greater success in major urban areas, as opposed to the smaller urban areas included in the Scheme.

Table 5.20: Local Authority Views on Housing Impact of the Scheme

The scheme has contributed significantly to housing supply in the area	Proportion (%)
Strongly agree	25.0
Agree	30.0
Neither agree nor disagree	15.0
Disagree	25.0
Strongly disagree	5.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

The evidence of the case studies is that this housing output was taken up, and there is no real evidence of oversupply or high vacancy levels. There are concerns however at the low level of owner occupation. In all of the case study areas, the proportion of investor/rental properties exceeded 90 per cent of the total. This has the potential to create social and other problems, an issue that will be discussed in Section 5.6.4 below.

This level of output would have encouraged population growth in the IAP areas. There is strong evidence from the case studies that such population growth is occurring e.g. Limerick, Athy, and the HARP area enjoyed a 1996-2002 growth rate of 22.3, 14 per cent and 43 per cent respectively. This shows that IAP areas are successfully regenerating, but also that some of this was occurring prior to the bulk of the housing output under the Scheme being delivered. In the case of Limerick and HARP, where the Scheme was part of a relatively long-standing process of urban renewal, the 2002 population growth probably reflects past urban renewal efforts. For other urban areas, which were incentivised for the first time, it is evidence that a resurgence was in part taking place prior to the Scheme impacting.

The conclusion is that the scheme has successfully contributed to housing and population growth, particularly in the major urban areas, but that there are concerns with the tenure mix resulting as well as the possibility of dead-weight losses.

5.5.3.3 Commercial and Industrial Development Impacts

As indicated in Section 5.5, the Scheme had a strong focus on industrial and commercial developments, with 292 out of the 426 completed developments including a commercial/industrial element. Expenditure on industrial/commercial accounted for the bulk of completed expenditure under the Scheme (€670.8m). An overwhelming majority of local authority officials were in agreement that the Scheme contributed significantly to the level of economic activity in their IAP area.

Table 5.21: Local Authority Views on Economic Activity Levels

The scheme has contributed significantly to economic activity in the area	Proportion (%)
Strongly agree	30.0
Agree	50.0
Neither agree nor disagree	10.0
Disagree	10.0
Strongly disagree	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

Based on a knowledge of square metres provided, it is possible to estimate the employment and value added potential associated with commercial and industrial development, based on standard factors. This suggests that investment in commercial and industrial development under the Scheme in the period up to 2004 had the potential to create 16,000 jobs and the capacity to produce just under €0.7bn in gross value added annually in the IAP area economies.

This indicates a strong commercial and industrial impact of the scheme in the targeted urban areas.

5.5.4 Scheme Effectiveness: Social and Community Benefits

5.5.4.1 Community Gain Impacts

There was an intention at the outset of the Scheme that it would provide community benefits through a number of mechanisms viz.

- Special levies on developers to fund community facilities and education and training initiatives;
- Allocation of jobs in the construction phase to local people.

In general terms, this aspect of the Scheme appears to have been poorly implemented.

This was due to both a failure to prioritise this aspect of the Scheme and concerns that application of special community levies could serve to deter developers. The evidence from the case studies is that the levies were relatively low. In the case of Tallaght the community levy has amounted to €1.3m (0.9 per cent) in a total Scheme expenditure of €142m to date. In the HARP area a levy of €2.2m or 1 per cent of total Scheme expenditure of €201m was obtained. In Limerick, it would appear that no special levies were put in place, although Athy levied commercial developments to help fund RAPID projects. Thus, the maximum contribution was about 1 per cent of Scheme expenditure in IAP areas where a serious effort was made.

Only those Schemes that were proactively managed had the capacity to influence developers and builders to take on local labour. Even then, there were generally very poor outcomes. Again Tallaght is an exception in that the Tallaght Local Employment Service Network engaged developers in order to maximise local employment effects, with up to 100 training and employment positions being obtained.

5.5.4.2 Social Housing Impacts

The Urban Renewal Guidelines indicates that at least 15 per cent of the additional bed spaces provided in IAP areas should be social housing. The Guidelines envisaged that social housing within the IAP area would be provided by the local authorities themselves, in co-operation with the voluntary housing agencies, or through special arrangements with the private sector. From the point of view of the cost-benefit of the Scheme, it is the latter arrangement that is relevant. However, no instances of the private support for social housing could be found. The local authority officials

surveyed indicated by an overwhelming majority (79 per cent) that the Scheme did not make a significant contribution in this area.

Table 5.22: Views of the Local Authorities on Social Housing

The scheme has contributed significantly to the supply of social housing in the area	Proportion (%)
Strongly agree	0.0
Agree	5.3
Neither agree nor disagree	15.8
Disagree	73.6
Strongly disagree	5.3
Total	**100.0**

Source: Goodbody Survey of Local Authorities

Moreover, it is clear that, for some of larger urban areas, the Scheme did not contribute to social integration aims, as the housing of social welfare recipients was concentrated in a few tax incentivised developments.

5.5.5 Spillover Benefits

The benefits of the Scheme would be enhanced, if developments within the IAP areas were to lead to a spillover into other non-IAP areas. None of the case studies supported this view that spillovers occurred. Rather, there were indications that tax designation caused developments that would have occurred elsewhere to transfer to designated sites (see Section 5.6.6 below). Additionally, a majority of local authority officials surveyed were of the opinion that such impacts were at most slight.

However, there was evidence from the case studies that the development of tax designated sites had spillover benefits for the IAP areas as a whole. Very often tax designated developments raised the quality of buildings in the area and improved its ambience. Tax designated residential developments *sometimes* changed the social mix, increasing the attractiveness of the whole area for further residential development. Again, this was a view supported by the survey of local authority officials (see Table 5.23)

Table 5.23: Local Authority Views on Success of the Scheme in Levering other Investment in the Area

Level of success	Proportion (%)
Very successful	15.8
Successful	31.6
Neither successful nor unsuccessful	42.1
Unsuccessful	10.5
Very unsuccessful	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

5.5.6 Management of the Scheme

Integrated Area Plans were the basis for designation under the Scheme. The better plans set clear objectives in terms of local needs and used tax designation to advance those objectives. A particularly successful feature of the IAP approach has been the manner in which the IAP process allowed for the bringing together of the many bodies who had an interest in development of particular localities e.g. resident's groupings, Chambers of Commerce and similar. The contributions of such bodies to the formulation of IAPs is viewed as being particularly positive, in that it arguably allowed for greater consensus to be achieved at the outset as to the nature of developments suited to particular locations, resulting in less difficulties in progressing schemes through statutory consents.

The level of leadership by local authorities in the promotion and management of the development process in designated areas has been a key actor in the success or otherwise of tax incentive-led development. The use of Integrated Area Plans as mechanisms to ensure an integrated approach to development in urban areas has been broadly successful, in that many of the failings in urban and environmental terms of the earlier tax-led schemes in urban areas have been addressed and to a significant extent, resolved. Community gain was a more prominent feature of the Schemes in those instances, as resources were available to make this aspect of the Scheme happen. The Tallaght and HARP IAPs are examples of where a dedicated management team aided the success of the Scheme, with Tallaght in particular achieving positive community benefits.

5.5.7 Additionality, Dead Weight and Displacement

The analysis of the effectiveness of the Scheme, which was set out above, was based on the outputs in terms of residential and commercial/industrial developments on designated sites. However, a key is the extent to which these developments are truly a consequence of the tax incentives or would have occurred in any event. That is, to what extent were they additional?

The extent of additionality is very difficult to gauge. This is especially the case as the key issue is the extent to which developments were additional to the IAP area, as opposed to the urban area as a whole. While our analyses indicated that non-Urban Renewal towns also underwent considerable development in the last five years, this does not prove that the Scheme had no effect. This is because the Scheme was targeted on sub-areas that were suffering from dereliction and other ills, and these may not have attracted developments even in a buoyant economy.

In order to assess the extent of additionality, the views of developers, local authority officials, and estate agents were canvassed. A range of views emerged. Local authority officials tended to see the Scheme as a success, particularly in kick-starting development. In other words, they saw it as a means of overcoming market failures associated with pioneer risk (as outlined in Section 3). This view would be supported by the case studies, where, for example, in the case of Athy, the surge in development coincided closely with the introduction of the Scheme. Developers indicated that the Scheme was vital element in influencing the *location* and *timing* of their investments. They also made reference to the role of the tax incentives in raising the commercial return on investment in urban centres, where commercial risks are often higher and the costs of development rise because of access and site assembly problems. However, they usually suggested that if the incentives had not been in place, they would have investment elsewhere in the urban area, usually on a green field site. In other words, the incentives displaced investment into the targeted areas.

Estate agents were similar to local authority officials in their view that tax incentivisation has kick-started development, but indicated that currently developments do not require tax incentivisation. This a view is corroborated by the case studies, which identified instances where:

- Other non-incentivised developments were taking place on significant scale in the IAP; and

- Developers were opting not to take up the tax incentives in order to allow greater commercial freedom in terms of the nature and mix of development.

These differing views can be reconciled. Local authority officials tend to view the Scheme as a whole. They therefore see the benefits of the Scheme in animating development during a first phase of its implementation, and that second phase developments occur because pioneer risk problems have been overcome. Developers views are determined by when they entered the market. Those who entered early on tend to view the Scheme as crucial in terms of investing in IAP locations or in the manner dictated by the IAP. Those that enter later have more mixed views, as investment in IAP areas have now become more commercially acceptable. They tend to look at their own circumstances and sometimes do not see the catalytic effect of the Scheme. Estate agents understand the catalytic effects of the Scheme, but as they are focused on individual properties, they recognise that later phase developments do not necessarily require incentivisation.

These observations suggest a number of conclusions regarding dead weight and additionality:

- Additionality may be viewed at the level of the Scheme as a whole, as well as individual developments. While individual developments may now have substantial dead weight, the Scheme as a whole may have substantial additional impact through its catalytic or animating effect.

- Additionality occurs not only in terms of additional developments, but crucially in terms of encouraging developers to invest in more problematic locations and to undertake developments, such as refurbishments, that may be commercially less rewarding.

- Quantifying additionality is extremely difficult as both the scheme and individual development effects have to be taken into account, as well as the phase of scheme implementation being considered.

With regard to additionality of individual developments, the feedback from the sources surveyed indicates that dead weight has increased over the duration of the Scheme. Figure 5.1 presents as stylised illustration of the way in which dead weight has risen. It depicts the annual expenditure on developments over the five-year period of the Scheme. There is evidence of strong additionality and relatively low dead weight at the early stages, but that dead weight is now at a high level. This is depicted by the expanding area ABDC, which shows that an increasingly lower proportion of developments are additional.

It is difficult to be precise about the level of dead weight, particularly as it will vary from location to location. However, the consultants are of the view that in the early stages of the Scheme, dead weight at the project level tended to lie in the range of 20 to 40 per cent, but that it has now risen above 70 per cent in many cases.

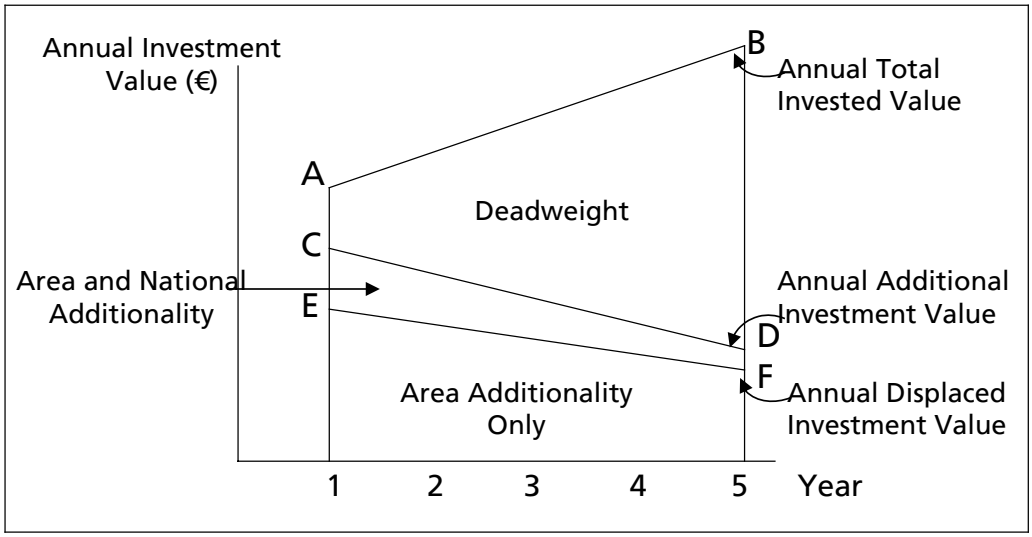
The Figure also encapsulates the view that at an early stage in the Scheme, a substantial proportion of the additional developments were not displacing other projects outside the IAP area, and that this has been maintained, if not increased as the supply of capital has increased.

Therefore, it is concluded that:

- The Scheme played a substantial role in animating developments in the IAP area and kick-starting the development process;

- The need for tax incentivisation of individual developments has diminished because of the Scheme's success and the higher levels of dead weight now occurring.

Figure 5.1: Additionality and Displaced in Urban Schemes



5.5.8 Equity Impacts

Analysis of the equity impacts of the Schemes requires consideration of two fundamental questions:

- To what extent are the benefits of the Scheme confined to a relatively few individuals; and
- To what extent are those individuals in the higher income and wealth groups.

The Urban Renewal Scheme is based on the identification of a limited number of tax designated sites in each area. This is in contrast to the Rural Renewal scheme where tax designation extended to whole counties or considerable parts of counties. The tax designation of a relatively few number of sites automatically confers benefits on these site owners, as they can either raise the price of the site if they chose to sell or gain additional economic rents on it through development of tax incentivised properties for onward sale. These developers and landowners thus garner a significant element of the tax benefits associated with the site. They can increase the benefits to them by raising their selling prices. The arguments set out in Section 2 suggest that site owners and developers in the Urban Scheme will have significant economic power to raise prices. Our case studies have identified instances in which tax incentivised apartments were on sale at higher prices than their equivalent non-incentivised dwellings close by. This is a view supported by the IAVI Annual Property Survey, which recorded a €55,000 to €70,000 price premium for tax incentivised apartments.[16]

[16] IAVI. Annual Property Survey. 2004.

Thus, developers have been able to achieve higher than normal prices for tax incentivised properties, some of which undoubtedly have been passed on to land owners.

Our analysis has indicated that over 90 per cent of residential units developed under the scheme have been sold to investors and rented out. The evidence of the case studies suggests that multiple purchase of tax incentivised properties was commonplace. As 4,527 housing units were developed under the Scheme, multiple purchase concentrated the tax benefits in the hands of an even smaller number of taxpayers. Moreover, as these taxpayers were obtaining Section 23 relief, it follows that they have rental income, and thus would have much above average incomes.

With regard to non-residential properties, there is less evidence on whether they are owner occupied or investor. However, in either case, as these properties tend to large, and thus expensive, and their ownership will be either corporate or in the hands one or a few investors. Thus, it is inevitable that the tax reliefs will be obtained by few individuals or entities.

It is difficult to escape the conclusion that the Scheme has had very negative equity impacts. It should be noted, however, the concentration of benefits among landowners is an inevitable result of the selective nature of tax designations and can hardly be avoided. With regard to investors, there is scope for reducing the inequitous aspects of the Scheme by limiting individual investor's access to tax reliefs.

5.5.9 Value for Money

Three indicators are presented below:

- The tax costs per additional unit/square metre;
- The present value of tax costs per additional unit/square metre;
- The ratio of the present value of tax costs to new build costs.

At €40,917 per residential unit, the discounted cost to the Exchequer is very substantial, especially as it does not take account of dead-weight. The discounted tax cost per unit is well above the approximately €26,000 calculated under Rural Renewal Scheme. The NPV of tax costs are 35.2 per cent of residential build costs, a higher tax costs than for the RRS and TRS and reflecting, in part, the increased investor involvement.

On the commercial side, the Exchequer cost is substantial at €498 per square metre (the highest of all four schemes). The NPV of tax forgone accounts for 40.4 per cent of commercial build costs incurred, the second highest ratio observed across the four schemes.

The tax costs of the Scheme will not be offset to a significant degree by either direct income tax and PRSI payments by the construction industry or developer contributions. Taken together, these amount to approximately 7 per cent of build costs.

Table 5.24: Efficiency Indicators

Item	Value
Tax cost per housing unit (€)	47,483
Present value of tax costs per housing unit (€)	40,917
Ratio of undiscounted tax cost to build costs	35.2
Tax cost per sq. metre of commercial space (€)	604
Present value of a sq. metre of commercial space (€)	498
Ratio of discounted tax cost to commercial build costs	40.5

5.6 Conclusions

The Urban Renewal Scheme has resulted in a high level of investment in the designated urban areas. Up to end 2004, some 426 developments have been completed at a cost of €1,281m. There was a good mix of expenditure as between residential and industrial/commercial. There was also a balance between refurbishment and new build developments, although the latter naturally dominated in terms of Scheme expenditure.

The NPV of all tax forgone associated with Scheme up to July 2006 is estimated at €1,423m, of which residential projects account for €636m or 45 per cent and commercial projects account for €787m or 55 per cent. With regard to developments completed by end 2004, the tax cost is estimated to be €436m.

The Integrated Area Approach has worked well and the Scheme has had very positive impacts on reducing dereliction, which was one of its key objectives. The Scheme has been reasonably successful in delivering urban design benefits.

However, it has been only moderately successful in supporting the conservation of architectural heritage buildings.

With regard to economic benefits, the Scheme has contributed significantly to housing supply within the IAP areas. Over 4,500 residential units have been developed under the Scheme in the period to end 2004. The evidence is that the additional housing output has been taken up and there is little evidence of over supply or vacant dwellings.

The Scheme had a strong focus on industrial/commercial developments. Investment in commercial and industrial development under the Scheme in the period up to 2004 had the potential to create 16,000 jobs and the capacity to produce just under €0.7bn in gross value added annually in the IAP area economies.

Social and community benefits arising from the Scheme were limited. Community gain impacts were small, although there are some examples of good practice. The scheme has not contributed to the supply of social housing. In many of the larger urban areas, a negative impact of tax-driven development has been the emergence of large transient or social welfare dependent populations in areas, which have a high proportion of investor-owned residential units. In consequence, there are concerns at low levels of social integration with allied social problems.

There is evidence that the Scheme kick started development in many urban areas, creating an environment in which the risks associated with development were reduced. The scheme successfully encouraged developers to invest in more problematic locations and to undertake developments, such as refurbishments, that may be commercially less rewarding.

However, there was evidence that the development of tax designated sites had spillover benefits for the IAP areas as a whole, but not to the wider urban environment.

The Scheme achieved the best impacts where there was a capacity to avail of the incentives either in terms of the infrastructure in place or the administrative resources devoted to it.

In the early stages of the Scheme, dead weight at the project level tended to lie in the range of 20 to 40 per cent, but has now risen above 70 per cent in many cases.

The Scheme has proved expensive in value for money terms. For example, at €40,917 per residential unit, the discounted cost to the Exchequer is very substantial, especially as it does not take account of dead weight.

The need for tax incentivisation of individual developments has now diminished because of the Scheme's success and the higher levels of dead weight now emerging.

The tax benefits of the Scheme have accrued to relatively few higher income individuals. There has been an inflation of property prices as a result of the Scheme, which has benefited landowners and developers. It is difficult to escape the conclusion that the Scheme has very negative equity impacts.

6. Review of the Town Renewal Scheme

6.1 Introduction

This Section of the Report presents a review of the Town Renewal Scheme. It begins with a brief description of the objectives of the Scheme. This is followed by analysis of expenditure under the Scheme in Section 6.3. That analysis is used to estimate the tax costs of the Scheme in Section 6.4. Sections 6.5. and 6.6 assess the Scheme outputs and impacts. Conclusions are presented in Section 6.7.

6.2 Objectives of the Town Renewal Scheme

The main aim of the scheme was to bring about the restoration, consolidation and improvement of the built fabric of Irish towns, to promote sensitive infill and, in the course of this, to revitalise the centres of small towns. As such, the main objectives of the scheme were to[17]:

- Increase the attractiveness of the town as a place to live, stabilise its population and counteract the trend of people moving to the outskirts and the countryside;
- Promote its position as a local commercial and social centre and thereby increase its sustainability as a place in which to live and work, and stem the loss of shopping and other facilities to larger towns;
- Promote the town as a centre for cultural and local heritage, including the further development of designated heritage towns, and thus enhance the sense of identity both psychically and socially;
- Enhance its environment and amenity in the interests of residents, businesses, visitors and the promotion of tourism; and
- Promote more sustainable development patterns.

6.3 Scheme Expenditure 1999-2004

6.3.1 Aggregate Scheme Expenditure

Expenditure under the Scheme is estimated at total of €122.6m for the period 1999-2004. There are no comprehensive data available to indicate the trend in expenditure over this period. A frequent comment made during the course of the case studies was that the decision in 2001 to extend residential investor (Section 23) type tax relief to sites that previously only had owner occupied relief effectively kick started the Scheme in certain areas. This suggests that many projects would have started towards the end of the 1999-2004 period. There is support for this view from an analysis of applications for certificates of compliance issued in respect of the residential aspects of the Scheme. These relate to numbers of completed residential projects. Table 6.1 below shows that 35.9 per cent of the residential projects completed by end 2004, were completed in that year.

[17] Town Renewal Scheme Guidelines, Department of the Environment, Heritage and Local Government, July 1999.

Table 6.1: Number of Completed Residential Developments under the Town Renewal Scheme, 1999 –2004

Year	Number	Proportion (%)
1999	0	0.0
2000	8	3.7
2001	34	15.7
2002	35	16.1
2003	62	28.6
2004	78	35.9
Total	**217**	**100.0**

Source: DOEHLG

6.3.2 Profile of Expenditure by Type of Sector and Type of Build

Of the total of €122.6m, € 67.5m (55.1 per cent) was in respect of residential activity and € 54.7m (44.6 per cent) related to commercial/industrial activity.

The bulk of expenditure was on new-build, which accounted for € 78.7m or 64.2.per cent of total expenditure. Expenditure on refurbishment was relatively high at €43.5m (35.5 per cent).

6.3.3 Profile of Expenditure by Project Type

Newbuild projects in total accounted for €66.6m or 54.3 per cent of all expenditure. Of these, newbuild projects that are residential have incurred the greatest expenditure (€29.6m or 24.1 per cent of the total). Projects that are pure refurbishment or a mix of newbuild and refurbishment accounted for €55.7m or 45.8 per cent of the total. Thus, refurbishment expenditure is more important in the Town Renewal than the Urban Renewal context.

Table 6.2. Estimated Expenditure by Type of Project 1999-2004 (€m)

	Newbuild (€ m)	Refurbishment (€ m)	Mix Newbuild & Refurb. (€ m)	Not Stated (€ m)	Total (€ m)
Commercial/Industrial	13.2	12.1	9.5	-	34.8
Residential	29.6	7.6	4.3	-	41.5
Mix Res. & Comm./Ind.	23.8	8.8	13.4	-	46.0
Not Stated	-	-	-	0.3	0.3
Total	**66.6**	**28.5**	**27.2**	**0.3**	**122.6**

6.4 Analysis of Tax Costs

6.4.1 Introduction

This section provides an analysis of the tax forgone arising from the town renewal scheme. We begin with residential developments and then present an analysis of the tax cost associated with commercial developments.

Allowing for exclusions (see Appendix 3) gives a net qualifying cost for each project. Just as costs were adjusted for exclusions so were the number of residential units and the commercial floor space arising. The net effect of this process was to take €18m of expenditure from the database information.

6.4.2 Tax Forgone on Residential Properties

Step 1: Estimating Housing Units by Type

The total number of units expected under the town renewal scheme to July 2006 is estimated to be some 2,905 units based on the housing output stated in the DOEHLG's Town Renewal Scheme database for projects known to be completed, currently in progress and an assumed delivery of 50 per cent of projects still in the planning phase. This is below the 75 per cent completion rate for Urban Renewal, as projects under the town scheme are smaller in scale and less likely to be undertaken by professional developers/builders.

These 2,905 housing units were then split into the four sub-categories of eligible residential reliefs. The disaggregation was based on the use mix indicated in the Town Renewal Scheme database on a project by project basis, leading to the overall mix of residential units presented in Table 6.3.

Residential build costs were calculated using the same methodology.

Step 2: Average Build Cost

Just like the Urban Renewal Scheme, the average build costs per sub-category of residential housing type was estimated across all completed, in progress and in planning projects with a residential element. Again, this produced a very high build cost for new build units, implying that new builds are unprofitable.

This problem was overcome by taking the data from completed projects and applying and average build costs. The completed projects would then have excluded the site costs in obtaining the relevant certification as it was the base for calculating development levies. These 'completed averages' were then adjusted for construction inflation to give the figures presented in Table 6.3. The need for an inflation adjustment accounts for the fact that most of the activity under the scheme is taking place towards the end of its life cycle.

Step 3: Average Selling Price and Site Costs

Data is required on the purchase or sale price and site cost in estimating gross tax relief in situations where units are purchased from a builder or developer. In cases of

own account developments undertaken by existing owners the gross value of the tax cost is set at the build cost allowing for a builder's margin.

As with the URS, the average selling price per unit was calculated based on Dept. of Environment, Heritage and Local Government's data on new apartment prices outside of the major town weighted to reflect the timing of activity under the scheme, which is loaded towards the end of the Town Renewal Scheme's timeframe. This gave a selling price per unit of €225,724. Investor properties were then given a price premium of €15,000 per unit to reflect the additional prices the vendors can get for these properties in smaller towns.

For new builds site costs are set at 65 per cent of build cost, based on observations from the IAVI and the Irish Home Builders Association. In the case of refurbishments an additional €50,000 is added to site costs as in these cases eligible site costs include the building occupying the site.

The results from applying these steps and assumptions are given in Table 6.3, with a total build cost of €222.9m.

Table 6.3: Unit Data Used in Estimating Tax Forgone on Residential Town Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
No. of Units Arising at 50% Completion of Projects in Planning	621	704	792	790	2,905
Database Average Build Cost per Unit	€169,815	€76,919	€128,986	€83,498	
Inflation Adjusted Average Build Cost per Completed Unit	€109,141	€42,009	€109,141	€49,626	
Gross Inflation Adjusted Build Costs	€67,725,328	€29,569,779	€86,462,401	€39,183,513	€222,941,020
Assumed Price per Unit	€225,724	€225,724	€240,724	€240,724	
Site Cost (set at 65% of build cost)	€70,942	€120,942	€70,942	€120,942	

Step 4: Gross Tax Forgone

Based on Dept. of Environment, Heritage and Local Government data information the Town Renewal Scheme mix was 30 per cent builder/developer and 70 per cent other for new builds (polar opposite to the URS). The mix for refurbishments was

put at 20 per cent builder/developer and 80 per cent other to account for the likelihood that many of these projects are undertaken by existing property owners.

Applying this mix to the data in the table above gives the gross tax relief arising, which is put at €242.3m in Table 6.4. Allowing for purchase price in situations where

the units are purchased from a builder/developer drives the gross value of the tax relief above build costs.

Step 5: Net Tax Forgone before Discounting

The second last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief attached to each unit. To do this the following enabling assumptions were made:

- For owner occupied units it is assumed that 30 per cent of owner occupiers have a marginal tax rate of 20 per cent and remaining owner occupiers pay tax at a marginal rate of 42 per cent. This assumption mirrors the mix under the RRS and allows for the lower purchase price in TRS areas relative to URS;
- It is assumed that all investors pay a marginal rate of 47 per cent (the higher rate plus PRSI and levies) in year one and 42 per cent thereafter.

Following all the steps detailed above gives Table 6.4.

Table 6.4: Undiscounted Tax Forgone on Residential Town Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
Unit Gross Tax Relief via formula	€136,803	€58,192	€145,893	€70,038	
Unit Gross Tax Relief at Cost	€109,141	€42,009	€109,141	€49,626	
All Units - Gross Tax Relief	€72,874,754	€31,848,011	€95,197,047	€42,406,819	€242,326,631
Net Tax Cost at Standard Marginal Rate	€2,186,243	€1,910,881	-	-	
Net Tax Cost at Higher Marginal Rate	€10,712,589	€9,363,315	€41,172,723	€18,340,949	
Total Net Tax Forgone	€12,898,831	€11,274,196	€41,172,723	€18,340,949	€83,686,699

The table shows that before discounting the net tax cost associated with Town Renewal Scheme residential units is €83.7m, as against a gross tax relief of €246.3m (before allowing for marginal tax rates).

Step 6: The Net Tax Forgone

The last step in arriving at net tax forgone is to calculate present values, by taking a 5 per cent discount rate to reflect that the relief is a fixed values but it has to be exhausted over a period of years, reducing its value today.

As per the scheme's rules owner occupiers must take the relief over 10 years. Again, investors do not operate to this time constraint and tend to consume the tax relief over a much shorter period, believed to be 4 years.

Combining the 5 per cent discount rate and 10 and 4 years periods gives the present values shown in Table 6.5.

Table 6.5: Discounted Tax Forgone on Residential Town Renewal Scheme Projects

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
Undiscounted Tax Forgone	€12,898,831	€11,274,196	€41,172,723	€18,340,949	€83,686,699
Annual Undiscounted Tax Forgone	€1,289,883	€1,127,420	€10,293,181	€4,585,237	€17,295,721
Discount Rate	5%	5%	5%	5%	
Time Period (in years)	10	10	4	4	
NPV of Tax Forgone	€9,960,136	€8,705,635	€36,499,109	€16,259,025	€71,423,905
NPV of Tax Forgone per Unit	€16,051	€12,368	€46,073	€20,592	€24,585

The total discounted tax forgone for residential projects is put at €71.4m, of which:

- Investor new builds accounts for €36.5m (51.1 per cent);
- Investor refurbishment accounts for €216.3m (22.8 per cent);
- Owner occupied new builds accounts for €10m (13.4 per cent);
- Owner occupied refurbishment/conversions accounts for €8.7m (12.2 per cent).

In all, the discounted tax forgone represents 32 per cent of the build cost associated with these projects and 29.5 per cent of the gross tax relief arising.

Looking at individual units, the table shows that the NPV tax cost per unit, for all types, is €24,585. The highest tax cost per unit is associated with investor new builds, followed by investor refurbishments. The tax cost per unit for owner occupier new builds and refurbishments are well below those associated with similar owner occupier held proprieties. To illustrate, the €46,073 tax cost associated with an investor new build is two and a half times the tax cost of a comparable owner occupier new build. Much of this gap is explained by the fact that new build owner occupiers are only entitled to 50 per cent of the gross relief while investors are entitled to 100 per cent of the gross relief. The difference in the marginal tax rates also accounts for some of the gap.

6.4.3 Tax Forgone on Commercial Properties

In calculating tax forgone each step in the process is explained in less detail as the steps involved are very similar to the residential scheme. Data on commercial projects was not disaggregated into different types of commercial buildings such as office, retail, industrial etc. as the same rates of capital allowances apply to each category.

Step 1: Estimating Square Metres

In arriving at an estimate of the square metres given to commercial use for each project a project's total floor space was multiplied by the percentage of the project stated to be commercial in the TRS database. Once this was repeated for all projects in the Town Renewal Scheme database the total commercial floor space was determined. As with the residential analysis, an adjustment was made by assuming that 50 per cent of projects still in planning will be delivered by July 2006. Those in progress are assumed to be fully completed by July 2006. This gives 189,974 square metres of commercial space arising under Town Renewal Scheme.

Commercial build costs were calculated using the same methodology.

Step 2: Average Build Cost

On average build costs per square metre was arrived at by dividing total estimated commercial build costs over the life of the scheme by the floor space expected to be developed up to July 2006. This gave an average build cost of €1,229 per square metre. Again, we repeated the calculation using data on completed projects only as completion costs are more likely to better capture true costs. This gave average build cost of €949 per square metre allowing for inflation.

Multiplying total floor space arising by €949 per square metre gives an indicative build cost of €180m.

Step 3: Average Price and Site Costs

To get in idea of the average price per square metre of commercial space data on rental values per square metre was compared with the associated yield to give a purchase price. Given that the scheme deals with a range of commercial space usage data was gathered on the retail, office and industrial rental sectors to give an

average price per square metre of €1,999. This average price accounts for the type of towns covered by the Town Renewal Scheme.

As per the IAVI's insight site costs were again set at 65 per cent of build costs.

Step 4: Gross Tax Forgone

For new build projects the gross tax forgone is calculated by applying the formula which yields a value of €1,176 per square metre and €949 per square metre in situations where the property is build directly or acquired from a non-builder/non-speculator.

We have assumed that commercial projects are split 70 per cent: 30 per cent between those purchased from builders/developers and others. This produces a gross tax forgone of €210.4m.

Step 5: Net Tax Forgone

The next step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief. It is assumed that a marginal tax rate of 47 per cent applies to 90 per cent all of these projects as they are owned by individual and the remaining 10 per cent are owned by companies with a marginal tax rate of 12.5 per cent.

Table 6.6 shows the results. Before discounting, €93.7m of tax forgone is associated with commercial projects, which represents 52 per cent of the build cost and 43.6 per cent of gross tax relief.

Table 6.6: Undiscounted Tax Forgone on Commercial Town Renewal Scheme Projects

	Commercial
Floor Space in Sq Metres at 50% Completion of Projects in Planning	189,974
Average Sq. Metre Build Cost (All Projects)	€1,229
Inflation Adjusted Sq. Metre Average Build Cost for Completions	€949
Total Inflation Adjusted Build Costs	€180,211,035
Sale Price per Sq. Metre	€1,999
Site Costs per Sq. Metre (65% of build costs)	€617
Sq. Metre Gross Tax Relief via formula	€1,211
Sq. Metre Gross Tax Relief at cost	€949
Total Gross Tax Cost	€215,167,217
Net Tax Cost at 47%	€91,015,733
Net Tax Cost at 12.5%	€2,689,590
Net Tax Cost	€93,705,323

The net present value of tax forgone is determined by discounting at 5 per cent over 14 years. This gives a net present value of tax forgone of €77.2m which represents 42.8 per cent of build costs and 35.9 per cent of gross relief. On a unit basis, the NPV of tax forgone works out at €406 per square metre.

Table 6.7: Discounted Tax Forgone on Commercial Town Renewal Scheme Projects

	Commercial
Undiscounted Tax Forgone	€93,705,323
Discount Rate	5%
Time Period (in years)	14
NPV of Tax Forgone	€77,207,518
NPV of Tax Forgone per Sq. Metre	€406

6.4.4 Tax Forgone on by Development Status

This section presents an analysis of residential and commercial projects by the development status of the projects. As per the Department's database projects are either completed, in progress or still in planning.

Residential Units

Table 6.8 gives the development status of residential units. Of the 2,905 residential units arising, 971 (33.5 per cent) were delivered, 704 (24.3 per cent) are in progress and the remaining units 1,230 (44.3 per cent) are in planning.

Table 6.8: The Development Status of Residential Town Renewal Scheme Projects and Tax Costs

	O.O. New Build	O.O. Refurb	Investor New Build	Investor Refurb	Total
NPV of Tax Forgone per Unit	€16,051	€12,368	€46,073	€20,592	€24,585
Number of Units by Development Status					
- Completed	207	235	265	264	971
- Work in Progress	150	171	192	191	704
- In Planning	262	298	335	334	1,230
Totals	620	704	792	790	2,905
NPV of Tax Forgone by Development Status					
- Completed	€3,324,279	€2,910,269	€12,201,547	€5,435,345	€23,876,806
- Work in Progress	€2,409,691	€2,109,585	€8,844,614	€3,939,954	€17,307,734
- In Planning	€4,210,114	€3,685,781	€15,452,948	€6,883,726	€30,239,365
Totals	€9,944,085	€8,705,635	€36,499,109	€16,259,025	€71,423,905
Share	13.9%	12.2%	51.1%	22.8%	100.0%

The NPV of tax forgone per sub-category of residential unit multiplied by units in each development status grouping gives the NPV of tax forgone by development status. Of the €71.4m of residential tax costs, €23.9m is associated with units which are complete, €17.3m is attributed to those in progress and €30.3m is related to units in planning.

Commercial Space

Table 6.9 repeats the analysis for commercial space.

Table 6.9: The Development Status of Commercial TRS Projects and Tax Costs

NPV of Tax Forgone per Sq. Metre	€406	
Sq. Metres by Development Status		
- Completed	66,225	
- Work in Progress	46,408	
- In Planning	77,342	
	189,974	
NPV of Tax Forgone by Development Status		Share
- Completed	€26,914,450	34.9%
- Work in Progress	€18,860,527	24.4%
- In Planning	€31,432,542	40.7%
	€77,207,518	100.0%

Of the €77.2m of tax costs, 34.9 per cent is associated with completed projects, 24.4 per cent is linked to work in progress and projects still to start account for 40.7 per cent.

6.4.5 Overview

In conclusion, the NPV of all tax forgone associated with Scheme up to July 2006 is estimated at €148.6m, of which residential projects account for €71.4m or 48 per cent and commercial projects account for €77.2m or 52 per cent. With regard to developments completed by end 2004, the tax cost is estimated to be €50.7m.

Table 6.10: Overview of Present Values of Scheme Tax Foregone

	Residential (€m)	Commercial (€m)	Total (€m)
Predicted Tax Cost to Mid July 2006	71.4	77.2	148.6
Tax Cost Incurred to end 2004	23.8	26.9	50.7

Source: Consultants' estimates

6.5 Scheme Outputs

6.5.1 Introduction

This Section of the report summarises the main outputs of the Scheme, such as the number of developments and housing units. The data presented are based on the DOEHLG database and the Survey of Local Authorities. With regard to the Survey of Local authorities, fifteen out of twenty-four local authorities responded in respect of 63 out of the 100 towns included in the Scheme.

6.5.2 Developments under the Scheme

Under the Town Renewal Scheme, a total of 100 Town Renewal Plans were approved across 23 counties. A total of 1,209 projects have been reported by local authorities, of which 372 have been completed. A further 196 are at work-in-progress stage, 568 or 46.8 per cent that have been either completed or commenced.

Table 6.11: All Projects by Project Development Status

Development Status	No. Projects	As % of All Projects
Completed	372	30.8
Work in Progress	196	16.2
Planning or Pre-Planning Stage	635	52.5
Not Stated	6	0.5
Totals	**1,209**	**100.0**

The database for the Town Renewal Scheme showed that only just over half (53.9 per cent) of developments has been granted planning permission. This raises the doubt that many developments may not be completed by July 2006.

6.5.3 Progress of the Scheme

The survey of local authorities revealed a substantial minority (35 per cent) of local authority officials who were dissatisfied with progress under the Scheme. Some 60 per cent indicated that they were satisfied with progress under the Scheme (see Table 6.12)

Of the 63 towns, for which the local authorities expressed an opinion, 23 were identified as having performed poorly.

Table 6.12: Distribution of Local Authorities by Satisfaction with Progress of the Scheme

Level of Satisfaction with Scheme	Proportion of Respondents (%)
Very satisfied	15.0
Satisfied	45.0
Neither satisfied nor dissatisfied	5.0
Dissatisfied	35.0
Very dissatisfied	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

Table 6.13 shows that only 4.1 per cent of towns had completed more than 75 per cent of the proposed developments, while over 80 per cent of towns had less than 50 per cent of their developments completed.

It is clear that much less progress has been made in implementing the Town Renewal Plans than is the case for the Urban Renewal Scheme.

Table 6.13: Distribution of Towns by Level of Development Completion

Development Completion Level	Proportion of Towns (%)
Less than 25 per cent of developments complete	52.6
More than 25 and less than 50 per cent complete	27.8
More than 50 and less than 75 per cent complete	15.5
More than 75 per cent complete	4.1
Total	**100.0**

Source: Derived from DOEHLG database

6.5.4 Reasons for Lack of Progress

Where progress was poor, a number of reasons were identified as follows:

- Lack of interest on part of developers, builders or owner-occupiers;
- Tax incentives available were not appropriate: in particular, some schemes were largely focused on refurbishment , which proved unattractive to developers;
- Property in hands of elderly and other people not interested in developing it;
- Failure of land/property owners to reach agreement;
- Disputes over legal title to land or property;
- Failure to acquire planning permission;
- Lack of Local authority services; and
- Poor marketing of the Scheme

Lack of interest on the part of developers was the most prevalent reason, often arising because refurbishment activity only was allowed.

6.5.5 Profile of Developments by Type of Sector and Type of Build

Developments are either new build, refurbishment or a combination of both. Similarly, they can be residential, industrial/commercial or a mixture of both. Table 6.14 indicates the number of developments that fall into each of the new categories. This shows that 142 or 38.2 per cent of developments involve commercial/industrial

development only, 125 or 33.6 per cent involved residential development only and 99 or 26.6 per cent are a combination of both. Over half (192 developments) are refurbishment, 117 or 31.4 per cent were newbuild only, and 57 (15.3 per cent) are a combination of both. With a number of developments having more than one use or type of build, the greatest number of completed developments (97) are a refurbishment of Commercial/Industrial properties.

This shows that a major focus of the Scheme is on refurbishment projects.

Table 6.14: Completed Projects by Use and Type of Build

	Newbuild	Refurbishment	Mix Newbuild & Refurb.	Not Stated	Total
Commercial/Industrial	22	97	23	-	142
Residential	61	55	9	-	125
Mix Res. & Comm./Ind.	34	40	25	-	99
Not Stated	-	-	-	6	6
Total	**117**	**192**	**57**	**6**	**372**

Source: Derived from DOEHLG Database

6.5.6 Scale of Developments

When all completed projects are analysed by scale of cost of development, 35.2 per cent have estimated costs of €100,000 or less. Just over 32 per cent have estimated costs of over €500,000, with only 7.8 per cent having costs of over €1 million. The relatively small scale of developments reflects the large refurbishment element in the Scheme.

Table 6.15: Estimated Cost of Completed Developments

Estimated Cost of Development	No. Projects	Distribution (%)
<= €50,000	77	20.7
€50,001 – €100,000	54	14.5
€100,001 – €250,000	86	23.1
€250,001 – €500,000	65	17.5
€500,001 – €1,000,000	26	7.0
€1,000,001 – €10,000,000	29	7.8
Missing	35	9.4
Total	**372**	**100.0**

Source: Derived from DOEHLG Database

6.5.7 Conclusions

To date, the Town Renewal Scheme has been less than successfully implemented, with only 372 out of total of 1,209 developments completed. In only 4.1 per cent of towns are more than 75 per cent of designated developments complete.

A sizeable minority of local authorities are dissatisfied with progress in implementing the Scheme.

For areas where progress has been poor, the major reasons are lack of interest on the part of developers or site owners. In the event, the justifiable emphasis on refurbishment within the Scheme proved unattractive to developers

Lack of local authority services and poor marketing of the Scheme were also cited as reasons for lack of progress.

6.6 Impact of the Scheme

6.6.1 Introduction

This Section of the Report identifies the impacts of the Scheme and evaluates them using the framework outlined in Section 2. The analysis draws on the DOEHLG database, the Survey of Local Authorities and the case studies to provide an overview of Scheme impacts. Case studies of Loughrea and Cavan towns were undertaken.

It begins with an analysis of Scheme effectiveness, followed by consideration of efficiency and equity impacts.

6.6.2 Scheme Effectiveness: Physical Development Benefits

6.6.2.1 Dereliction

For many towns, to the extent that development has occurred, it has often focussed on the outskirts of the town. This resulted in under use and dereliction of town centre properties. As a result, many small towns have a streetscape characterised by buildings in poor external and internal condition. The focus of the Scheme was on refurbishment of these properties. Where the Scheme was successfully implemented they were positive impacts on these properties.

The survey of Local authorities also indicated significant impacts in this area. Table 6.16 shows that 87 per cent of local officials surveyed indicated agreed or strongly agreed with the view that there were positive impacts on dereliction.

Table 6.16: Local Authority Views on Dereliction Impact

The scheme has contributed to a reduction in the degree of dereliction in the area	Proportion of Respondents %
Strongly agree	43.7
Agree	43.7
Neither agree nor disagree	0.0
Disagree	12.6
Strongly disagree	0.0
Total	**100.0**

Source: Goodbody survey of Local Authorities

The overall conclusion is that the Scheme performed strongly in this area in certain towns.

6.6.2.2 Urban Design and Conservation

Where the Schemes have been successfully, there have been significant positive impacts on conservation. While relatively few town centre properties would be listed, many are of architectural or heritage merit. The relative concentration of the Town scheme on refurbishment of commercial properties resulted in a renewal of buildings, with consequent positive impacts on the streetscape. The result has been an overall improvement in the town environment.

The local authorities surveyed were of the view that this was an area in which the Scheme has a profound impact, as evidenced by the fact that 82 per cent of respondents indicated that there were positive impacts.

Table 6.17: Local Authority Views on Conservation Impact

The scheme has contributed to the preservation of the natural architectural and archaeological heritage in the area	Proportion of Respondents (%)
Strongly agree	11.8
Agree	70.6
Neither agree nor disagree	11.8
Disagree	5.8
Strongly disagree	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

6.6.3 Scheme Effectiveness: Economic Benefits

6.6.3.1 Construction Employment

The €122.6m spent of the Scheme in the period 2000-2004 would have given rise to significant demand for labour in the building industry. Based on the average employment content in building and construction[18], this level of spend would have created a demand for approximately 673 person years of direct employment during the period 2000 to 2004, or an average annual demand for 154 workers. Income tax, Employers PRSI and Employees PRSI payments to the Exchequer would have been of the order of €4.5m, €1.1m and €1.9m, making €7.5m in total.

As for the Rural Renewal Scheme, the fact that additional employment demand and Exchequer payments were created does not imply that economic benefits occurred. Given that, as depicted in Section 2, national and regional unemployment rates were very low throughout the scheme period, very little of this increased employment would have been drawn from the ranks of the unemployed, so that the

net impact on unemployment levels and Exchequer receipts would have been minimal

6.6.3.2 Housing Development and Population Growth

An additional 988 housing units were developed with the aid of the Town Renewal Scheme in the period to end 2004. This output must be viewed against the background that much of the designation was in respect of refurbishment, so that the performance was bound to be relatively modest. There were obviously a group of towns where the designation allowed significant house building, reflected in the largely positive view of local authority officials on housing output.

In towns where housing output was high, again there are concerns at the low level of owner occupation.

Table 6.18: Local Authority Views on Housing Impact of the Scheme

The scheme has contributed significantly to housing supply in the area	Proportion (%)
Strongly agree	17.6
Agree	41.2
Neither agree nor disagree	5.9
Disagree	29.4
Strongly disagree	5.9
Total	**100.0**

Source: Goodbody Survey of Local Authorities

[18] See: CSO. 2002 Census of Building and Construction

6.6.3.3 Commercial and Industrial Development Impacts

The Scheme had a strong focus on industrial and commercial developments, with 241 out of the 372 completed developments including a commercial/industrial element. More than two-thirds of local authority officials were in agreement that the Scheme contributed significantly to the level of economic activity in their Town Renewal area.

Case Study - Cavan Town

Cavan town is located in the centre of county Cavan, on the N3 between Dublin and Donegal. The town acts as the anchor and focus for much of the economic and social activity in the County of Cavan and is the county's administrative centre. The main employers in the town include the VEC, Elliots Construction, Quinn Direct and the Regional Hospital.

In the period leading up to the designation under the Town Renewal Scheme, the population in Cavan Town was increasing very moderately, at an average annual rate of 0.4 per cent over the period 1981 – 1996. The relative stagnation of the inner town area and the growth in population of the town environs was one of the main reasons put forward by advocates of Cavan Town's designation under the Town Renewal Scheme. The overall aim of the Town Renewal Scheme in Cavan Town was to revitalise and bring life back to the town of Cavan. Prior to designation there were a lot of old, abandoned buildings and derelict sites scattered throughout the town, especially at the back of retail premises in the town centre. A large proportion of the town centre was impoverished and in need of regeneration.

In total, 66 projects have been recorded under Town Renewal Scheme in Cavan town. To date, 24 of these have been completed, 10 are in progress, while the remaining 32 projects are in the planning stage. The total costs of all 66 developments are €45.4 million. All projects were privately financed.

Of the 24 completed, just over half of these are totally commercial in nature. These developments include a small number of newbuild purpose-built office developments, (including a medical centre), and several refurbished retail premises such as shops and pub fronts. Eight of the 24 completed projects are entirely residential in nature. These projects include four new-build apartment projects ranging in size from 20 – 34 units, and two refurbishment developments which together amount to 15 units.

Residential development under the TRS could potentially create 287 additional housing units. It is reported that the residential units constructed to date have sold quickly, mostly to investors rather than owner-occupiers. It is estimated that investors bought up approximately 80 per cent of most residential developments. The occupancy rate for these units is high at an estimated 90%.

Opinions vary regarding the current and future demand for residential accommodation in the town. Some believe that there is still a demand for apartments in the town, otherwise the market would stop supplying them. It is anticipated that the opening of a College of Further Education, currently under construction, which will cater for up to 800 students, will increase the demand for rental property in the town.

Others claim that the market for residential property in the town has softened and the town and is entering a position of over-supply where rents are flattening because demand has slowed while supply has continued.

A number of stakeholders blamed the scheme for the creation of a dual property market in the town, where two apartments, similar in all aspects, are selling at a price differential of up to 50 per cent because one is part of the scheme and the

other is not. An apartment under the scheme is reaching €300,000 while a similar non-designated apartment within relatively close proximity is selling for €165,000. This price differential is explained by some as relating to the heavier costs (in terms of access/storage/time costs) associated with building in restricted and difficult TRS sites.

There are 22 projects involving commercial activity either completed or in the process of being completed in Cavan Town. These projects include a small number of new build and refurbished office developments and a large number of refurbished shop/pub fronts. One large medical centre was constructed under the scheme. There was also one relatively large-scale office development to the north west of the town, which has been rented by local solicitors/accountants/architects who have moved premises to avail of the new high quality office development.

Retail and commercial property is currently selling at a premium in Cavan Town. There is still a growing demand for commercial developments, especially new-build purpose built developments. A review of rental incomes showed that Commercial rental incomes are increasing. There has been minimal dead weight arising from the scheme with 80 per cent of developers stating that their projects would not have gone ahead in the absence of the TRS. There was a general consensus that the scheme did not divert developments from other areas into TRS areas.

A number of issues were cited as having limited the take up of the scheme, including:

- Difficulties with site ownership/access/clearance costs
- Sites in ownership of bodies (such as a Church of Ireland School) with limited capital;
- Sites with residing tenants where tenancy agreements could not be broken to allow the commencement of development within scheme's timeframe; and
- Inappropriate development incentives.
- Land assembly difficulties;
- Lengthy planning process;
- Lack of investor mentality among site owners;
- A lack of developers with the expertise and capital necessary to deal with lengthy planning process.

Local Authorities and key stakeholders in Cavan town feel that the scheme has been successful in tidying up and revitalising the town. The scheme stimulated development in derelict and abandoned areas where no previous development has taken place. The scheme also induced the release of capital in Cavan Town by both developers and by others who were not normally risk takers. As more people have started to reside in town, more retail units are being refurbished/developed. Also, the refurbished shop fronts and commercial developments have created a more positive image of the town, especially in the main street. According to one stakeholder, the TRS developments have given Cavan "an air of a town that is going places". The scheme is also credited with Cavan having been chosen as a location for decentralisation.

The Local Authorities believe the scheme should be continued but with some modifications in terms of to whom the benefits from the scheme accrue and to focus on particular sites within the town.

Table 6.19: Local Authority Views on Economic Activity Levels

The scheme has contributed significantly to economic activity in the area	Proportion (%)
Strongly agree	31.3
Agree	37.5
Neither agree nor disagree	18.7
Disagree	12.5
Strongly disagree	0.0
Total	**100.0**

Source: Goodbody Survey of Local Authorities

Based on a knowledge of the quantity of commercial and industrial floor space provided under the Scheme, it is possible to estimate the employment and value added potential associated with commercial and industrial development, based on standard factors. This suggests that investment in commercial and industrial development under the Scheme in the period up to 2004 had the potential to create 902 additional jobs and the capacity to produce just under €29m in gross value added annually in the town renewal areas.

This indicates a modest commercial and industrial impact of the scheme in the targeted town areas.

6.6.4 Scheme Effectiveness: Social and Community Benefits

6.6.4.1 Community Gain Impacts and Social Housing Impacts

There is little evidence of any significant impacts in this area. The difficulties with take-up militated against any levies to fund initiatives in this area. A conclusion confirmed by local authority officials

Table 6.20: Views of the Local Authorities on Social Housing

The scheme has contributed significantly to the supply of social housing in the area	Proportion (%)
Strongly agree	0.0
Agree	11.8
Neither agree nor disagree	23.5
Disagree	47.1
Strongly disagree	17.6
Total	**100.0**

Source: Goodbody Survey of Local Authorities

6.6.5 Additionality, Dead Weight and Displacement

The view emanating from the case studies and consultations was the Scheme had a crucial role to play in animating development in certain towns. For other towns, the availability of tax incentives was not sufficient to overcome the lack of market demand. Because development was less commercially attractive, the Scheme was vital in marginal situations in encouraging development. As a result, the dead - weight element appears to have been lower than for the Urban Scheme. In the consultant's view dead-weight at the project level would initially have been low at approximately 20 per cent.

With regard to the current situation, towns would appear to fall into three categories:

- Those where the Scheme has been a success and dead-weight associated with developments has increased, in some instances to above 70 per cent;
- Those where lack of market demand means that the Scheme will continue to be of limited value; and
- The remainder where the Scheme is beginning to have an impact and significant dead -weight has not yet emerged.

6.6.6 Equity Impacts

As with the Urban Renewal Scheme, there was evidence that landowners and developers garnered some of the tax benefits of the Scheme. The case study of Cavan Town (See Box) indicated that a premium was demanded and paid for incentivised housing. Some of this would have been passed on to landowners.

In the larger towns and for the larger developments, much of the residential output was sold to investors. The same tendency for multiple purchases was evident as for the Urban Scheme.

However, the Scheme had a strong emphasis on the refurbishment rather than new build of commercial premises. Thus, a meant that a considerable proportion of the take-up of the Scheme was by owner-occupier retailers making relatively small-scale improvements to their premises. To this extent, the Scheme benefits were more widely distributed than was the case for the Urban Scheme. To that extent, while this Scheme, as with all such tax driven schemes, was fundamentally inequitable in its impact, its benefits would not have been as concentrated among high-income individuals as was the Urban Scheme.

6.6.7 Value for Money

Three indicators are presented below:

- The tax costs per additional unit/square metre;
- The present value of tax costs per additional unit/square metre;

- The ratio of the present value of tax costs to new build costs.

At €24,585 per residential unit, the cost to the Exchequer is substantial, especially as it does not take account of dead-weight. However, the cost per unit is not as excessive as for the Urban Scheme and similar to the Rural Scheme. Tax costs account for 32 per cent of residential build costs incurred, again not as high as the Urban Scheme and in line with the Rural Scheme.

On the commercial side, the Exchequer cost is substantial at €406 per square metre. However, the tax cost per square metre is not high as per URS and LOTS. The NPV of tax forgone accounts for 43.8 per cent of commercial build costs incurred, the highest ratio observed across the four schemes.

The tax costs of the Scheme will not be offset to a significant degree by either direct income tax and PRSI payments by the construction industry or developer contributions. Taken together, these amount to approximately 7 per cent of build costs.

Table 6.21: Efficiency Indicators

Item	Value
Tax cost per housing unit (€)	28,806
Present value of tax costs per housing unit (€)	24,585
Ratio of discounted tax cost to residential build costs	32
Tax cost per sq. metre of commercial space (€)	493
Present value of a sq. metre of commercial space (€)	406
Ratio of discounted tax cost to commercial build costs	43.8

6.7 Conclusions and Recommendations

Expenditure under the Scheme is estimated at total of €122.6m for the period 1999-2004.

Of the total of €122.6m, € 67.5m (55.1per cent) was in respect of residential activity and € 54.7m (44.6 per cent) related to commercial/industrial activity.

The bulk of expenditure was on new-build, which accounted for € 78.7m or 64.2.per cent of total expenditure. Expenditure on refurbishment was relatively high at €43.5m (35.5 per cent).

To date, the Town Renewal Scheme has been less than successfully implemented, with only 372 out of total of 1,209 developments completed. In only 4.1 per cent of towns are more than 75 per cent of designated developments complete.

A sizeable minority of local authorities are dissatisfied with progress in implementing the Scheme.

For areas where progress has been poor, the major reasons are lack of interest on the part of developers or site owners. The emphasis on refurbishment within the Scheme proved unattractive to developers

Lack of local authority services and poor marketing of the Scheme were also cited as reasons for lack of progress.

The present value of all tax forgone associated with Scheme up to July 2006 is estimated at €149m, of which residential projects account for €71m or 48 per cent and commercial projects account for €77m or 52 per cent. With regard to developments completed by end 2004, the tax cost is estimated to be €51m.

There is some evidence that the Town Renewal Scheme was not as well managed as the Urban Scheme. Local authority resources were often spread too thinly across a number of towns. Either the allocation of greater managerial resources or a limit on the number of towns included in the Scheme would have produced better outcomes.

The impact of the Scheme has thus been relatively patchy. Where the Scheme was successfully implemented the impacts would have been on a par with those of the Urban schemes. This was not the case for a significant minority of towns.

Where successfully implemented, the Scheme, given its justifiable emphasis on refurbishment, had a strong impact on dereliction and conservation. Urban design issues featured less strongly than for the Urban Scheme. Because of the relatively low level of new build, economic impacts have not been to the fore. Community and social impacts were not really a feature of the Scheme, and there would not have been any real prospect of raising levies to fund initiatives in this area.

It must be recognised that there was substantial cross over between in terms of scale between areas designated under the Urban and Town Schemes. Larger towns in the Town scheme that had a relatively high level of designation for new build tended to derive similar economic benefits as did their counterparts in the Urban Scheme.

With regard to dead weight, it would appear that this was lower than for the Urban, as the higher risks in towns with lower populations made the tax incentives more crucial in the decision to develop a site.

7. Review of the Living over the Shop Scheme

7.1 Introduction

Under the 1986 Urban Renewal Scheme, certain areas in the five cities – Cork, Dublin, Galway, Limerick and Waterford, were designated for tax incentives aimed at tackling the issues of dereliction and decay, which were affecting inner city areas. In order to build on the progress made under this scheme in inner city areas, the Living over the Shop Scheme was introduced in 2001, in the five city boroughs of Cork, Dublin, Galway, Limerick and Waterford.

This Section of the report first sets out a description of the Scheme in terms of its objectives and eligibility conditions and tax benefits that apply. It then provides an overview of expenditure and tax forgone under the Scheme in Sections 7.3 and 7.4. Section 7.5 describes the outputs of the Scheme, while Section 7.6 assesses the Scheme impacts. Conclusions and recommendations are presented in Section 7.7.

7.2 Description of the Scheme

7.2.1 Objectives

The objectives of this scheme were to:

- Provide additional residential units in areas suitable and attractive for such development;
- Achieve greater economic use of such premises with a view to relieving the pressure on housing supply, particularly for rented residential accommodation;
- Promote sustainable development patterns and assist in fostering a living urban environment in certain designated streets; and
- Promote more sustainable use of existing building stock and infrastructure and relieve pressure for green field development.

Under the Living over the Shop Scheme, tax incentives were available for the construction and refurbishment of residential accommodation and associated commercial development of premises in the designated streets. As with the other Schemes, the closing date for the scheme is 31st July 2006 having been extended from the original date of 31st December 2004.

This section of the report begins with a description of the incentives available under the Living Over the Shop scheme. A breakdown of the expenditure, which has been incurred under the scheme, is then presented. The cost of the scheme to the Exchequer in terms of tax foregone in presented and overall outputs of the scheme are evaluated. An analysis of the scheme's costs and benefits is then conducted.

7.2.2 Designated Areas

Under the LOTS scheme, certain streets in the five city boroughs – Cork, Dublin, Galway, Limerick and Waterford - were designated. The decision, as to which streets

to include in the Scheme, was taken by an Expert Advisory Panel based on proposals from the relevant Local Authorities. Following an assessment of the proposals, the Expert Advisory Panel made recommendations to the Minister for the Environment and Local Government. The designated streets were announced in April 2001. A total of almost 13,000 linear metres of street were designated.

In order to quality for designation the following criteria for streets had to be met:

- Streets where the ground floor use was primarily commercial, located in areas where residential was an appropriate use and permissible under the Development Plan zoning;

- Streets containing a high proportion of vacant or under-utilised space in the upper floors;

- Streets containing premises capable of being adapted to form residential units generally of minimum floor area of 55 square metres and complying in other respects with the Department of the Environment's Guidelines on Residential Developments in Urban Renewal Tax incentive Areas of September 1995;

- Streets containing premises capable of providing accommodation to comply with building/fire regulations and to meet the Department of the Environment's standards for grant-aided accommodation;

- Streets which could benefit, in streetscape terms, from new build development in cases where
    - Extra storeys were needed to restore/enhance the streetscape i.e. to bring the height up to that of adjacent buildings
    - A Dangerous Building Order had been issued by the Local Authority and a replacement building was needed to restore the streetscape; and

- Streets where there was a clear need for incentives i.e. where the desired development is not likely to take place without the aid of incentives.

7.2.3 Tax Incentives Available

The tax incentives available under the scheme were as follows:

Residential Development

Owner-occupiers could claim tax relief on 100 per cent of the eligible expenditure on the refurbishment or conversion of under-utilised space for residential accommodation, at a rate of 10 per cent per annum over 10 years against total income. Residential units had to have a minimum floor space of 38 square metres.

Investors or lessors could claim relief on 100 per cent of eligible expenditure on the refurbishment, conversion or necessary new build costs of residential accommodation, against Irish rental income, including income from other lettings.

Associated Commercial Development
Owner-occupiers could claim a capital allowance in the form of a 50 per cent initial allowance in Year 1 and a 4 per cent annual allowance up to a maximum of 100 per cent. Alternatively, free depreciation could be claimed, of up to 50 per cent in Year 1 and a 4 per cent annual allowance up to a maximum of 100 per cent. The free depreciation could be taken over a number of years, but the maximum amount on which the increased rate may be claimed was limited to 50 per cent of the qualifying expenditure.

Investors or lessors could claim a capital allowance in the form of a 50 per cent initial allowance in Year 1 and a 4 per cent annual allowance up to a maximum of 100 per cent.

The commercial incentives were conditional on the residential element of the development being carried out.

7.2.4 Allowable Expenditure

The Living Over the Shop scheme provides tax relief on expenditure incurred for residential and commercial development. The commercial development however, was restricted to retail and the provision of services only within the State, excluding mail order and financial services. Office and industrial developments were also excluded. Expenditure on the commercial element could not exceed expenditure on the residential element.

Expenditure on new build was only allowable for tax relief where limited extensions to existing premises are necessary to facilitate access to the residential accommodation or to provide essential facilities such as toilets. New build incentives were only allowable where the extension did not exceed 30 per cent of the total floor area.

7.3 Overview of Expenditure

7.3.1 Introduction

This section of the report presents an analysis of the allowable expenditure incurred under the scheme. The data used in this analysis was provided by the monitoring returns submitted to the Department of the Environment, Heritage and Local Government by the relevant Local Authorities. Under the monitoring guidelines set out by the DOEHLG, each Local Authority provided details of projects initiated under the scheme in relation to the type of development being carried out as well as the scale and estimated costs of the project.

7.3.2 Scheme Expenditure

7.3.2.1 Completed Projects

The total expenditure under the scheme for completed projects is €31.2 million, €27.2 million of which relates to residential development and €4 million of which relates to commercial development.

Dublin had the highest proportion of expenditure under the scheme at €21,1m or 67.8 per cent of the total. The expenditure under the scheme in Cork amounts to €7.3m or 23.3 per cent of the total while Waterford accounts for only 1.6 per cent of the costs. There was no recorded expenditure under the scheme in Galway. [19]

Table 7.1: Total Costs of Completed Projects by City

City	No. Projects	Costs Incurred by Residential Development (€ '000s)	Costs Incurred by Commercial Development (€ '000s)	Total Estimated Costs (€ '000s)
Cork	18	7,274.9	-	7,274.9
Dublin	13	17,544.3	3,594.0	21,138.3
Galway	-	-	-	-
Limerick	2	1,863.2	412.6	2,275.8
Waterford	3	492.0	-	492.0
Totals	**36**	**27,174.4**	**4,006.6**	**31,181.0**

7.3.2.2 Scale of Development

The projects carried out under the scheme were relatively small in terms of the level of expenditure with 44.4 per cent of projects incurring residential development costs of less than €250,000. Just 16.6 per cent of completed projects involved expenditure of €1million or greater. Where 30.6 per cent of projects incur residential development costs of more than €500,000, just 8.4 per cent of projects incur associated retail development costs in excess of this amount.

Table 7.2: Profile of Completed Projects by Scale of Costs of Development

Scale of Cost of Development	Residential Element %	Commercial Element %	Entire Development %
<= €250,000	44.4	16.7	41.7
€250,001 – €500,000	25.0	8.3	19.4
€500,001 – €750,000	11.1	5.6	16.7
€750,001 – €1,000,000	5.6	2.8	5.6
€1,000,001 – €2,500,000	11.1	-	8.3
>€2,500,000	2.8	-	8.3
None (no assoc. retail dev.)	-	27.8	-
Not Stated	-	38.8	-
Totals	**100.0**	**100.0**	**100.0**

[19] It would appear that some costs in respect of commercial development may have been excluded from the database.

7.3.3 Predicting Future Scheme Expenditure

There are a total of 132 projects identified under the Living Over the Shop scheme of which 98 have either been granted, or are exempt from planning permission. Of these 98 projects, 36 have been completed, 34 are work in progress and 28 are in the planning stage.

In predicting the future expenditure under the scheme to July 2006, it was assumed that:

- All projects for which planning permission has been granted or exempted, and which are currently work in progress, will be completed by the deadline of July 2006; and,
- 10 per cent of projects which are currently in the planning stage will be completed by the deadline.

Based on the above, the total expenditure under the scheme to the end of July 2006 is expected to be €72.3million.

Table 7.3: Predicted expenditure to July 2006

Status of Project	Residential Expenditure (€ '000s)	Commercial Expenditure (€ '000s)	Total (€ '000s)
Completed Projects	27,174.4	4,006.6	31,181.0
Work in Progress	31,126.5	7,952.3	39,078.8
Planning (10 per cent)	1,390.4	687.9	2,078.3
Totals	**59,691.3**	**12,646.8**	**72,338.1**

7.3.4 Summary

- Total estimated costs for completed projects amount to €31.2 million, which can be broken down into €27.2 million on the residential aspect of development and €4.0 million on the commercial or associated retail development aspect.

- Of the five cities designated under the scheme, Dublin has had the most development, accounting for €21.1 million of total expenditure. Cork has the next highest level with total development amounting to €7.2million. There has been no expenditure under the LOTS scheme in Galway city.

- By the end of the scheme in July 2006 it is estimated that the total expenditure will be €72.3 million of which €59.6 million will relate to residential development and €12.6 million will relate to commercial development.

7.4 Analysis of Tax Costs

7.4.1 Introduction

This section provides an analysis of the tax forgone arising from the living over the shop scheme. Like before, this section begins with residential units and then presents an analysis of the tax forgone associated with commercial developments.

7.4.2 Tax Forgone on Residential Properties

Step 1: Estimating Housing Units by Type

As already pointed out, this scheme is much smaller than the others under the area-based tax incentive umbrella. Across the 100 or so live projects some 440 residential units are expected to be delivered by July 2006. The number of residential units was worked as per the Urban and Rural Schemes. Given the small number of projects pending it is assumed that all will be delivered by the end of the scheme's operational life.

These 440 units fall into two categories:

- Owner occupier refurbishments accounting for some 114 units;
- Investor held refurbishments accounting for 326 units.

Build cost for residential activity was provided in the Department's database and did not have to be worked out.

Step 2: Average Build Cost

Across projects which are complete, those in progress and those in planning the average build cost per residential unit was €162,031. In order to maintain consistency with the analysis of the other schemes, the average build cost for completed projects was also calculated at €172,258. This figure is used for subsequent analysis and gives and indicative total build cost of €75.8m for all projects.

Step 3: Average Selling Price and Site Costs

The average selling price for an apartment was calculated based on Dept. of Environment, Heritage and Local Government data for Dublin, Cork, Galway, Limerick and Waterford weighted to allow for the timing of projects to be delivered. This gave a selling price per unit of €248,696. Investor properties were then given a price premium of €50,000 per unit to reflect the additional prices the vendors can get for these urban properties.

Site costs are set at 35 per cent of build cost, given the nature of LOTS designated sites.

The results from applying these assumptions are given in Table 7.4.

Table 7.4: Unit Data Used in Estimating Tax Forgone on Residential Living Over The Shop Projects

	OO	Investor	Total
Residential Units Arising	114	326	440
Average Build Cost for All Units	€162,031	€162,031	
Average Build Cost for Completions	€172,258	€172,258	
Total Build Cost based on Completions Data	€19,625,061	€56,168,279	€75,793,341
Assumed Price	€248,696	€298,696	
Site Cost (set at 35% of build cost)	€56,711	€56,711	

Step 4: Gross Tax Forgone

Taking account of the refurbishment nature of these projects the builder/developer versus non-builder/non-developer mix was put at 30 per cent builder/developer and 70 per cent other to account for the likelihood that many of these projects are undertaken by existing property owners.

Applying this mix to the data in the table above gives the gross tax relief arising, which is put at €81.4m in Table 7.5. The gross value of the tax relief exceeds build costs because purchase price is taken into account in calculating gross relief in situations where units are purchased from a builder/developer.

Step 5: Net Tax Forgone before Discounting

The second last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief attached to each unit. To do this the following enabling assumptions were made:

- For owner occupied units we take the higher marginal rate (42 per cent) as the people who own and occupy these units are likely to own the commercial space within the same LOTS development. The price of these units also puts them out of the reach of the average standard rate tax payer; and

- It is assumed that all investors pay a marginal rate of 47 per cent. However, we have to modify this marginal rate to better reflect reality because relief carried forward does not attach to PRSI and levies, lowering the marginal rate to 42 per cent. On the basis that investors exhaust the tax relief over four years the relevant marginal rate is 47 per cent in year one and 42 per cent in years two, three and four. This gives an average marginal rate of 43.25 per cent over the four years.

  Following all the steps detailed above gives Table 7.5.

Table 7.5: Tax Forgone on Residential Living over the Shop Projects

	OO	Investor	Total
Unit Gross Tax Relief via formula	€187,099	€224,715	
Unit Gross Tax Relief at Cost	€172,258	€172,258	
All Units - Gross Tax Relief	€20,132,308	€61,299,706	€81,432,014
Net Tax Cost at Higher Marginal Rate	€8,455,569	€26,512,123	€34,967,692
NPV of Net Tax Forgone	€6,529,167	€23,502,669	€30,031,835
NPV of Net Tax Forgone Per Unit	€57,309	€72,078	

Table 7.5 shows that before discounting the net tax cost associated with residential units is €35m, as against a gross tax relief of €81.4m.

Step 5: Net Tax Forgone in Current Terms

The last step in arriving at net tax forgone is to calculate present values, by taking a 5 per cent discount rate to reflect that the relief is at fixed values but it has to be exhausted over a period of years, reducing its value today. As per the scheme's rules owner occupiers must take the relief over 10 years. Again, investors do not operate to this time constraint and tend to consume the tax relief over a much shorter period, believed to be 4 years.

Combining the 5 per cent discount rate and 10 and 4 years periods gives the present values shown above. The total discounted tax forgone for residential LOTS units is put at €30m, of which:

- Investor refurbishments accounts for €23.5m (78.4 per cent); and
- Owner occupied refurbishments accounts for €6.5m (21.7 per cent).

In all, the discounted tax forgone represents 39.6 per cent of the build cost associated with these projects and 36.9 per cent of the gross tax relief arising.

Looking at individual units, the table shows that the NPV tax cost per unit ranges between €57,309 and €72,078.

7.4.3 Tax Forgone on Commercial Properties

As before each step in the process is explained, but in less detail as the steps involved are very similar and data on commercial projects was not disaggregated into different types of commercial buildings such as office, retail, industrial etc. as the relief categories are identical.

Step 1: Estimating Square Metres and Costs

Data on the floor space of commercial developments was provided in the DOEHLG's database and did not have to be estimated. In all 11,400 square metres of space are expected to be developed under LOTS.

Commercial build costs were provided and did not have to be worked out.

Step 2: Average Build Cost

The average build cost for all projects was €1,653. However, we take the average for completions only and this gives a build cost €1,136 per square metre. Multiplying total floor space arising by the €1,136 gives an indicative build cost of €12.9m.

Step 3: Average Purchase Price and Site Costs

The average selling price for a retail space in the areas covered by LOTS is estimated to be €2,500 per square metre as the sites are in less central locations.

Site costs are set at 35 per cent of build cost, given the nature of LOTS designated sites.

Step 4: Gross Tax Forgone

Taking account of the refurbishment nature of these projects the builder/developer versus non-builder/non-developer mix was put at 30 per cent builder/developer and 70 per cent other.

Applying this mix gives the gross tax relief arising put at €15.4m in Table 7.6. As before, allowing for site costs in situations where the units are purchased from a builder/developer pushes gross value relief above build costs.

Step 5: Net Tax Forgone before Discounting

The second last step in arriving at net tax forgone is to apply a marginal tax rate to the gross tax relief. It is assumed that a marginal tax rate of 47 per cent applies to 90 per cent all of these developments as they are owned by individual and the remaining 10 per cent are owned by companies. As the relief is given by way of capital allowance the issues of rolling over relief does not arise and the individual's marginal rate is taken to include PRSI and levies.

Table 7.6 shows the results. Before discounting, €6.7m of tax forgone is associated with commercial projects, which represents 43.6 per cent of the gross tax costs.

Table 7.6: Tax Forgone on Commercial Living over the Shop Projects

	Total
Build Cost	€18,838,520
Floor Space in Sq Metres	11,400
Average Build Cost for All Projects	€1,653
Average Build Cost Completions (Inflation Adjusted)	€1,136
Total Build Cost based on Completions Data	€12,947,251
Purchase Price per Sq. Metre	€2,500
Site Cost (set at 35% of build cost)	€398
Unit Gross Tax Relief via formula	€1,852
Unit Gross Tax Relief at cost	€1,136
Total Gross Tax Cost at Cost	€15,396,409
Net Tax Cost at 47%	€6,512,681
Net Tax Cost at 12.5%	€192,455
Net Tax Cost	€6,705,136
NPV of Net Tax Forgone	€5,524,627
NPV of Net Tax Forgone Per Square Metre	€485

The net present value of tax forgone is determined by discounting at 5 per cent over 14 years. This gives a net present value of tax forgone of €5.5m, which represents 35.7 per cent of gross relief. On a unit basis, the NPV of tax forgone works out at €484 per square metre.

7.4.4 Tax Forgone on by Development Status

This section presents an analysis of residential and commercial projects by the development status of the projects. As per the Department's database projects are either completed, in progress or still in planning.

Residential Units
Table 7.7 gives the development status of residential units. Of the 440 residential units arising, 157 were delivered, 159 are in progress and the remaining 124 are in planning.

Table 7.7: The Development Status of Residential Living over the Shop Projects and Tax Costs

	OO	Investor	All
NPV of Tax Forgone per Unit	€57,309	€72,078	€68,254
Number of Units by Development Status			
- Completed	41	116	157
- Work in Progress	41	118	159
- In Planning	32	92	124
Total	114	326	440
NPV of Tax Forgone by Development Status			
- Completed	€2,329,725	€8,386,180	€10,715,905
- Work in Progress	€2,359,403	€8,493,010	€10,852,413
- In Planning	€1,840,038	€6,623,479	€8,463,517
Total	€6,529,167	€23,502,669	€30,031,835

The NPV of tax forgone per sub-category of residential unit multiplied by units in each development status grouping gives the NPV of tax forgone by development status. Of the €30.8m of residential tax costs, €10.7m is associated with units which are complete, €10.8m is attributed to those in progress and €8.sm is related to units in planning.

Commercial Space

Table 7.8 repeats the analysis for commercial space.

Table 7.8: The Development Status of Commercial Living over the Shop Projects and Tax Costs

NPV of Tax Forgone per Sq. Metre	€485	
Sq. Metres by Development Status		
- Completed	4057	
- Work in Progress	4206	
- In Planning	3137	
Total	11400	
		Share
NPV of Tax Forgone by Development Status		
- Completed	€1,966,089	35.6%
- Work in Progress	€2,038,296	36.9%
- In Planning	€1,520,242	27.5%
Total	€5,524,627	100.0%

Of the €5.5m of tax costs, 35.6 per cent is associated with completed projects, 36.9 per cent is linked to work in progress and projects still to start account for 27.5 per cent.

7.4.5 Overview of the Tax Costs

In conclusion, the NPV of all tax forgone associated with Scheme up to July 2006 is estimated at €35.5m. With regard to developments completed by end 2004, the tax cost is estimated to be €12.7 m.

Table 7.9: Overview of Present Values of Scheme Tax Foregone

	Residential (€m)	Commercial (€m)	Total (€m)
Predicted Tax Cost to Mid July 2006	30.0	5.5	35.5
Tax Cost Incurred to end 2004	10.7	2.0	12.7

Source : Consultants' estimates

7.5 Scheme Outputs

7.5.1 Introduction

This section of the report presents an analysis of the outputs of the scheme in terms of residential units and other developments. The data presented here relates to completed projects as notified by the Department of the Environment, Heritage and Local Government database.

7.5.2 Developments Under the Scheme

The two primary incentive types under the Living Over the Shop scheme are Residential Investor and Residential Owner-Occupier. A number of projects also involve a third incentive, Associated Retail Development, and some of them overlap all three incentive types.

Since the introduction of the Living Over the Shop scheme in 2001, a total of 36 projects have been completed, accounting for 27.3 per cent of all projects. Table 7.10 below shows the distribution of completed projects by incentive type.

Table 7.10: Number of Completed Projects incorporating each Incentive Type

Incentive Type	No. Projects	Distribution (%)
Residential Investor	30	83.3
Residential Owner-Occupier	6	16.7
Associated Retail Development	22	61.1

Note: Totals do not add up, as some projects are a combination of more than one incentive type.

Over 40 per cent of the projects completed were in the category Residential Investor with associated retail development. A total of 15 projects in this category have been completed. Owner-occupiers account for only 15.7 per cent of completed projects.

Table 7.11: Completed Projects by Project Type

Project Type	No. Projects	As % of All Projects
Residential Investor	11	30.6
Res. Investor with Assoc. Retail Dev.	15	41.7
Res. Owner-Occupier with Assoc. Retail Dev.	2	5.6
Res. Inv. & Res. Owner-Occ. with Assoc. Retail Dev.	4	11.1
Unspecified Res. Type with Assoc. Retail Dev.	1	2.7
Not Stated	3	8.3
Total	**36**	**100.0**

7.5.3 Residential Developments

A total of 155 residential units have been developed under the scheme, of which 24 were existing units which have been refurbished, and 131 are additional units created as part of the development.

The breakdown of residential units by city is shown in Table 7.12 below. As can be seen from this table, the majority of residential developments took place in Dublin, which accounts for 53.6 per cent of the total, while Waterford accounts for only 4.5 per cent.

Table 7.12: Profile of Residential Units by Designated Area

City	No. of Residential Units Created	As % of Total Residential Units
Cork	54	34.8
Dublin	83	53.6
Galway	0	0.0
Limerick	11	7.1
Waterford	7	4.5
Total	**155**	**100.0**

7.5.4 Commercial Developments

Under the LOTS scheme, associated commercial development was allowed where residential development is also being carried out and where the costs of the commercial element do not exceed the costs of the residential element. Most of the commercial development was carried out in Dublin which accounted for 68.6 per cent of the total. Waterford had the lowest level of commercial development, accounting for just 1.1 per cent of the total.

Table 7.13: Profile of Commercial Development by Designated Area

City	No of Projects with Commercial Element	Total scale of commercial development (Sq Mts)	As proportion of total commercial development (%)
Cork	11	1006	25.2
Dublin	10	2740	68.6
Limerick	2	203	5.1
Galway	0	0	0
Waterford	3	45	1.1
Total	**26**	**3994**	**100.0**

7.5.5 Scale of Completed Developments

The scale of development projects under this scheme was relatively small. As Table 7.14 shows, 69.5 per cent of the completed projects are between 100 and 400 square metres in scale with only 13.9 per cent accounted for by large scale projects of 600 square metres or greater. This prevalence of relatively small scale development would be expected given the nature of the scheme which incentivises the development of individual properties.

Table 7.14: Profile of Completed Developments by Scale

Scale (m²)	Residential Development %	Commercial Development %	Entire Project %
0 –100	16.7	36.1	8.3
100 – 200	47.2	27.8	38.9
200 – 400	22.2	2.8	30.6
400 – 600	2.8	2.8	8.3
600 – 800	5.5	0	2.8
800 – 1000	2.8	2.8	2.8
> 1000	2.8	0	8.3
No Assoc. Retail Development	0	22.2	0
Not stated	0	5.5	0
Total	**100.0**	**100.0**	**100.0**

7.5.6 Summary

- The Living Over the Shop scheme has resulted in the development of 155 residential units and 3,994 square metres of commercial development.
- The vast majority of this development has taken place in Dublin, accounting for 53.6 per cent of the residential development and 68.6 per cent of the commercial development.
- Cork City had the next highest level of development with 54 residential units being created, accounting for 34.8 per cent of the total; and 1006 square metres of commercial development which represents 25.2 per cent of the total.
- There has been no development under the scheme in Galway City.

7.6 Impact of the Scheme

7.6.1 Introduction

This section of the report presents an analysis of the impacts, which the Scheme has had on the designated areas. It begins with an assessment of the success of the Scheme.

7.6.2 Evaluation of the Scheme

The findings of the 1996 KPMG report on the Living Over the Shop scheme were that while it had been successful in a small number of areas, it had failed to make a significant impact because refurbishment of existing properties was not as attractive as new build, because of the costs involved. The level of take up of the current

scheme suggests that this continues to be the case, for example, in Limerick the take up rate was only 4 per cent with only two of the twelve recorded projects having been completed. The Local Authorities in Cork have had success with the scheme and believe it has delivered value, however there was no take up of the scheme in Galway.

7.6.2.1 Reasons for Lack of Take up

A number of issues have been cited as having hindered the take up of the Scheme:

- The prospect of taking on an extensive refurbishment project may not have appealed to individuals whose primary occupation was in retail;
- The potential for disruption to the retail business for the duration of the development work may have dissuaded shopkeepers from developing their premises;
- Shopkeepers may have to relinquish valuable retail or storage space to allow for access to the residential accommodation;
- There may be security concerns associated with having tenants living above commercial premise;
- A residential unit over a shop may not be attractive to potential tenants given the availability of alternative apartments in purpose built apartment blocks which may offer better facilities. For this reason it is also likely that above-the-shop units would not be attractive to owner-occupiers, leaving the developer dependant on rental income to provide a return on the investment;
- There are sometimes difficulties in marketing the Scheme due to problems in identifying owners as distinct from tenants of properties; and
- As the designated streets for this scheme are in city centre locations, they may not be attractive places to live given the proximity of bars and night-clubs resulting in noise, litter and anti-social behaviour.

7.6.2.2 Economic Impacts

The Scheme has produced 155 residential units and 3,994 squared metres of retail space in the period to end 2004. If all of the latter were additional, it would have given rise to an extra 143 persons employed and an annual gross retail value added of €4.5m annually. However, as a maximum of 30 per cent of the development can be new build, a more reasonable estimate is an extra 43 persons employed and €1.4m in retail value added.

In the construction phase, it is estimated that the Scheme gave rise to 171 man-years of direct employment and direct income tax and PRSI receipts of €2m. However, the impact of the Scheme should primarily be measured by its contribution to fostering a living urban environment. The Scheme has obviously had beneficial impacts of this nature, while making use of existing structures rather than requiring new build.

Case Study 1 – Limerick City

Despite the proactive management and promotion of the LOTS scheme in Limerick, the take up of the scheme was limited. Of the 300 buildings which were eligible for the refurbishment incentives, planning applications were submitted for only 12, or 4 per cent, and only two projects had been completed at the end of 2004.

A number of reasons were put forward of the lack of uptake, including:

- The relative unattractiveness of refurbishment-oriented LOTS projects as against new build projects
- A lack on interest on the part of some property owners
- Unwillingness of traders to cease trading for even limited periods while properties are refurbished
- Excessive valuations put on eligible properties by vendors pushed the overall cost of projects to a level where it was uneconomical for developers to pursue LOTS, taking account of the higher costs associated with refurbishment as opposed to new build
- Legal and insurance difficulties

Financial advisors were important in picking up on the attractiveness of URS to developers and packaging projects for development, however their relative lack of interest in LOTS was perceived as a limiting factor. A report submitted by the Local Authority in Limerick stated that a number of prospective developers had withdrawn from the scheme as a result of advice given to them by their financial advisors.

Those projects that have been progressed under the scheme have had a positive effect on the city and have contributed to urban regeneration on some inner city streets which had been in decline. The LOTS programme has been described as having made a small but useful contribution to promoting sustainability in Limerick City centre.[20]

Case Study 2 - HARP

Under the LOTS scheme, 306 buildings were approved for the scheme in the HARP area of Dublin City. The buildings were approved in clusters to encourage take up of the scheme and a total of 33 developments were planned. These 33 developments involve almost 80 retail units, or between 10 and 15 percent of the potential scheme participants.

Of these 33 projects, only 4 have been completed with a further 26 still in planning, and the remaining 3 being work in progress. Of the 26 projects that are in the planning stage, 14 have been granted planning permission. The estimated total expenditures of these projects, were they all to be completed, is €33.8 million.

[20] Limerick City "Living Over the Shop" Progress Report, December 2004

While take up of LOTS has been relatively good in the HARP area, there have been a number of difficulties with the scheme also. These include:

- The prohibitive costs of developing old, often listed buildings (e.g. Capel Street);
- Long term ownership of non-viable retail units by persons who are unwilling/unable to sell or invest;
- Adjoining owners not willing to participate; and
- Difficulties establishing title to some properties.

The scheme was very well promoted in the area. For instance, two sites owned by the local authority in Capel Street were developed and exhibited to demonstrate what could be achieved. A wide range of other promotions were carried out and Dublin City Council provided a team of people to support potential developers including architects, planners, engineers and financial planners.

The promotion, supported by the access to a team of experts at no cost to the developer, coupled with the enormous potential of the area contributed to the relative success of the scheme in the HARP area.

7.6.3 Value for Money

Three indicators are presented below:

- The tax costs per additional unit/square metre;
- The present value of tax costs per additional unit/square metre;
- The ratio of the present value of tax costs to new build costs.

At €68,254 per housing unit, the cost to the Exchequer is very substantial, the highest of all the area-based incentive schemes. Tax costs account for 35.1 per cent of build costs, comparable with the other incentive schemes examined under this review.

Focusing on commercial space, the discounted tax cost per square metre under LOTS is €485, comparable to the costs arising under Urban Renewal Scheme, but well above Town Renewal Scheme's tax costs per metre of €406. However, at 29.3 per cent the ratio of tax forgone to build costs is lower than for the other schemes.

The tax costs of the Scheme will not be offset to a significant degree by either direct income tax and PRSI payments by the construction industry or developer contributions. Taken together, these amount to approximately 7 per cent of build costs.

Table 7.15: Efficiency Indicators

Item	Value
Tax cost per housing unit (€)	79,472
Present value of tax costs per housing unit (€)	68,254
Ratio of discounted tax cost to residential build costs	35.1
Tax cost per sq. metre of commercial space (€)	588
Present value of a sq. metre of commercial space (€)	485
Ratio of discounted tax cost to commercial build costs	29.3

7.7 Conclusions and Recommendations

7.7.1 Scheme Expenditure

The total expenditure under the scheme for the period April 2001 to December 2004 is €31.2million, of which €27.2 million is expenditure on residential development and €4 million is expenditure on commercial development.

Of the five cities designated under the scheme, Dublin accounts for the highest level of expenditure at €21.1million (68 per cent) of the total, followed by Cork with €7.2 million (23 per cent). Expenditure in Limerick and Waterford accounts for just 7.3 per cent and 1.6 per cent respectively. There was no expenditure recorded for Galway.

By the end of the scheme in July 2006, it is estimated that the total expenditure will be €72.3 million of which €59.6 million will relate to residential development and €12.6 million will relate to commercial development.

The discounted value of the total tax costs to mid 2006 is €35.5m of which €30.0m will relate to residential development and €5.5m to commercial development.

A total of 155 residential units have been created under the LOTS scheme along with 3,994 square metre of commercial development. The majority of this development has taken place in Dublin.

While take up of this scheme has been limited with a total of 132 projects recorded for the five designated cities, the scheme has proved successful in those areas where it has been implemented.

The scheme contributed to urban regeneration through the refurbishment of existing buildings and has provided 155 new residential units.. The refurbishment of retail units under the scheme will result in extra employment for an estimated 43 persons and generate €1.4million in retail value added.

While there have been some factors which contributed to the low take up of the scheme, such as disruption to a business while works are being carried out, the scheme itself has not given rise to any issues. The limited take up of the scheme has meant that there has been no discernible impact on the supply of residential or retail property in the designated areas.

8. Future of the Schemes

8.1 Introduction

This section of the report considers the future of the schemes. This must be set against the backdrop of the overall tax costs to the Exchequer and the first part of the Section provides such an overview. As the capacity of Government to use such schemes depends on their compliance with the European Union's State Aid guidelines, this is followed by a summary of the current situation in that regard. Following this, the case for extension of the expiry date of the current schemes is evaluated. A comparison of the role of tax based incentives compared to other urban regeneration measures is then set out. The final two sub-sections consider appropriate reforms of the schemes and their future targeting.

8.2 Overall Exchequer Cost

Table 8.1 summarises the overall costs to the Exchequer arising from tax forgone. In respect of developments completed up to end 2004, the total Exchequer tax costs of the Schemes is estimated to be €639m. This is anticipated to treble by the end July 2006 expiry date to €1,933m. Almost 74 per cent of the total anticipated cost will arise in respect of the Urban Scheme.

Table 8.1: Total Present Value of Exchequer Costs of the Area-Based Tax Incentive Renewal Schemes

Scheme	Residential (€m)	Commercial (€m)	Total (€m)
Completed Developments			
Rural Renewal Scheme	119	21	139
Urban Renewal Scheme	166	270	436
Town Renewal Scheme	24	27	51
Living over the Shop Scheme	11	2	13
Total	320	320	639
All Developments			
Rural Renewal Scheme	277	48	326
Urban Renewal Scheme	636	787	1,423
Town Renewal Scheme	71	77	148
Living over the Shop Scheme	30	6	36
Total	1,014	918	1,933

Source: Consultants' Estimate
Note: Present values at 5 per cent; apparent errors due to rounding

In interpreting the above figures, it should be noted that the major impact on the Exchequer is yet to come, as even those developments completed by end 2004 will give rise to claims for tax relief for a considerable future period.

8.3 State Aids and the Schemes

8.3.1 Existing Position

The Rural, Urban and Town Renewal Schemes are affected by the European Union's State Aid Rules.

Under Article 87(1) of the Treaty "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market." Tax measures, including the Rural, Urban and Town Renewal Schemes come within the scope of the Article by virtue of the reference to "State resources in any form whatsoever". The commercial and industrial, but not the residential elements of these schemes, are regarded as State Aids. The Living over the Shop Scheme is not regarded as breaching the State Aids provisions as it is viewed as impacting on local services only.

Exemptions from the State Aids rules are permitted under Article 87(3)(a) and Article 87 (3)(c) of the Treaty. These relate to measures that may be compatible with the common market e.g. aid to promote the economic development of areas with low standard of living or serious underemployment (87(3)(a)) or the development of certain economic activities or areas where such aid does not adversely affect trading conditions to an extent contrary to the common interest (87(3)(c)).

Derogations under these Articles are based on a demarcation of eligible regions and the setting of maximum aid levels. Under Article 93(3) of the Treaty, Member States must establish a Regional Aid Map setting out the regions and aid levels and have that map adopted by the Commission, in keeping with the commission's Guidelines on Regional Aid. The current Regional Aid Map was adopted in December 1999 and relates to the period up to the end of 2006.[21] Under the map, Ireland was divided into two NUTS 2 regions – the Border Midlands and Western Region and the Southern and Eastern Region, with the former being coming with Article 87(3)(a) and the latter Article 87(3)(c).

Maximum aid levels for large enterprises must not exceed 40 per cent of the Net Grant Equivalent in relation to regions eligible under Article (87(3)(a)[22], while those under Article (87(3)(c)) must not exceed 20 per cent.

The Regional Aid Map established aid intensity ceilings for Ireland ranging from 40 per cent for the BMW region to17.5 per cent for the Dublin region. Aid to small and medium sized enterprises may be 15 and 10 per cent above these levels respectively.

[21] European Commission SG (99) D/10276. 1999.

[22] Net Grant Equivalent (NGE) is the net after tax value of the state aid, whether it is in the form of a grant, subsidised loan or tax relief.

The Net Grant Equivalent of aid under the Tax Renewal Schemes amounts to a maximum of 11.56 per cent. Thus, the schemes fall below the maximum aid levels set for large enterprises, even in relation to the Dublin region. However, projects, for which the eligible expenditure exceeds €50m are subject to separate notification and maximum aid provisions under the EU's Multisectoral Frameworks on Regional Aid for Large Investment Projects, which was established in 2002.

The State Aids and provisions of the Treaty and the Guidelines for Regional Aid have impacted on the operation of the tax renewal schemes. Adjustments to the schemes, including extension to their termination dates have been subject to EU approval. Additionally. Changes have had to be made to the schemes as originally approved to ensure their compatibility with EU law, for example:

- The exclusion of expenditures in respect of buildings used in a range of industries including the agriculture and transport sectors;
- The exclusion of property developers from availing of the Urban Renewal scheme;
- The provisions in the Finance acts 2001 and 2002 that capital allowances cannot be claimed under the Schemes where any other form of State aid is paid: this was to ensure that State grants and tax reliefs cannot exceed the maximum NGE ceilings;

8.3.2 Future Developments

The European Commission has issued Draft Guidelines on National Regional Aid for 2007-2013.[23] Under these guidelines, it is envisaged that no region of Ireland will qualify for aid under Article (87(3)(a) and the BMW region will qualify for significantly reduced aid levels. It is the intention of the Commission to adopt these Guidelines before end 2005. For Ireland to benefit from the state aid exemptions envisaged a new regional aid map will have to be devised and adopted. The European Commission will not give consideration to any new schemes, until this process is complete.

8.3.3 Implications of the Rural, Urban and Town Renewal Schemes

There are significant implications for the commercial and industrial incentives contained in the Schemes:

- Prolonging the period for which expenditures are eligible under the current schemes beyond July 2006 and into 2007 will bring them under the yet to be agreed regional aid regime for post-2007. This means that it may not be possible to extend the Schemes in respect of commercial and industrial incentives in this manner until the current process of establishing the new regional aid regime is complete.

[23] Draft Guidelines on National Regional Aid for 2007-2013. Commission of the European Communities, C (2005).

- Any new schemes that may be considered to succeed the current schemes or extensions of existing schemes beyond end 2006 will fall under the new regional Guidelines. This is likely to mean that a scheme of commercial and industrial incentives that benefit large firms in the SE region will no longer be possible, although a scheme confined to small and medium sized enterprises may be eligible under block exemption arrangements. [24] Lower maximum aid rates will also apply.

8.4 Expiry of the Current Schemes

In light of concerns about the orderly winding down of the Schemes, the expiry date of the Schemes was extended to end July 2006 from the previous expiry date of end December 2004. With regard to Urban Renewal projects, the extension is only in relation to projects for which 15 per cent of project costs had been incurred by 30th June 2003. With regard to the Town and Rural Renewal schemes, the extension was confined to projects for which a planning application had been lodged by the 31st December 2004.

As was indicated in Section 3 the deadline extension has resulted in a flood of applications under the Rural Renewal Scheme.

A similar increase has not occurred in respect of the Urban Scheme, as the 15 per cent rule means that any late applications would not be eligible. However, there are a significant number of projects, which by virtue of their size or other issues are unlikely to be complete by end July 2006.

With regard to the Town Renewal Scheme, as was demonstrated in Section 5, progress in relation to this Scheme has been slow, and there are large number of projects still going through the planning process.

There are a number of adverse aspects of the current position:

- There will be peaking of building activity, as developers seek to complete their projects to meet the deadline. This will give rise to upward pressure on building costs and prices;

- Some projects may be delayed in the planning process and fail to meet the deadline through no fault of the developer;

- There will be pressure on the planning process to expedite applications, which may lead to poor decision-making;

- Some large projects in urban areas may not commence, with negative impacts on IAP objectives;

- There is a basic unfairness in a situation where applications are received, but sufficient time is not allowed for building.

[24] See: Commission Regulation EC No.70/2001

It has been suggested that to address these problems, projects should retain entitlement to tax relief for the period of validity of their planning permission i.e. five years. This is viewed as excessive as developers may postpone projects in the hope of further capital appreciation. It is considered that an extension to end 2007 would be a suitable compromise, giving a reasonable but not excessive time for completion of projects.

State aid rules, as outlined above, complicate such an extension in relation to industrial and commercial projects. One option would be to extend the deadline in respect of residential project elements only. This is not recommended as, in the case of the Urban and Town Schemes, it might distort the outcomes of the IAPs and Town Renewal Plans. Accordingly, it is recommended that any extension apply to all elements of the Schemes.

The real problem in this regard is that current State aid provisions run to the end of 2006 and an application that relates to the period after that might not be currently entertained by the EU. In light of this, the following procedure is proposed:

- An immediate prior notification to extend the schemes up to end 2006 be lodged; and
- Declaration of an intention to notify a further extension, when the new Regional Aid Map is agreed, provided that map permits such an extension.

8.5 Consideration of Alternative Measures

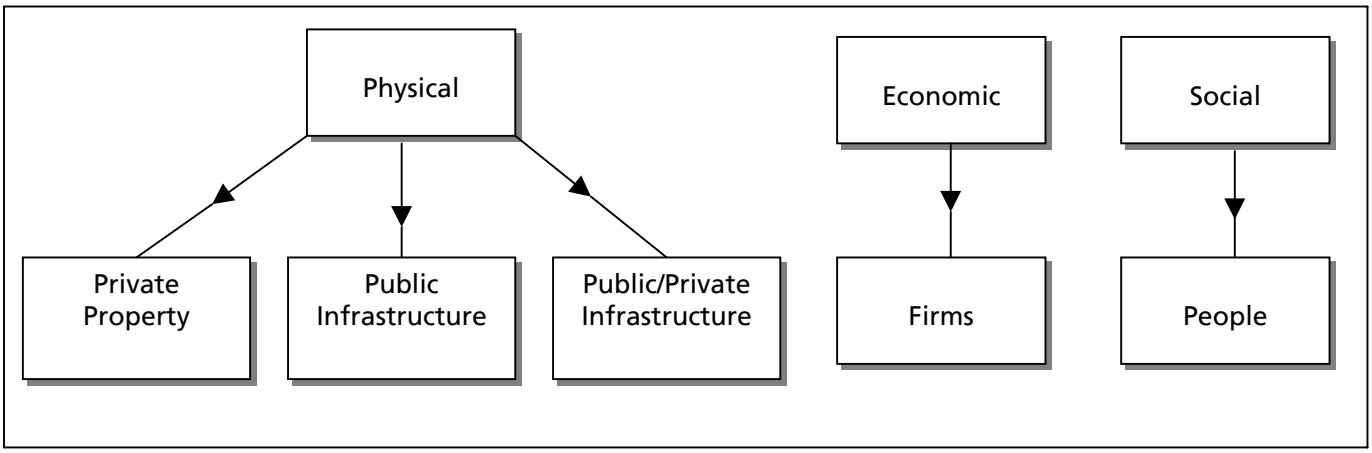
8.5.1 Introduction

The Urban and Town Renewal Schemes are property-focussed fiscal measures aimed at addressing geographically bounded market failures. Consideration of alternatives raises three questions:

- Are there better alternatives to the use of fiscal instruments to encourage private property development?
- Should the emphasis be on development of public rather than private property?
- Are there better alternatives to the focus on property?

Figure 8.1 sets out a typology of urban regeneration mechanisms. This distinguishes between those that are focussed on physical, economic or social development. Within the physical, a distinction is made between those that impact on private and public property.

Figure 8.1: Typology of Urban Regeneration Mechanism



8.5.2 Other Mechanisms for Private Property Development

The alternative to the use of fiscal measures in urban regeneration through private property enhancements is the use of grants. The latter have traditionally been and continue to be the principal policy instrument in use in the UK, its most recent form being the Single Regeneration Budget. This initiative was commenced in 1994 and combined a number of schemes that were then in operation covering a variety of themes that include:

- Enhancing the employment prospects, education and skills of local people;
- Addressing social exclusion, as well as enhancing opportunities for the disadvantaged;
- Promoting sustainable regeneration by improving and protecting the environment and infrastructure including housing;
- Supporting and promoting growth in local communities and businesses; and
- Tackling crime and drug abuse and improving community safety.

The Single Regeneration Budget resources are intended to act as a catalyst for local sustainable regeneration, economic development and industrial competitiveness. Funding is provided for a defined period to local partnerships. There has been an emphasis on tangible outputs, which has resulted in a focus on building development.

However, in contrast, another initiative adopted in the UK - the Enterprise Zone Initiative - included fiscal mechanisms.[25]

There has been significant debate about the relative merits of each approach. This debate has characterised fiscal measures as being administratively simple, flexible, easy for developers to understand and capable of reducing uncertainty, but with the

[25] See: Evaluation of the Enterprise Zone Experiment. Department of the Environment. 1987.

potential for significant dead weight and displacement effects. Grant systems have been identified as administratively cumbersome, opaque, inflexible but with greater capacity for targeting and budgetary control.

In practice, however, there is less difference between the two mechanisms. This is because fiscal approaches have often adopted the so-called 'gateway' approach, in which eligibility for tax incentives has to be established administratively.[26] In these circumstances, developers are likely to be relatively indifferent between the two approaches.

The current Urban and Rural schemes embody aspects of the gateway approach in that the geographic areas are tightly delineated and the types of activity incentivised is tailored to local needs. This creates substantial targeting and some measure of budgetary control. At the same time, the fiscal nature ensures that the scale of incentives offered responds to the scale of development. While a grant-based approach would ensure tighter budgetary control, its administrative nature could create additional uncertainty and thus deter potential investors and purchasers. Accordingly, it is considered that the fiscally based approach is valuable and should
be retained, especially if some of the reforms outlined in Section 8.6 below are implemented.

8.5.3 Mechanisms for Public Property Development

Public property development has traditionally taken place through wholly publicly funded schemes. In recent years, however, a number of alternative means of financing public property development have been used or are in train:

- Increased developer contributions;
- Use of public private partnerships arrangements;
- Establishment of Business Improvement Districts;

The latter arranges for enhancements to local services in return for special voluntary levies on the businesses that will ultimately benefit. As all of these instruments are primarily aimed at improving public rather than private infrastructure, they are essentially complementary to tax incentives for private property development.

Another approach adopted in the USA is Tax Incremental Financing (TIF). This is a programme that allocates future increases in property taxes from designated areas to pay for improved public infrastructure. The absence of rates on residential properties in Ireland would limit the application of such an approach in the Irish context.

Improvements in public property and infrastructure, while vital for urban renewal, can act on only a part of the built environment. In a situation, where the market provides the requisite private property development, the focus of Government

[26] See: The Potential for Fiscal Incentives. ODPM, UK, 2004.

funding should be on public property. However, where market failure occurs, public property enhancements may not be sufficient to stimulate private investment and direct support for the latter is required. In this view, tax-based property initiatives are essentially complementary to public investment in situations where market failure occurs, requiring actions to ensure that both public and private property is enhanced.

8.5.4 Non-Property Related Mechanisms

The third question is whether non-property related interventions would be more successful. Physical mechanisms improve the physical environment and have the advantage of creating a lasting impact on the target area. They are also a means of demonstrating that change is possible and giving hope of enduring renewal. Social mechanisms are largely people-based. They have the advantage of impacting directly on people's well being, although they may have transient effects, because of the possibility of high turnover of population within the target area. Economic mechanisms that support firms to increase employment opportunities raise local incomes, but may be similarly transient and do not impact directly on social problems. Thus, the three approaches may be seen to be somewhat complementary in form. Indeed, there is a widely held view that a holistic approach to regeneration is required, embracing physical, economic and social development.

The Integrated Area Plans, which underpin the Urban Renewal Scheme, include economic, social and environmental objectives. With regard to the social aspects, it was demonstrated in Section 5 that the Scheme achieved only limited success in this area. However, one of the case studies presents an example of very good practice in this regard. As well as seeking to enhance Tallaght town centre, the integrated area plan for that area also included the socially disadvantaged areas of Jobstown, Fettercairn and Killinarden. Along with identifying the needs of the latter area, the IAP also provided for the levying of a community charge on developers, the proceeds of which were to be used in favour of the deprived areas. Additionally, significant efforts were made to ensure that builder developers offered employment opportunities to local people from these areas. These aspects of the IAP were carried through with reasonable success: for example, a total of over €3.5m has been allocated from the Community Infrastructure Fund to social and community development. This indicates that well-managed IAPs can successfully use urban renewal incentives to achieve social, economic as well as physical development objectives. It is recommended that such an integrated approach continue to be a feature of any future urban renewal schemes.

It is also recognised that a similar approach may not be as feasible in respect of Town Renewal schemes, as it is often more difficult to incentivise development and additional levies may hinder such development.

8.5.5 Non Area Based Initiatives

During the course of the study, it was suggested tax incentives should be used to fund local economic and social infrastructure, such as parks, libraries and other community facilities, not necessarily within an area-based approach. While it is not the purpose of this report to give consideration to such proposals, it is clear that they would need to be based on market failure arguments and not simply be a means of reducing the burden on local authority financing.

8.5.6 Conclusions

It is concluded that:

- The tax incentivisation of private property development should continue to have a role in urban regeneration;
- Such incentives are complementary to mechanisms such as PPP and BIDs that are aimed at enhancing public infrastructure; and
- There is scope for tax incentivisation of private property development to take place within a coherent framework aimed at enhancing physical, economic and social development.

8.6 Reform of the Urban and Town Renewal Schemes

8.6.1 Introduction

This Section presents proposals for reform of the Urban and Town Renewal schemes, in the event that similar schemes might be introduced in the future. Reforms to both the Scheme processes and structures are considered.

8.6.2 Reform of the Process

Management Resources

As indicated in the body of the report, the implementation, particularly of some town renewal schemes, was inadequate. In particular, some town schemes were inadequately marketed and insufficient resources devoted to their ongoing management. This was a significant factor in poor take up of the scheme in some instances. It is recommended that, in future, local authorities be required to demonstrate, in advance of areas or towns being admitted to the scheme, that they are committing sufficient resources to its management.

The Urban and Town Renewal Schemes took place within the context of Integrated Area and Town Renewal plans. Guidelines for the monitoring and progress reporting of these plans were set by the DOEHLG. However, monitoring reports were often of poor quality and delivered late or not at all. If adequate resources are committed by local authorities, then this problem should be overcome.

It is noteworthy, too, that no structures were put in place whereby local authorities could share experiences in implementing and managing schemes. It is recommended that any future schemes incorporate such structures to be managed by the DOEHLG. This would also aid the ongoing monitoring processes.

Scale of Designations

In this context also, it is clear that in the case of the Town Renewal Scheme the large number of towns that were designated meant that some towns were included where development prospects were so poor that tax incentivisation was insufficient

to encourage development. As the purpose of the Scheme is to address market failure at *specific sites* in towns, one criterion for inclusion in the Scheme would be that the town in question is undergoing significant development generally, but that problem sites are being neglected.

Scheme Control

It is a matter of concern that prospective beneficiaries, particularly under the residential elements of the Schemes, may not have been fully informed as to the conditions under which tax relief may be granted. For example, it came to notice, during the review of the Rural Renewal Scheme, that auctioneers and estate agents, in advertising the Schemes did not specify the eligibility conditions viz. that either owner-occupation or letting on a continuous basis was required. It was also put to us by local officials that those advising purchasers, such as solicitors and accountants, were not always au fait with the provisions of the schemes. This leaves scope for those claiming tax relief to misuse the Scheme, either out of ignorance or by design e.g. by using the property as a holiday home. It is recommended that in future, the local authorities should issue a certificate in respect of each *unit* of property made available for sale under the Schemes. This certificate would identify the unit in question and would stipulate the conditions under which a tax relief is granted. It would be passed on to subsequent purchasers of the property, should it change hands. Presentation of this certificate to the Revenue Commissioners would be a condition of obtaining tax relief. It would also facilitate the latter in controlling abuse of the Schemes.

8.6.3 Reform of Scheme Structures

Duration of the Schemes

Originally, the Schemes were established for a duration of three years. In general terms, this is too short a period in which to arrange for site assembly, design the development and bring a development through the planning process. There is a danger that schemes of short duration increase the likelihood of dead weight, as those schemes already being planned are more likely to proceed and or have a larger proportion of their expenditure eligible for tax relief. Accordingly, it is recommended that any future schemes should operate for a minimum of five years.

Site Designation

In a minority of cases, the reason developments did not progress was that sites were not serviced. Site designation should be contingent on the existence of adequate services or the real prospect that such services will be in place in the first half of the scheme's duration.

Investor and Owner-Occupier Mix

There are a number of features of the schemes that need to be changed. The Urban and Town Renewal schemes have resulted in an inordinate focus on investor rather than owner-occupied purchase. Transient occupation of rental properties has also been a feature, raising fears of future degradation of the buildings. The dominance of rental occupation can, on occasion, reduce the spin-off impacts of these properties on the local economy and run counter to policies for socially integrated

housing provision. Future schemes should incorporate a more balance allocation of housing units between owner-occupation and letting, consistent with local area needs. Two options for achieving this present themselves:

- The Section 23 type reliefs for investors are inherently more generous than those for owner-occupiers. If the reliefs available for the two types of occupancy were rebalanced, then there would be greater impetus towards owner-occupation would increase. This could be achieved by granting 100 per cent relief to owner-occupiers over ten years and restricting the investor relief to 50 per cent.

- Another approach would be to stipulate an owner occupation/investor mix for residential units under the scheme, dictated by local conditions. The certification process, which is set out above, would facilitate this in that individual residential units could be designated as either for owner occupation or letting.

The first approach is unlikely to work on its own, as investors tend to have greater resources than owner-occupiers and may still dominate demand for tax incentivised housing. It is recommended that a combination of the to approaches be adopted viz. stipulation of a minimum owner occupation/investor mix, together with a rebalancing of the relative incentives.

Distribution of Tax Benefits

An uneven distribution of tax benefits is evident also because the Urban and Town schemes have resulted in high levels of investor purchase of residential units. This and other aspects of the schemes have raised concerns that the tax benefits are accruing to a relatively small group of people. Equity considerations support a wider distribution of participation in the schemes. This would be partly achieved by changing the owner occupation/investor mix as suggested above.

Scale of Incentives

Finally, there is a need to consider whether the scale of incentives offered under the schemes continues to be appropriate. For individual participants in the schemes, relief will normally obtained against income taxed at the higher 42 per cent rate. Given that there is currently no shortage of capital and continued and more dispersed growth in economic activity, a lower level of relief would not seriously impair the flow of funds into the schemes.

There are a number of options for reforming the way in which reliefs are calculated so as to reduce the costs to the Exchequer. These are:

- Standard rating the reliefs;

- Reducing allowable expenditure to a proportion of that incurred;

- Calculating gross tax relief based on build costs alone;

- Parity of treatment between investors and owner occupiers; and

- Capping gross relief in exchequer cost terms.

Standard Rating the Reliefs

Under this option the gross tax relief is taken at the standard rate and not the higher marginal rate. This has the following advantages:

- It introduces parity between tax payers;
- It would apply to all types of developments and Scheme participants;
- It is in keeping with current policies in respect of tax allowances.

Reducing allowable Expenditure to a Proportion of that Incurred

- It is administratively very simple;
- It would apply to all types of developments and Scheme participants;
- It is flexible in that the proportion of allowable expenditure could be determined in light of economic conditions prevailing at the time of the introduction of the Scheme

Calculating Gross Tax Relief Based on Build Costs Alone

The suggestion here is that gross costs are limited to build costs and the formula for working out gross relief no longer applies. This would apply only to residential properties. The positives are:

- A lower administrative burden;
- Reduced administrative complexity;
- Greater parity between vendors;
- Provides incentives to purchasers to resist house price increases

Parity of Treatment between Investors and Owner Occupiers

Given that the residential outputs of the Urban Scheme were weighted in favour of investors it could be argued that the limiting of reliefs to owner-occupiers who bought new builds to half the gross relief available to investors skewed the purchaser profile. This could be accomplished by reducing the relief available to investors, which would reduce Exchequer costs.

This would apply only to residential developments and would run counter to the proposal outlined above viz. that of raising the level of relief to owner-occupiers.

Capping Gross Relief in Exchequer Cost Terms

The suggestion would be that the gross relief is fixed in cash terms, perhaps on an area by area basis with areas of greater need benefiting from a higher cap and therefore attracting more tax relief. The upside of this suggestion is that the tax costs are limited and known with relative certainty.

However, this suggestion has a too many negatives, such as:

- It could be hard to administer;
- It could lead to a fragmentation of projects to keep costs below the cap; and
- It may require specific legislation, which is likely to be complex.

The capping option has too many problems and is not recommended.

In considering the other options, the preference is for changes that are flexible and simple to administer, apply to all types of development, would not distort investor decision-making as between residential and commercial/industrial developments, and would not unduly deter investor interest. It is considered that reducing allowable expenditure to a proportion of that incurred represents the best option in this regard.

As it is also proposed to restrict the investor relief to 50 per cent in respect of residential developments for the purposes of achieving a better tenancy mix, the reduction in allowable expenditure should be relatively modest, so as not to deter investor interest excessively.

8.7 Future Use of Area-based Tax Incentive Schemes

As indicated above, existing schemes should be allowed an extended termination date of end 2007.

In respect of the post 2007 period, it is recommended that:

- The Rural Renewal Scheme should not be renewed or extended to other areas of the country; and
- The option of using tax incentivisation as a tool of urban renewal be retained and appropriate schemes be considered in the light of economic conditions then prevailing.

With regard to the latter, given the scale of activity that has taken place under the existing Schemes, and given the strength of the economy, the need for urban regeneration based on market failures is likely to be much diminished.

As a result, it is recommended that any such schemes be targeted on a small number of town and urban black spots. In order to align the Schemes with economic and social objectives, priority should be given to urban areas identified as Gateways and Hubs in the National Spatial Strategy and to towns and cities that host RAPID areas.

There is also a need to ensure that future schemes lead to improved impacts, particularly on urban design. This would be encouraged through increasing the competitive nature of the schemes, by reducing the number of areas to benefit and granting scheme status to those that produce the best plans, that incorporate key objectives set for urban renewal, such as improvements to urban design. Greater competition could be introduced by signalling in advance a maximum number of areas/towns that would receive designation, and basing access to the Scheme on the basis of the best supported proposals that are made.

9. Conclusions and Recommendations

9.1 Conclusions

Cost to the Exchequer

It is estimated that the area-based tax incentive Schemes will cost the Exchequer €639 m in tax forgone in present value terms in respect of developments undertaken to end of 2004.

By the end of July 2006, when the Schemes are due to expire, it is predicted that the costs to the Exchequer will have risen to €1,933m. Almost 74 per cent of these anticipated costs will arise in respect of the Urban Renewal Scheme.

The major impact on the Exchequer is yet to come, as even those developments completed by end 2004 will give rise to claims for tax relief for a considerable future period.

These tax costs are high relative to the outputs achieved. For example, the present value of tax costs represent up to 43 per cent of the building cost associated with developments undertaken as part of the Schemes.

The Rural Renewal Scheme

Th Rural Renewal Scheme has delivered a modest increase in housing output and has improved the quality of the housing stock in the participating areas. Overall, it has had relatively little impact on industrial and commercial development and thus directly on economic activity. However, it has helped vitalise the towns of Longford and Leitrim, through both residential and commercial developments.

With regard to the housing output under the Scheme, it is evident that there is substantial dead-weight and a significant proportion of the output would have occurred in any event. A key objective of the Scheme was to support a reversal of the population decline in the participating areas. There is evidence that much of the housing output has been taken up by existing residents, further increasing the dead weight associated with the Scheme. As a result, the Scheme has not represented value for money. This has been exacerbated by the tendency, on the part of a significant minority of participants to build relatively large houses.

It is now evident that the very substantial increase in housing output has now resulted in excess supply and that house prices are softening and rents have declined.

A positive feature of the Scheme has been the large number of participants, and thus a reasonably widespread distribution of the tax benefits. However, the Scheme, in common with the other area based incentive, has fundamentally adverse equity impacts.

The Urban Renewal Scheme

The Urban Renewal Scheme has been successfully implemented, and it is anticipated that by mid July 2006 a very high proportion of developments earmarked for the designated sites will have been completed. The structures put in place, including the Integrated Area Plans, have been vital in matching development to local needs and priorities. Areas where resources were applied to managing and marketing the Scheme were particularly successful.

The Scheme has had very positive impacts on dereliction and has been reasonably successful in improving urban design. With regard to economic impacts, the Scheme has enhanced housing outputs in the target areas. This housing has been taken up and there is no evidence of excess supply. Moreover, the Scheme had a strong emphasis on commercial development and has delivered significant benefits in this area.

The Scheme has been less successful in delivering social and community benefits, as significant funding for initiatives in this area was not raised. Because of the heavy involvement of residential investors in the Scheme and the increased supply of rental properties, concerns have arisen that there have been negative impacts on social integration. This has arisen because rental properties have often attracted a transient population, with excessive dependency on occupation by social welfare recipients.

While dead-weight continues to be an aspect of all such schemes, there is evidence that the Urban Scheme kick started developments in a number of areas, and was crucial in focusing developments on inner city locations, that developers might normally have eschewed.

While the Scheme has proved extremely valuable, its very success, together with the strength of the economy and the increase in private capital, has reduced the need for it going forward. Dead weight is now relatively high at the level of the individual project.

The tax benefits of the Scheme have accrued to relatively few higher income individuals. There has also been significant inflation of property prices as a result of the tax incentives and this has benefited a small number of landowners and developers. Thus, the Scheme has had strong negative income distributional effects, although this is to some extent inevitable when only a small number of sites are tax designated.

The Town Renewal Scheme

The Town Renewal Scheme has been less successfully implemented than the Urban Renewal scheme. A large number of developments at designated sites remain to be commenced. In a significant proportion of towns only a minority of developments have been completed by end of 2004. That said, some towns have benefited enormously from the Scheme.

Where progress has been poor, this is largely a result of lack of interest on the part of developers and site owners. To some extent this lack of interest reflected a level of risk of investment in relatively small towns, which the tax incentives were

insufficient to offset. It was also the result of the fact that in many towns the designations provided largely for refurbishment of existing commercial property and this proved less attractive to developers than new build.

There is some evidence that the Town Renewal Scheme was not as well managed as the Urban Scheme. Local authority resources were often spread too thinly across a number of towns. Either the allocation of greater managerial resources or a limit on the number of towns included in the Scheme would have produced better outcomes.

The impact of the Scheme has thus been relatively patchy. Where the Scheme was successfully implemented the impacts would have been on a par with those of the Urban schemes. This was not the case for a significant minority of towns.

Where successfully implemented, given its emphasis on refurbishment, the Scheme had a strong impact on dereliction. Urban design issues featured less strongly than for the Urban Scheme, as did conservation. Because of the relatively low level of new build, economic impacts have not been to the fore. Community and social impacts were not really a feature of the Scheme, and there would not have been any real prospect of raising levies to fund initiatives in this area.

It must be recognised that there was substantial cross over in terms of scale between areas designated under the Urban and Town Schemes. Larger towns in the Town scheme that had a relatively high level of designation for new build tended to derive similar economic benefits as did their counterparts in the Urban Scheme.

With regard to dead weight, it would appear that this was lower for the Urban, as the higher risks in towns with lower populations made the tax incentives more crucial in the decision to develop a site.

Living over the Shop Scheme

The Living over the Shop Scheme, as with its predecessors, suffered from low levels of take up. This is a problem that is unlikely to be overcome, as the disruption to retail activities and the loss of storage space act as a deterrent to shopkeepers. Additionally, over the shop residences may not be very attractive to prospective tenants. Because of low take-up, the impacts of the Scheme on the urban environment has been limited. However, the Scheme has been more successful in some urban areas than others. The key factor appears to have been the application of resources to managing and marketing the Scheme.

9.2 Recommendations

It is recommended, subject to compliance with EU State Aids policies, that the expiry date for the current Schemes be extended to end 2007. This would solely be to facilitate the completion of developments that have been granted planning permission under the scheme, but where work has yet to commence.

Thereafter, the Rural Renewal Scheme should not be continued. It is not regarded as cost-effective approach to the problems of rural decline, and is not a model that should be employed elsewhere in the country.

As the Living over the Shop Scheme has a narrow focus on fostering a living urban environment, it should be retained, despite the difficulties with take-up. It is recommended that the tax incentives be made available contingent on a commitment of resources by local authorities to managing the process.

With regard to the Urban and Town Renewal Schemes, the scale of economic activity and the availability of capital have reduced the need for such Schemes. That said, it is recommended that Government retain tax incentivisation as a tool of policy, should economic conditions require further action to regenerate urban areas.

If Government chooses to reintroduce area based tax incentivisation in the post 2007 period, then it is recommended that changes to the structure of the schemes be implemented to reduce the cost to the Exchequer and their inequitable effects.

These changes include:

- Targeting the schemes in areas or towns for which there is evidence of development activity, but where problem sites, such as old dock lands and industrial sites, are being neglected;
- Giving priority to urban areas identified as Gateways and Hubs in the National Spatial Strategy and to towns and cities that host RAPID areas;
- Ensuring that adequate resources are applied to the management of the Schemes;
- Incorporating structures to share experience and promote good practice
- Introducing measures to control abuse of the Schemes;
- Ensuring that designated sites have a prospect of being serviced;
- Establishing the Scheme for a sufficient duration to allow developers to respond;
- Increasing the level of owner-occupation in the housing output mix;
- In order to incentivise the latter, granting 100 per cent relief to owner- occupiers over ten years and restricting the investor relief to 50 per cent; and
- Improving the equity and cost effectiveness of the Schemes by allowing the relief in relation to a proportion of expenditure only.

Appendix 1: Incidence of Tax Benefits

While the tax relief is paid to owner-occupiers or investors purchasing properties, all the benefits of the relief may not accrue to them. This is partly because builder/developers may have to raise property prices in order to obtain the resources to increase supply. The responsiveness of the supply of properties to price (the price elasticity of supply) encapsulates this effect. The responsiveness of supply is in turn determined by two factors:

Figure 1 encapsulates the situation, which may be taken as an illustration of the demand for and supply of housing in a particular location, such as a townland or urban area. In Figure 1A, the supply of properties is depicted by the curve SS1. Supply is relatively inelastic, so that substantial price increases are required to elicit modest supply changes. In this situation, when the demand for housing shifts (from D0D0 to D1D1) because of the availability of tax reliefs, prices rise sharply, and relatively few houses are built. Figure 1B depicts the opposite situation. Here small changes in price elicit substantial increases in supply, so that the rise in price is small in face of rising demand, and a larger number of houses are built. In Figure 1A, the bulk of the benefit of tax designation is garnered by the building industry in the form of rising prices, while in Figure 1B, purchasers of property gain.
The elasticity of supply is determined by:

- The availability of tax designated sites; and
- The extent to which there are unused or underused building resources (e.g. labour) that can be readily put to use to provide the increased supply.

If there are few tax-designated sites, then supply is relatively fixed, and the pressure of demand for these few sites will raise their price and thus the price of the property. While relatively few sites were designated under the Urban and Town Renewal Schemes, this was not true of the Rural Scheme. The whole of the counties of Leitrim and Longford and significant parts of Cavan, Roscommon and Sligo were designated. Therefore, site availability would not have been a factor in inhibiting supply.

The incidence of the Scheme benefits is determined not only by supply side conditions, but also by demand side. If demand is very sensitive to price, then the capacity of builder/developers to raise prices is limited, as potential purchasers will be deterred by the price increases. Again, the fact that in the Rural Renewal Scheme large areas were tax designated would have tended to increase the price elasticity of demand. Purchasers seeking properties in a particular townland or urban area would have a choice of locations, both within and without that area. This is illustrated by Figures 1A and 1B. In Figure 1A, the shape of the demand curve indicates that as prices rise, few purchasers will be deterred, while in Figure 1B, a small increase in price elicits a reduction in demand. The opposite would be true of the Urban and Town Schemes, where tax designated sites in any location would be few in number, increasing the insensitivity of demand to prices

The conclusion is that very different impacts on property prices may be expected from the Urban and Town Renewal Schemes on the one hand the and Rural Renewal Scheme on the other.

Over and Under Supply

New house building under the Schemes comprised both construction for owner-occupation by the site owner and speculative house building. When speculative house building takes place, speculative builders base their decisions as to the levels of output to provide on the demand they anticipate may arise in the future. If they get this decision wrong, then they provide too little or too much housing output, leading to either a softening or hardening of house prices. For example, figure 2A illustrates the situation where speculative builders believe that as a result of the tax reliefs available, the demand for housing will shift to D2D2, and they supply output of OQ2. In fact, only demand at the level of D1D1 arises, and housing output is excessive, so that the price falls from P0 to P2. Figure 2B illustrates the reverse situation, in which speculative builders underestimate the true level of demand and under supply the market, giving rise to price rises. Thus, it may be seen that the incidence of benefits under the scheme also depends on the behaviour of speculative builders in anticipating the market. Professional builders would have a wealth of experience in judging the market and therefore may avoid oversupplying the market. On the other hand private site owners developing houses would not have this experience and could contribute to oversupply in the market. Such private development was a feature of the Rural Renewal scheme but not the Urban or Town.

Figure 1A Inelastic Supply

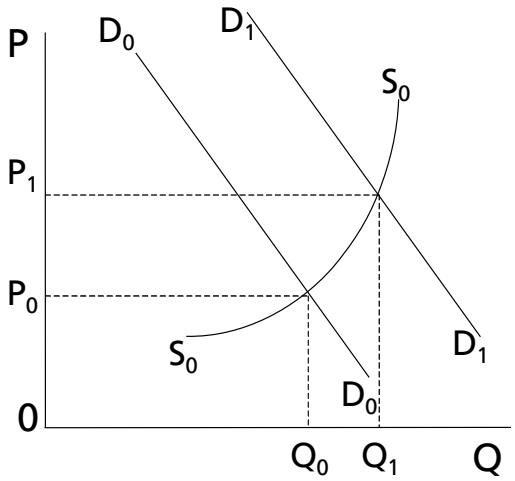


Figure 1B Elastic Supply

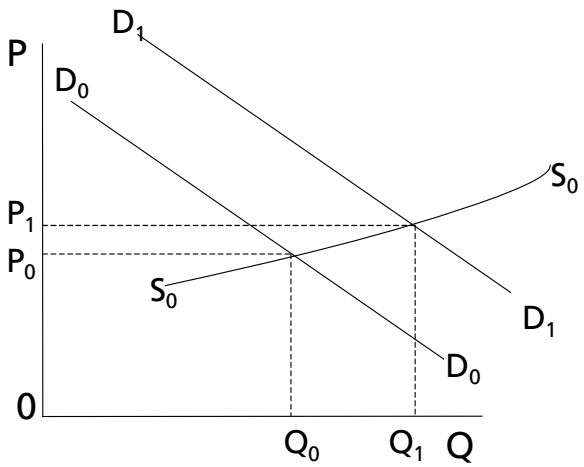


Figure 2A Excess Supply

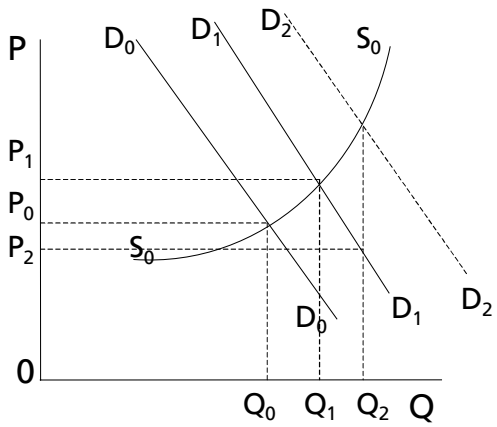
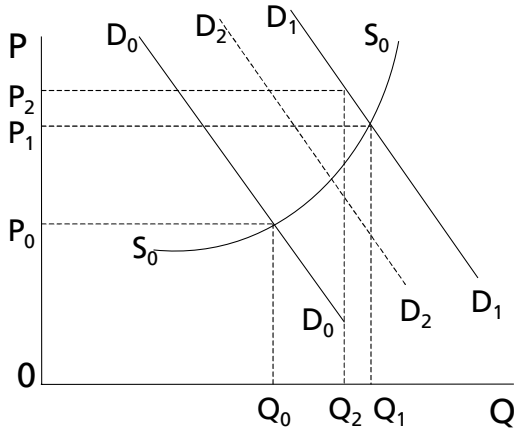


Figure 2B Insufficient Supply



Appendix 2: Methodology for Estimating Expenditure under the Rural Renewal Scheme

Introduction

The methodology employed consisted of a separate estimation of residential and commercial/industrial spending under the Scheme.

Estimating Residential Expenditure

Under the RRS, house owners and developers were required to obtain either a Certificate of Compliance or a Certificate of Reasonable Cost from the Building Grants Section of Department of the Environment and Local Government in Ballina.

A Certificate of Compliance is required where a newly constructed, refurbished or converted house is purchased from a builder. This certifies that the house complies with Department of the Environment construction standards, is within the specified floor space allowed under the scheme and, in the case of refurbishment, that the work was necessary to ensure the suitability of the house as a dwelling. A Certificate of Compliance is usually sought when the property is put up for sale. The Certificate of Compliance does not contain information on the price of the property or the cost of building.

A Certificate of Reasonable Cost is required where:

- A newly built house/flat is to be lived in or let by the person who built it, or had it built, or
- A refurbished or converted house/flat is lived in or let by the person who had it refurbished or converted.

Certificates of Reasonable Cost are generally issued to individuals building on their own site. The costs of the building are confirmed by a quantity surveyor. The certificate is issued following an inspection of the property in question. 4383 Certificates of Compliance and 961 Certificates of Reasonable Cost have been issued for developments under the Rural Renewal Scheme between 1999 and June 2005.

Sampling of Housing Certificates

While the Department was in a position to provide data on the number of certificates issued, no more detailed analysis was available. As a result, the consultants undertook a sample survey of Departmental files containing the certificates.

A stratified quota-based sampling frame was established of the certificate files maintained by the Department. The population of certificates was stratified by year and county, and a number of sample files was drawn for each year and county. A total sample of 300 files were surveyed, divided roughly equally between Certificates of Compliance and Certificates of Reasonable Cost.

The information collected from the sampled files was as follows:

- Address of the property;
- Type of build (New Construction/Conversion/Refurbishment);
- End use (Owner Occupied/ Rented);
- Floor Area of development;
- Whether the applicant is purchasing the property or having it built
- Number of units of accommodation being provided; and
- Estimated cost of development (Certs. of Reasonable Costs only)

Deriving an Estimate of Housing Expenditure

As noted above, the Certificate of Compliance does not contain data on the price or building costs associated with developments. It was thus necessary to derive a methodology for imputing such costs. The approach adopted was to use the data provided by the Certificates of Reasonable Cost to establish the relationship between cost of developments and their floor area as measured in square metres. As the square metres of Certificate of Compliance developments was known, their costs could be estimated.

A regression analysis was undertaken which related building costs to square metres for the Certificates of Reasonable Costs, with the following results:

Building cost = -23,866 + 823.9 Floor Area

This relationship fitted the data reasonably well and was judged to be a sound basis for cost estimation. However, it was also recognised that because developments under the Certificates of Compliance were purchased from a builder, there was a need to inflate the estimates to include the builder's margin. The latter was estimated from CSO statistics at 14 per cent of turnover.

Table A2.1 sets out the results. It shows that the average cost per housing unit developed under the Scheme was €94,499 for Certificates of Reasonable Cost and €86,978 for Certificates of Compliance.

Table A2.1: Average Cost per Housing Unit

Type of Certificate	Average Cost per Unit €
Certs of Compliance	86,978
Certs of Reasonable Cost	94,499

Source: Goodbody Economic Consultants Survey

These estimates were then applied to the total number of housing units developed under the Scheme (4535) to arrive at an estimate of total housing expenditure in the period 1999-2004. The total number of housing units was estimated by adding the

number of certificates of compliance (each of which relates to one housing unit) to the number of certificates of reasonable cost multiplied by the number of units per certificate (1.05 per certificate).

Estimating Commercial and Industrial Expenditure

The approach used to estimate residential expenditure was not available in respect of commercial and industrial expenditure, as a similar certification process was not involved. The approach adopted had two stages:

- Estimation of the number of commercial/industrial developments under the Scheme; and

- Application of an average expenditure per development.

In order to establish the number of commercial/industrial developments that might have benefited under the Scheme, the number of commercial/industrial developments and residential developments in the Scheme area for which planning permission was sought was first estimated, and the ratio of commercial/industrial to residential developments was established. It was then assumed that commercial/industrial developments would benefit from the Scheme in the ratio of the planning permissions sought. As the number of residential developments benefiting from the Scheme was known, the number of commercial developments could be inferred.

Based on these data, it was estimated based on an analysis of planning applications in Cavan and Sligo that commercial and industrial developments typically accounted for 6.5 per cent of total developments, or 7 per cent of the level of residential developments. It was estimated on this basis that 122 commercial/industrial developments benefited from the Scheme in the period 1999-2004. These developments were further broken down by type of build.

This was done on the basis of the survey of planning applications conducted in Sligo. The results are presented in Table A2.2, which indicates that 71 (58.2 per cent) of the 122 developments were new build only, 10 (8.2 per cent) were refurbishment/conversion only and 41 (33.6 per cent) were mixed new build and refurbishment/conversion.

Table A.2.2: Number of Commercial/Industrial Developments by Type of Build

Type of Build	Number of Developments	Proportion (%)
New Build Only	71	58.2
Refurbishment or Conversion Only	10	8.2
Combination of New Build and Refurbishment/Conversion	41	33.6
Total	122	100.0

Source: Goodbody Economic Consultants Estimate

Having estimated the number of commercial developments under the Scheme, the next step was to apply an average expenditure per development. There were no directly relevant data on the average expenditure per development. However, such data were available from the Town Renewal Scheme as set out in Table A2.3 below. This indicates a typical spend of €297,000 per development.

Table A2.3: Assumed Average Expenditure per Commercial/Industrial Development

Type of Build	Average Cost per Development €000
New Build Only	476.5
Refurbishment or Conversion Only	159.5
Combination of New Build and Refurbishment/Conversion	463.0
All	296.6

Source: Estimated from DOEHLG Town Renewal Scheme database

Appendix 3: Estimating Gross Costs and Tax Costs

Introduction

This section details how the URS and TRS's gross costs are broken down into the various types of qualifying categories of reliefs. It then goes on to explain how estimates of tax forgone are arrived at. The source databases from DOEHLG are similar for both schemes which allows the same steps to be followed.

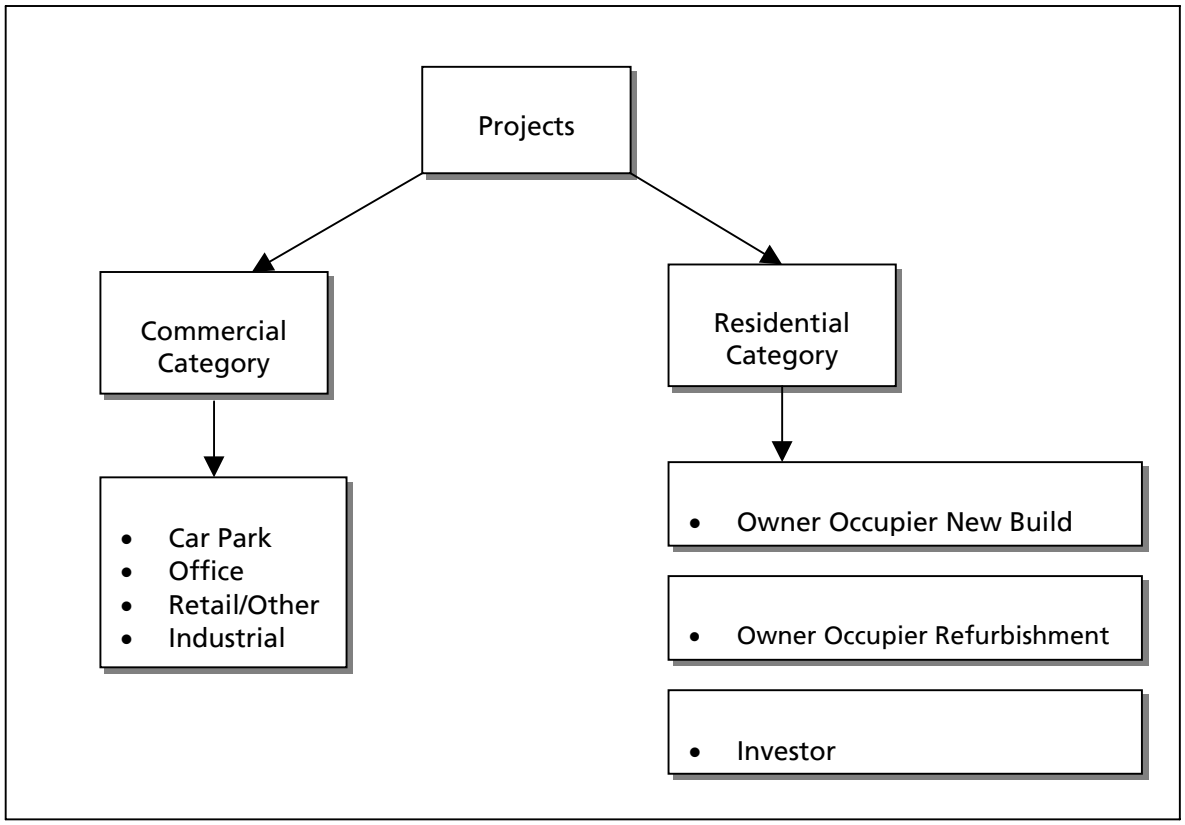
Given that there was no comparable DOEHLG database for the RRS scheme the relevant costs data was sourced from sampling planning applications in the relevant areas and costs were not estimated as described in this section (see Appendix 2 for more details). However, tax forgone was calculated as described in this section.

Estimating Gross Costs, Residential Unit and Commercial Square Metres

In order to (a) break down the gross build costs and (b) allocate build costs across the various types of qualifying expenditure the following steps were taken.

Step 1: The Classification System

The classification system used mirrored that used by the DOEHLG, as shown below.



The source data from DOEHLG noted projects as follows:

- 100 per cent commercial;
- 100 per cent residential; and
- or mixed use as indicated by the percentage mix between commercial and residential use.

This database, in most cases, also give further details on the sub-categorisation of projects breaking them into:

- Commercial car parks;
- Commercial office;
- Commercial retail/other;
- Industrial;
- Residential owner occupier refurbished;
- Residential owner occupier new build;
- Residential investor refurbishment; and
- Residential investor new build.

This classification information was used in disaggregating build costs into the various categories of qualifying reliefs.

Please note that residential output counted in actual units where as the commercial output is measured in floor space as this is how the market tends to value these outputs.

Step 2: Exclusions

For each project, the gross build cost was first taken from the Department's database and we then took account of exclusions which could arise for four reasons, each impacting on the project and its build costs in different ways:

- General Exclusions arising when a project did not take place and will not take place. In this case the project's build costs is excluded from further analysis;
- Timing Exclusions arising when only a portion of a project will take place within the scheme's qualifying timeframe. In this case the relevant exclusion value is taken from the project's total build cost and all subsequent disaggregated figures relating to that project are adjusted proportionately;

- Commercial/Residential Exclusions arising when either a commercial or a Commercial/Residential Exclusions arising when either a commercial or a residential element of a mixed use project is excluded as the site on which that project took place only qualifies for relief for one type of use (not both). In this case only the excluded component's costs are affected, with the cost of the eligible component unadjusted; and

- Other Exclusion arising when a particular commercial or residential sub-categorisation of use is ineligible for tax relief, in which case only the affected cost is excluded and the remaining costs are unaffected as they still qualify for relief.

Allowing for exclusions gives a net qualifying cost for each project.

When the as costs were adjusted for exclusions the relative number of so was the number of residential units and the commercial floor space were also amended.

By way of explanation, information on exclusions was sourced from individual local authorities either by the DOEHLG or by the Review team with an emphasis placed on areas with a lot of activity under the schemes and also on large projects in other areas. For example, for all URS projects in planning with a build costs over €5m the relevant local authority was contacted for further details. This process was assisted by an analysis of all projects against the relevant statutory instrument giving effect to the renewal schemes to highlights those with sub-components in conflict with the relevant designation.

Step 3: Allocating Net Costs, Residential Units and Commercial Floor Space Across Sub-Categories

For each scheme, the total expenditure on residential developments was arrived at by multiplying each project's net build cost by the stated percentage of that project given over to residential purposes. The process was repeated, for each individual project, to establish the total expenditure on commercial developments.

Gaps or missing data for projects in the TRS and URS databases were addressed as follows:

- For projects with missing data on build cost but with indicative information on the project's floor space a build costs was established by multiplying the square metreage by the average costs per square metre for projects in that town. This adjustment mainly arose on the TRS scheme;

- For projects with missing data on floor space but with cost information, the square metreage was established by dividing build costs by the average cost per square metre for that town. Again, this adjustment mainly arose on the TRS scheme; and

- Where a project's percentage mix between commercial and residential use was not provided the average mix for that town was applied. This adjustment affected both schemes.

Then, for both TRS and URS all qualifying expenditure falling under the commercial heading was put into one group as the available tax reliefs are homogenous across building uses and ownership types.

The same project-by-project process was followed in determining total residential build costs. However, a further sub-categorisation was needed as the tax reliefs differ depending on the type of ownership and whether or not the qualifying expenditure relates to refurbishment or new builds. For example, owner-occupiers of new build residential units are entitled to 50 per cent relief whereas investors get 100 per cent relief. In the case of residential refurbishments both owner-occupiers and investors are entitled to 100 per cent relief but over differing time periods. The calculation of reliefs or tax forgone is explained in S.

For each individual project residential build costs were disaggregated in to sub-headings by dividing the total residential expenditure by the sub-categorisation of uses indicated in the databases for that project. For example, if the data indicated that a project's residential elements related to owner occupier new build and owner occupier refurbishment then total residential expenditure was divided in two and so on.

In a few limited cases projects did not have information on use within the residential heading. When this problem arose it was addressed in one of two ways:

- When the affected expenditure was €100,000 or less it was assumed to related to owner occupier refurbishments; and

- When the affected expenditure was greater than €100,000 it was placed in a balancing column and then reallocating across the residential sub-categorises based on the use pattern for the town/urban areas in which the project was located.

Lastly, owning to differing interpretations of the term car park by local authorities the Steering Group directed that the each project's expenditure on car parks be reallocated across the residential and commercial headings based on the stated use mix. It appears that some local authorities misclassified non-commercial car parks attached to residential developments as commercial car parks and this adjustment attempted to correct for this.

Residential and commercial outputs were disaggregated in the same was as costs.

Step 4: Differentiating by Projects' Development Status

Once expenditure was apportioned over the different types the next stage was to sort the projects into those classified as:

- Completed

- Work-in-progress

- In planning.

This was done to enable the Review team to clarify the costs associated with completed projects as against those in progress and those in planning. The case studies highlighted that the build costs indicated in the database may be an overestimated of the actual build costs as applicants incorrectly in included sites and other non-build costs in with build costs either in error or, in the case of the URS, to ensure that the complied with the condition that 15 per cent of costs had to be incurred by mid-2003.

This step also allows the Review team to focus on the projects still in planning in order to model different completion rates to reflect the reality that not all the projects will be delivered within the qualifying timeframe.

Estimating Tax Forgone

The cost data and output data are key parts of the analysis. However, due to the ways in which tax reliefs are calculated data on sale prices and site costs are also needed. We start by explaining by the reliefs are determined.

Step 1: Residential Units - Working Out the Gross Tax Relief

Purchased from a Developer/Builder
Where a newly constructed property is purchased from a developer or a builder the value of the gross tax break to the purchaser is calculated as follows:

Price paid to developer or builder * A / (B + C)

Where:
A = Qualifying construction expenditure incurred in the relevant period

B = Total construction expenditure on that property

C = Expenditure on acquisition of the site.

In the case of refurbished properties, A and B represent the refurbishment costs with C being the costs of the building inclusive of the site before refurbishment.

Purchased from a Non-Developer/Non-Builder
Where the property is purchased from a person not carrying on the trade of a builder or is not a developer then the build costs will normally equal the gross tax relief as gross relief is the lower of:

- The direct cost of construction, excluding site costs and costs attributable to the purchase of the site, or

- The amount produced by the above formula.

In a property market with rising prices the direct construction costs will be the lower of the two (i.e. the formula will not apply).

Own Account
Where an individual engages a builder to construct a residential unit on his or her own behalf all that qualifies for gross relief is the amount charged by the builder; site costs are not eligible for relief and the formula does not apply.

Given that the purchase price and site costs are required to calculate the gross relief when the formula applies this data had to be derived.

Data on the price of an average residential unit was established from DOEHLG data (a) weighted to reflect the location of the developments under schemes and (b) weighted to account for the fact that most of the developments under each scheme take place towards the end of the scheme's life.

Contacts with the IAVI revealed that, in general, site costs work out at between 65 per cent and 75 per cent of a project's build costs. Hence, as a rule of thumb site costs were set a 70 per cent per cent of build costs (with some exceptions).

Once this data was established the Review team was in a position to estimate gross tax relief attached to residential units.

Step 2: Commercial Floor Space - Working Out the Gross Tax Relief

Purchased from a Developer/Builder
As per a residential unit, the formula is applied in working out the tax relief.

Purchased from a Non-builder/Non-developer
Again, if a commercial property is purchased from a non-builder/non-developer the value of the gross tax break is the lower of:

- The direct cost of construction, excluding site costs and costs attributable to the purchase of the site, or

- The amount produced by the above formula

In a property market with rising prices the construction costs will be the lower of the two (again, the formula will not apply).

Own Account
Where an individual or company engages a builder to construct a commercial unit on their behalf all that qualifies for gross relief is the amount charged by the builder; site costs are not eligible for relief and the formula does not apply.

Step 3: Residential Units - Working Out the Net Tax Relief
To move from a gross tax relief figure to net tax relief one must apply a marginal tax rate to the gross tax relief. On the basis that residential units are owned by individual:

- For owner occupiers two rates could apply; 25 per cent (the standard rate plus PRSI and levies) or 47 per cent (the higher rate plus PRSI and levies). As the amount of relief these owner can claim each year is set in legislation there is not issue regarding roll-over; and

- It is assumed that all investor obtain relief at 47 per cent. However, we have to modify this marginal rate to better reflect the fact that net relief carried forward does not attach to PRSI and levies, lowering the marginal rate to 42 per cent. On the basis that investors exhaust the tax relief over four years the relevant marginal rate is 47 per cent in year one and 42 per cent in years two, three and four. This gives an average marginal rate of 43.25 per cent over the four years.

Step 4: Commercial Units/Floor Space - Working Out the Net Tax Relief
The move from gross tax relief to net relief with regard to commercial projects is more straightforward as it can be assumed that those individuals who own commercial units are top rate tax payers (47 per cent - the higher rate plus PRSI and levies) and there is no issue about roll-over as the relief is given by way of capital allowance.

The calculations have also allowed for ownership of commercial units by companies with the split set at 90 per cent owned by individual and 10 per cent owned by companies. The logic behind the low ownership rate by companies is that it is tax inefficient to claim at 12.5 per cent of gross costs when 47 per cent of gross costs is available.

Step 5: Discounting to Net Present Values
The last step in arriving at net tax forgone is to calculate present values.

The Discount Rate
The Review team took a 5 per cent discount rate to reflect that the relief is a fixed values but it has to be exhausted over a period of years, reducing its value today.

Residential Timing
As per the schemes' rules owner occupiers must take the relief over 10 years. Investors do not operate to this time constraint and in practice tend to consume the tax relief over a much shorter period, believed to be 4 years.

Commercial Timing
14 years is used is discounting the net commercial tax relief as the capital allowance rate is up to 50 per cent in the first year of use and 4 per cent p.a. there after up to 100 per cent of eligible costs/relief.

Budget 2006:

Review of Tax Schemes

Volume I:

Indecon Review of
Property-based Tax Incentive Schemes

Department of Finance
February 2006

Introductory Note

A major review of existing tax incentive schemes was undertaken in 2005, on foot of the announcement by the Minister for Finance, Mr Brian Cowen T.D., to this effect in Budget 2005.

The review process involved internal reviews conducted by officials in the Department of Finance and the Office of the Revenue Commissioners, as well as reviews of certain schemes by external consultants. Indecon International Economic Consultants were retained in April 2005 to conduct a detailed review of certain sectoral property-based tax incentive schemes.

Indecon submitted their report on 17 October 2005. The full text of the Indecon report is reproduced in this volume, which is Volume I of the series. The review of area-based tax incentive renewal schemes, conducted by Goodbody Economic Consultants, is set out in Volume II. Volume III reproduces the finalised reports of the internal reviews.

Department of Finance
February 2006

Indecon Review of Property-based Tax Incentive Schemes

Report for the

Department of Finance

Prepared by

Indecon

17th October 2005

Contents

Page

Contents

Page

Contents

Contents

Contents

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Tables & Figures

Page

Executive Summary

Introduction and Background

Indecon International Economic Consultants were appointed by the Department of Finance to conduct an independent review of certain property-based tax incentive schemes in operation in Ireland. This report examines each of the tax incentive schemes, evaluates the success of these schemes in terms of their economic impact and provides recommendations on policy options for the Government. The main findings of this study are summarised in this Executive Summary.

Our Approach to the Review

Our approach to this study has been to evaluate the contribution that each tax incentive scheme has made to its sector by use of a cost-benefit analysis. We examine the total capital expenditure under each scheme and the associated cost to the Exchequer and economic benefits. The study also identifies changes which could be considered to the ongoing schemes and, should it arise, in any new tax-based incentive schemes. Major information deficiencies existed in relation to many of the schemes. These have been addressed by Indecon as part of this study by utilising extensive new survey evidence and other rigorous approaches. For the first time, detailed estimates of the costs of these schemes have been prepared. In general the estimated costs relate to projects undertaken over a five year period except in the case of more recent schemes.

In our estimates of tax costs we take account of the fact that allowances are claimed over time and allowances on capital expenditure incurred will arise only when the allowances are claimed. Future estimates of allowances are therefore included in our estimate and an NPV based on discounted values at 5% per annum is utilised. While there is uncertainty concerning future take-up in some sectors, this does not, in general, impact on the cost-benefit ratios or on the merits of continuing or ending the incentives.

Review of Construction Sector

We have presented an analysis of the importance of the construction sector to the Irish economy. It accounts for over 19% of GDP and nearly 16% of employment. There has been an increase in construction activity over the past number of years, and while an immediate cessation of all the property tax incentive schemes would , on its own, not cause a decline in the sector, it could contribute to an acceleration of any decline. While the property-based tax incentives have led to increases in site prices and financial returns to promoters, they have also resulted in significant increased investment in projects. Indecon believes that the timing of changes to these schemes may have important implications for inflationary pressures in the construction sector.

Review of Capital Allowances for Hotels and Holiday Camps

The hotel sector has experienced considerable growth since the introduction of the tax incentive, with a large increase in the number of rooms available. This has been accompanied by a renewal and modernisation of hotel accommodation and an increase in the average size of hotels. Since 2000, however, there has been a fall in utilization rates. The existence of the tax incentive has improved both the quality and quantity of supply and the levels of investment experienced since 1997 would not have occurred in the absence of the incentive. The incentive has also increased site prices and construction costs. In total, the level of capital investment associated with

projects availing of this incentive has amounted to €664m and the gross Exchequer costs are estimated to be €196m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight. Future significant capital expenditure of €651m to €1,302m is predicted under this scheme.

Hotels & Holiday Camps: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	664
Gross Tax Costs of Allowances	- 196
Indirect Exchequer Tax Revenues	71
Economic Benefit	42
Net Tax Foregone	-125
Capital Expenditure on likely Future Projects	651 - 1,302

Review of Capital Allowances for Registered Holiday Cottages

The tax incentive for holiday cottages has had a lower level of uptake than the hotel scheme. However, the existence of the incentive had a large positive impact on supply in the sector. The significant increase in supply of holiday cottages would not have occurred in the absence of the incentive. There is evidence of emerging oversupply in the sector and capital spend on projects which have proceeded amounted to €103m with an estimate of future spend of €38m. We estimate the gross net cost of the tax incentive to the Exchequer, in terms of tax revenue foregone, to be of the order of €38 million. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight.

Group-Registered Holiday Cottages: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	103
Gross Tax Costs of Allowances	- 38
Indirect Exchequer Tax Revenues	11
Economic Benefit	6
Net Tax Foregone	- 27
Capital Expenditure on likely Future Projects	38

Review of Capital Allowances for Private Hospitals

While there has not yet been a high level of investment in private hospitals under the tax incentive scheme for this sector, there are plans for a large number of these facilities coming online. Existing investment would not have occurred in the absence of the tax incentive. There is still a significant shortage of beds in the combined public and private health sector and the incentives have the potential to contribute to the challenges facing the health sector. We estimate capital expenditure on current projects of €154 million with future spend likely of the order of €454m. The gross Exchequer costs are estimated at €37m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight.

Private Hospitals: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	154
Gross Tax Costs of Allowances	- 37
Indirect Exchequer Tax Revenues	14
Economic Benefit	29
Net Tax Foregone	- 23
Capital Expenditure on likely Future Projects	454

Review of Capital Allowances for Sports Injury Clinics

There is limited data available on investment in sports injury clinics and very little uptake of the incentives. Most operators either did not know about the existence of the incentive or were unsure of its details. The existing incentives do not address any causes of market failure and if utilised would be likely to be characterised by high levels of deadweight.

Review of Capital Allowances for Nursing Homes

Our analysis of nursing homes indicates that there are high levels of regional heterogeneity in the supply of beds, as well as in costs and average occupancy rate. Operators in this sector, as well as others consulted, widely believe that the tax incentive has been effective in increasing the level of supply of nursing home spaces and that this increase would not have occurred in the absence of the incentive. There is still a significant shortage in supply of nursing home spaces. The weekly cost of places has increased over the last few years. Capital investment is estimated to have been €171 million and our estimate for future capital investment is €30m. We estimate the gross cost of this incentive scheme to the Exchequer to be of the order of €55 million. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight.

Nursing Homes: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	171
Gross Tax Costs of Allowances	- 55
Indirect Exchequer Tax Revenues	16
Economic Benefit	43
Net Tax Foregone	- 38
Capital Expenditure on likely Future Projects	30

Review of Capital Allowances for Third Level Educational Buildings

There is broad support for the tax incentive for third level educational buildings among institutions that have benefited from it, although many indicated a preference for public expenditure alternatives. Indecon's analysis indicates that the incentive has facilitated investment in research and led to the development of new R&D facilities as well as an improvement in existing ones. Much of the recent investment in third level educational buildings would either not have gone ahead in the absence of the tax incentive or would have taken longer to come on-line. The incentive however represents a very expensive form of borrowing for the state and much lower cost public expenditure options are available. There is a need for on-going investment in the third level sector. Estimated capital expenditure on projects is estimated to be €348m with a gross Exchequer cost of €87m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight.

Third level Educational Buildings: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	348
Gross Tax Costs of Allowances	- 87
Indirect Exchequer Tax Revenues	34
Economic Benefit *	22
Net Tax Foregone	- 54
Capital Expenditure on likely Future Projects	79

** Refers only to macroeconomic benefit and not the impact of the spend*

Review of Section 23 Relief for Student Accommodation

Since the creation of the tax incentive for student accommodation in 1999, 15,000 new student bedspaces have been created. The extent of investment in this sector has transformed the availability of high quality student accommodation. This has occurred at time of significant improvements in the wider stock of private rented accommodation. Estimated capital spend is €510m and the gross Exchequer costs are estimated to be €214m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight. We estimate capital spend on likely future projects to be €936m.

Student Accommodation: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	510
Gross Tax Costs of Allowances	- 214
Indirect Exchequer Tax Revenues	55
Economic Benefit	32
Net Tax Foregone	- 159
Capital Expenditure on likely Future Projects	936

Review of Capital Allowances for Childcare Facilities

There has been a significant increase in the number places in the childcare sector over recent years. However supply has not been sufficient to meet the growth in demand and childcare costs have increased significantly. The market for childcare facilities is characterised by a significant supply shortage. Most of the recent investment in childcare facilities either would not have proceeded in the absence of the tax incentive or would have taken longer to complete. We have estimated capital expenditure of €31 million with estimate of capital expenditure on future projects of €21m. The gross Exchequer costs have amounted to €9m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight.

Childcare Facilities: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	31
Gross Tax Costs of Allowances	- 9
Indirect Exchequer Tax Revenues	3
Economic Benefit	8
Net Tax Foregone	- 6
Capital Expenditure on likely Future Projects	21

Review of Capital Allowances and Other Reliefs for Park & Ride Facilities

There has been a limited uptake of the tax incentive for park and ride facilities since the creation of the scheme. Only 2 schemes have gone ahead since 1999. There is currently a significant shortage of park and ride facilities and these have significant economic benefits in terms of reduced congestion costs. We estimate capital spend of €16m and spend on future projects of €25m. The gross Exchequer costs of projects are estimated to be €5.8m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight.

Park & Ride Facilities: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	16
Gross Tax Costs of Allowances	- 6
Indirect Exchequer Tax Revenues	2
Economic Benefit	2
Net Tax Foregone	- 4
Capital Expenditure on likely Future Projects	25

Review of Capital Allowances for Investment in Multi-storey Car Parks

Available evidence on the tax incentive for multi-storey car parks indicates that there has been a high level of uptake on the scheme. The incentive has been successful in increasing the supply of multi-storey car-parks but we do not see an economic case for government intervention in this sector. Capital spend on projects which have proceeded is estimated to be €61m at a gross Exchequer cost of €23m. The Indirect Exchequer Tax Revenues and the Net Tax Foregone estimates are adjusted for opportunity cost and deadweight. Future spend is estimated to be €13m.

Multi-Storey Car Parks: Summary of Indecon Estimates

Estimate	€ million
Capital Expenditure on Projects that have Proceeded	61
Gross Tax Costs of Allowances	- 23
Indirect Exchequer Tax Revenues	6
Economic Benefit	4
Net Tax Foregone	- 17
Capital Expenditure on likely Future Projects	13

Review of Relief for the Refurbishment of Certain Rented Residential Properties

Indecon also reviewed the property-based tax incentive on certain types of rented residential accommodation. There is very little awareness regarding the availability of these incentives and we believe usage has been very limited.

High Income Earners

Our analysis indicates that nearly all of the property tax incentives reviewed have been used primarily by high income earners. Structural features of the incentives including the restriction to rental income have had the unintended impact of facilitating this outcome. There is no doubt that the incentives have been a key mechanism for high income earners to reduce their tax liabilities. An assessment of the extent to which the individual tax allowances have been claimed by high earners is examined in the individual chapters dealing with each of the incentives.

Recommendations

Our general recommendations, applicable across all incentive schemes, are contained in the table overleaf.

General Recommendations on Property-based Tax Incentive Schemes

1. All tax incentives schemes should require full disclosures of key information to the Exchequer by investors/promoters via a certification scheme or other mechanism to enable the full cost and impact of the schemes to be monitored.
2. The decision to introduce any new tax incentives should be informed by a formal assessment of the likely costs and benefits.
3. Where there is justification for government incentives the option of direct public expenditure as an alternative to tax incentives should be considered.
4. Any tax incentive schemes which are introduced should have a defined lifespan of a maximum of 3 years and extensions should only be considered after evaluation of the results of a formal cost-benefit appraisal.
5. Developers/investors in any tax incentive scheme should be responsible for securing independent certification that the conditions of the schemes have been met.
6. On equity and cost efficiency grounds restrictions on capital allowances which focus exclusively on shelters on rental income rather than on personal income should be refocused.
7. Consideration should be given to introducing a cap on total annual allowances which can be claimed by any individual.
8. Differential allowances in any tax incentive scheme should be introduced depending on whether these allowances are being claimed at corporate or personal tax rates.

Indecon has also made recommendations specific to each incentive scheme. Our specific recommendations are contained in the table overleaf. In many cases while the schemes have had a benefit our analysis suggests they have served their purpose and there is absolutely no case for future government incentives. Continuing to approve new projects would contribute to oversupply and represent a clear waste of scarce public resources.

In a number of cases on-going government support for the activity is needed (for example in case of third level buildings) but the tax incentives are an extremely high cost and wasteful mechanism to achieve the objectives. In a limited number of cases (hospitals, nursing homes and childcare facilities) increased private sector investment is needed to address the economic and social needs in these sectors and would reduce demands on the public sector and have significant economic benefits.

For the incentives which we believe should not continue there is an important issue of the timing of projects which have already secured approval. We see little or no merit in requiring all of these projects to be completed in a very short timeframe. Such an approach would damage the construction sector and increase inflationary pressures. Permitting a much longer timeframe with an associated adjustment in allowable capital expenditure could reduce Exchequer costs and have other economic efficiency benefits.

Specific Recommendations for each Property-based Tax Incentive Scheme

1. There should be no further extension of capital allowances for hotels and holiday camps for projects which have not lodged a full and valid planning application before 31 December 2004.
2. There should be no further extension of capital allowances for registered holiday cottages which have not lodged a full and valid planning application before 31 December 2004.
3. The capital allowances scheme for sports injury clinics should be ended with immediate effect at the earliest feasible date.
4. There should be no extension of the capital allowances for third level education buildings for projects which have not secured Ministerial certificate of approval.
5. Additional public expenditure resources for third level education buildings should be provided.
6. There should be no extension of the capital allowances for student accommodation for projects which had not lodged full planning applications by December 2004.
7. The tax relief to lessors in respect of the expenditure incurred on the refurbishment of certain rented residential accommodation should be ended with immediate effect.
8. There should be no further extension to the capital allowances for investment in multi-storey car parks for projects which had not incurred at least 15 per cent of costs by 30 September 2003.
9. The capital allowance scheme for associated commercial or residential investments with park and ride facilities should be ended with immediate effect. We would support continuation of the incentive for specific investment in park and ride facilities.
10. Public expenditure to support park and ride facilities should be provided.
11. Capital allowances for childcare facilities should continue subject to certain amendments.
12. Capital allowances for private hospitals should continue subject to certain amendments.
13. Capital allowances for private nursing homes should continue subject to certain amendments.
14. For projects under the hotel, holiday cottages, third level buildings, student accommodation and multi-storey car parks, which have already met the requirements for planning and/or Ministerial or other approvals a five year extension to the timescale for completion of the projects should be introduced but the level of all capital allowances claimed should be restricted to 50%.

1 Introduction and Background

Indecon International Economic Consultants have been appointed by the Department of Finance to conduct an independent review of certain property-based tax incentive schemes in operation in Ireland.

This report examines each of the tax incentive schemes, evaluate the success of these schemes in terms of their economic impact and provide recommendations on policy options for the Government. We outline our approach to the review in more detail later in this section.

1.1 Background to the Review

In his Budget 2005 statement on 1 December 2004, the Minister for Finance announced that the Department of Finance and the Office of the Revenue Commissioners will undertake a detailed review of certain tax incentive schemes and tax exemptions in 2005.

As outlined in the Budget Summary, this review is to evaluate the impact and operation of certain incentive schemes including their economic benefits for the sectors involved and to the wider community. In addition, this review examines the degree to which these schemes allow high-income individuals to reduce their tax liabilities.

This study involves a review of certain property-based tax incentive schemes. The schemes which are covered are:

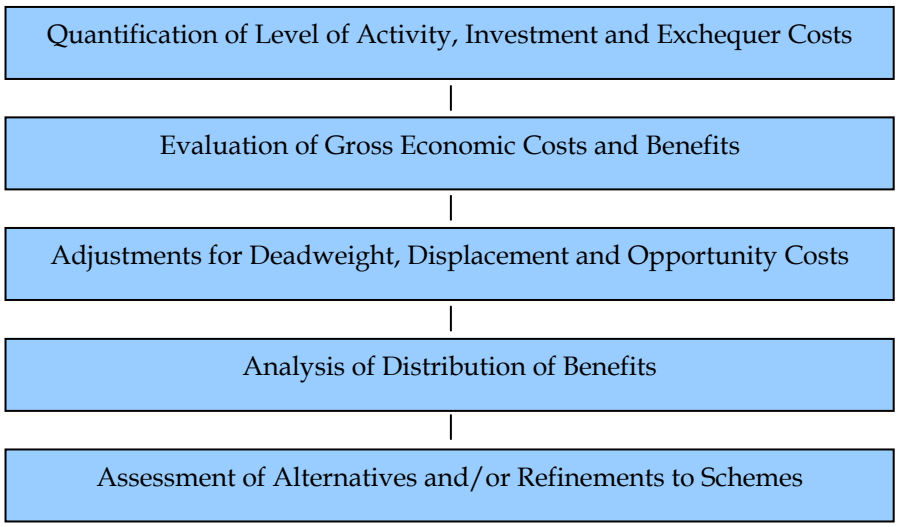
- Capital allowances for hotels (accelerated 7 year scheme);
- Capital allowances for holiday cottages;
- Capital allowances for private hospitals (including day hospitals);
- Capital allowances for sports injury clinics;
- Capital allowances for nursing homes (including convalescent facilities and associated residential units);
- Capital allowances for third level educational buildings;
- 'Section 23' type relief for student accommodation;
- Capital allowances for childcare facilities;
- Capital allowances and other reliefs for Park and Ride facilities;
- Capital allowances for investment in Multi Storey Car Parks; and
- Relief for the refurbishment of certain rented residential properties (Countrywide Refurbishment Scheme).

1.2 Overview of Our Approach

Our approach to this study involves an examination of each of the schemes and an assessment of the extent to which the schemes have justified their introduction and the contribution that each relief has made and can make to the wider policy objectives of the sector in which the relief applies. We rigorously establish and assess the costs and benefits of each scheme through a formal cost/benefit analysis. We also implicitly consider whether the schemes have served their purpose and significantly whether any structural features of the incentives have presented non high income tax payers from benefiting from the incentives. The study also examines, where appropriate, the potential impact on the effectiveness of the schemes if additional restrictions had applied that limited the extent to which high income individuals could use these reliefs to reduce their tax liability. Indecon believes that if it is deemed that continuation of any of the schemes is justified it may also be useful to consider other potential modifications to the schemes to reduce deadweight or Exchequer costs. The study also identifies changes which could be considered to the ongoing schemes and, should it arise, in any new tax-based incentive schemes targeted at specific objectives, bearing in mind changes in economic and other circumstances, the need to ensure effectiveness and value for money and the balance within the tax system. EU State aid policy is also implicitly considered in this respect where necessary.

Our approach involved five main areas of focus as presented in Figure 1.1.

Figure 1.1: Main Areas of Focus



As part of the review of the property-based tax incentives, we surveyed Local Authorities on the number of panning applications and other aspects in relation to the incentive schemes. Completed responses were received from all Local Authorities. We also received completed responses from 5 Financial Institutions, 226 Auctioneers, and 6 Accountancy/Tax practices. In a number of cases views by the sector or by professionals are provided based on their judgment and experience and there is therefore some uncertainty re specific details. We also secured exceptionally high co-operation from individual operators in each of the sectors examined. This included completed detailed survey responses from 156 hotels, 13 holiday cottages, 66 nursing homes, 11 third level institutions and 90 childcare providers. We also received significant inputs and assistance from the regional boards within the Health Services Executive and also co-operation from a major private hospital operator.

We have also undertaken case studies of tax incentives for each sector which are presented in the relevant individual sections and are designed to illustrate how the tax incentives operate and the financing structures which apply. They are in particular focused on the impact of the incentives for investors. In the case studies we assume that a Cash Flow to Equity model is used to compute an Incentive Ratio. This ratio measures the relationship between the present value of the cash flow to equity holders (after repayment of all debt) relative to the construction cost of a project.

In each case study, the Incentive Ratio is compared with the present value of the tax incentive. In practice, optimal utilization of the incentives requires elaborate financial structures and the rationale for these structures is evaluated in Annex 1. We do not see the issue of the specific financial structures being utilised as in any sense a problem as investors will understandably seek to utilise the most effective tax structure. There is however an issue for the Exchequer in terms of differential levels of allowances depending on what tax rate is used to claim the allowances.

1.3 Brief Discussion of Concepts Underpinning the Review

The fact that a sector is economically important does not justify tax incentives. Neither does the fact that the economic benefits exceed the economic costs of the investment. The justification for tax incentives should be based on the identification of market failure. (The potential ranges of market failure are discussed below and include estimates which could, inter alia, include a shift in demands from the Exchequer and other potential benefits of the incentives.) We also discussed the concepts of deadweight, displacement opportunity costs and multiplier effects which we use in our evaluation in subsequent sections of this report.

1.3.1 Market Failure

The concept of 'market failure' is the appropriate economic justification for Government intervention in various markets. It occurs when markets are not optimally efficient.

Perfectly competitive markets display the following characteristics:

- Buyers and sellers have perfect information;
- There are no barriers to entry and;
- Firms are price-takers.

When a market is perfectly competitive, the price will be equal to marginal cost ('allocative efficiency') and production will occur at minimum average cost ('productive efficiency'). There will be no excess profits and the market will function optimally for consumers by delivering the highest possible output at economic cost.

In practice, however, markets are not always perfectly competitive and may not, therefore, be characterised by these factors. 'Market failure' occurs when one or more of the assumptions outlined above do not hold or where economic externalities exist. The existence of such cases means that non-optimal outcomes occur and markets do not function at optimal efficiently. The existence of market failure serves as a basis for why governments and other institutions (such as regulators) should intervene in some markets. Their role is to identify and address the sources of market failure and take appropriate corrective action to help the market function effectively.

The main sources of market failure encountered in practice are as follows:

- Asymmetric information;
- Unaligned incentives;
- Externalities;
- Public goods;
- Merit goods;
- Market power.

Asymmetric information occurs in markets where one party (buyers or sellers) has more information than the other party. A potential adverse consequence of asymmetric information is that too much low quality output or too little high quality output may be produced.

Unaligned incentives may be related to asymmetric information insofar as the interests of buyers and sellers, and other parties, such as, for example, regulators, are out of line with each other. This may result in too few of the good or service being produced, in the absence of Government intervention.

An **externality** arises when the costs or benefits of a good or service are not fully reflected in the market price of the good or service. Negative externalities are generally more noticeable than positive externalities and arise when the private cost of production is less than the social cost. In contrast, a positive externality occurs when the marginal private benefit of the good or service is less than the marginal social benefit. In the absence of Government intervention or regulation, this particular kind of market failure may result in too little of the good or service being produced relative to the socially optimal level.

A **public good** is one that can be consumed by everybody in a society, regardless of whether they pay for them or not. Most goods and services are 'private goods' – we have to pay for them and one person's consumption may limit another's consumption of the good or service. On the other hand, 'public goods' are non-rivalrous (i.e. one person consuming them does not necessarily stop another person's consumption) and non-excludable (i.e. it is not possible to prevent non-payers from consuming them). The combination of these two characteristics makes it difficult for producers to charge for these goods, so their markets are usually characterised by Government provision.

Merit goods are very similar to public goods – they satisfy the two properties of non-rival and non-excludable but not fully. They are goods with positive externalities that governments believe the consumer undervalues due to imperfect information. Examples include education and some aspects of childcare.

Market power refers to the ability of buyers or sellers to exert influence over price or quantity in a market. Market power depends on the number of parties on each side of the market. If a market has few buyers, but many sellers, the buyers tend to have relatively more market power than sellers. The converse occurs if there are many buyers, but relatively few sellers. If a single seller controls the market on the supply side, the market is a monopoly. If a single buyer controls the market, we have monopoly. Most markets are subject to some degree of power by their participants and most market power occurs on the supply side – monopoly or oligopoly (a few suppliers or firms). Barriers to entry are a principal cause of market power on the supply side. These prevent new (potentially more efficient) firms from entering the market and mean that incumbent firms with market power can continue to price at above cost in the long run without fear of losing market share to new rivals.

1.3.2 Deadweight

Deadweight refers to the extent to which the benefits of a tax incentive or subsidy are reduced or eliminated. In the case of this study, deadweight of the tax incentive relates to the extent to which investments benefiting from the tax relief under the scheme would have occurred in the absence of the incentive. If investment would have proceeded in the absence of the tax incentive, then the tax revenue foregone through the tax relief extended under the scheme represents an unnecessary cost to the Exchequer.

1.3.3 Displacement

This refers to the extent to which Government involvement in a particular sector may lead to other negative side effects that result in a reduction in overall benefits. For example, incentives to one project could result in business being displaced from an existing operator. In cases where supply is in balance with demand or where there is supply, government incentives for additional investment could impact negatively on existing providers. Our analysis suggests that there is a very real issue for many of the current property based tax incentives reviewed.

1.3.4 Opportunity Cost

The opportunity cost of any expenditure or investment refers to the cost of the opportunity foregone (i.e. the benefits that could be received from the alternative expenditure or investment). In the context of property tax incentives, the opportunity cost of the investment under the incentive will be the value foregone from investors using their money to invest in a different sector of the economy, or of simply spending the money on consumption. In a near full employment economy such as currently exists in Ireland the opportunity costs of resources is very high.

1.3.5 Multiplier Effect

The multiplier effect relates to the impact of indirect and second and subsequent round impacts arising out of the initial capital or current expenditure. The multiplier is concerned with how national income changes as a result of a change in an injection in a given area of the economy, the construction sector in the case of this study. The size of any multiplier effect is determined by the extent of 'leakages' from an economy, such as imports and taxation. Of course multipliers simply measure the linkages between different sectors and the existence of indirect benefits for other sectors arising from an investment does not provide any justification for government incentives.

Many of the sectors reviewed such as tourism, education, nursing homes, and childcare are characterised by labour intensive activities with low impact levels and if this was not the case lower multiplier estimates would have been utilised. We also consider a number of scenarios for these and other key variables.

1.4 State Aids

1.4.1 Background and Definitions

An analysis of state aids is included in the report from the European Commission. (The State Aid Score Card is published by the Commission twice a year.) In the following sections, extracts from this are presented as background to the Irish context.

Article 87(1) of the Treaty of Rome defines state aids as: "Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the common market".

It is the EU Competition Commissioner – under the advice of DG Competition – who currently applies 87(1). The Commission defines four categories of aid as follows:

- A – direct transfers to firms, grants, interest subsidies and tax reductions;
- B – equity participation and debt conversion;
- C – interest saved (e.g. through tax deferrals);
- D – guarantees.

State aids can have an economic efficiency rationale, which are generally introduced in order to address an 'externality' or 'market failure'. The following are categorical examples:[1]

- Production externalities;
    - R&D – firms tend to under invest in R&D since not all the benefits of an invention can be appropriated by the firm
    - Labour training – firms tend to under invest in labour training since employees are mobile and may decide to leave for a competitor once trained
- Agglomeration externalities – the nature of production in certain industries (e.g. financial services) may be such that greater returns and efficiency can be produced if complementary activities are closely located (this is the economic rationale behind support to 'clusters');
- Intertemporal externalities – firms may fear to commit to long-term investments, which may therefore require government assistance;

[1] See, for example, Fingleton, J., Ruane, F. and Ryan, V., 'Market Definition and State Aid Control in State Aid and the Single Market', *European Economy*, No. 3, 1999, pp. 65-88.

- Environmental externalities – this is where a firm's actions results in a greater cost to society than the production cost to the firm and here the purpose of the aid is to correct the externality;
- Public goods – these are goods where those who benefit can free-ride on others who pay, in which little or none of the good would be produced in the absence of aid (e.g. education, defence).

In each and every case above, state aid may be economically beneficial if, firstly, one can show that an externality or market failure exists and, secondly, how the intervention can directly ensure that the market or industry will function more effectively as a result.

It is anticipated that Commission examination of state aids will from now on involve more of the elements of competition analysis found, for example, in merger appraisal (e.g. market definition, concentration, barriers to entry and competitive effects). Each of these areas is potentially very important to aid decisions, which ultimately focuses on whether the intervention serves to benefit suppliers or competition/trade/consumers.

1.4.2 Development

Starting with the Lisbon agenda in 2000, which launched the process of reducing the general level of State aid and shifted the emphasis from supporting individual companies or sectors towards tackling horizontal objectives of Community interest, the Council has adopted a series of conclusions on State aid. In 2001, at the Stockholm European Council, Member States committed themselves "to demonstrate a downward trend in State aid in relation to GDP by 2003, taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives." The latest European Council held on 22-23 March 2005 reiterated its call to Member States "to continue working towards a reduction in the general level of State aid, while making allowance for any market failures." Similarly a recent Commission Communication on the mid-term review of the Lisbon Strategy stated that Member States "should reduce and redirect State Aids to address market failures in sectors with a high growth potential as well as to stimulate innovation."

While a slight decline in the level of aid in relation to GDP can be observed in the majority of Member States, the underlying trend since the launch of the Lisbon agenda is more stable than downward. In contrast, Member States appear to have responded more positively to the call for the second part of the equation, i.e. "better targeted State aid".

The overall level of State aid granted by the fifteen Member States was estimated at €53 billion in 2003. From the relatively high levels of State aid in the early and mid-nineties, the overall volume of aid[3] fell dramatically from €74 billion in 1996 to €55 billion in 1999. Between 1999 and 2001, total aid hovered around the €55 billion mark, rising to €57 billion in 2002 but then falling in 2003 by some €4 billion to €53 billion.

In the mid-1990s when State aid levels were much higher, the share of total aid earmarked for horizontal objectives such as R&D, small and medium-sized enterprises, environment, employment and training and regional economic development was around 50%. In line with the commitments undertaken at various European Councils, Member States have continued to redirect aid towards such horizontal objectives. Over the period 1999-2001 to 2001-2003, the share of total aid for horizontal objectives increased by 5 percentage points, largely as the result of significant increases in aid for the environment and energy saving (+6 points) and R&D (+2 points) as well as a reduction in sectoral aid for some Member States.

By 2003, the share of horizontal aid had risen to 79% of total aid (excluding agriculture, fisheries and transport). The four main horizontal objectives were environment and energy saving (23% of total aid), regional economic development (21%), R&D (14%) and SMEs (13%) – see Table 7. The remaining 21% was aid directed at specific sectors (mainly coal) including aid to rescue and restructure ailing firms.

1.4.3 Irish Context

An important issue relevant to state aids is our proposal to permit a five year extension for completion of certain projects subject to a cap on allowances of 50% (of total aid). Many of the proposed schemes are not relevant from a state aid perspective but we understand that an extension of the allowances for the hotel sector would require clearance for state aids.

While this would be a matter for the state aid division in the European Commission Competition Directorate we believe that there are a number of very significant factors which should be highlighted in this context as follows:

- Firstly, there is no question of permitting new projects to be eligible and the extension would only apply to projects which have already received approval and have met eligibility criteria for state aids.

- Requiring all these projects to proceed before July 2006 in order to meet a state aid requirement would result in market distortions and increase inflationary pressures in the Irish construction industry.
- As a condition for the extension would be a reduction in capital allowances by 50%, permitting this extension would effectively be reducing the level of state aids for qualifying projects.

1.5 Structure of this Report

This report is structured as follows: in Section 2 of this report we consider the impact of property based incentives on the Irish Construction Sector. In the subsequent sections we examine and evaluate each of the property-based tax incentive schemes. A common structure is adopted within each of these individual sections, as follows. The tax incentive and background to the scheme is introduced, followed by an outline of the specific policy context for each scheme. The nature and operation of the incentive is then examined. Next, the overall level of activity and investment in the sector is quantified, focusing on the role of the tax incentive, followed by a rigorous assessment of the impact of the tax incentive. In the final section of the report we outline our recommendations.

1.6 Acknowledgements

Indecon would like to acknowledge the valuable inputs and assistance provided by the Steering Committee and from other government departments including – Kevin Ring, Ronnie Downes, Liam Murphy, John Hogan and Karen Cullen (Department of Finance), Gerry O'Regan (Department of Justice, Equality and Law Reform), Mary Jackson and Frank Rochford (Department of Arts, Sport and Tourism), Sean O'Connor, Fionnuala Ryan (Revenue Commissioners), Denise Mullins (Department of Enterprise, Trade and Employment), Paul Hannon, Tom Ferris (Department of Transport), Dympna Butler, Aidan O'Reilly (Department of Health and Children), David McLoughlin (Department of the Environment, Heritage and Local Government), Aidan Marsden (Department of Education and Science). Thanks are also due to Kevin Corduff and Donal McNally of the Department of Finance. In addition, we wish in particular to acknowledge the assistance of the Local Authorities, HSE, Fáilte Ireland and individual hotels, holiday cottages, sports injury clinics, nursing homes, third level institutions, childcare providers and hospitals that responded to the various Indecon surveys. We also appreciate the invaluable inputs from financial institutions, auctioneers, and accountancy/tax practices. We also acknowledge the useful views received from numerous representative organisations and other parties who made submissions or other inputs to this Review. The usual disclaimer applies and all of the information, analysis and views in the report are the sole responsibility of Indecon.

We would also like in particular to acknowledge the expert inputs on financial structures case studies provided by Professor Eamon Walsh of UCD and of the input to the design / physical case study provided by Murray O'Laoire Architects.

2 Impact of Property-Based Tax Incentives on Construction

2.1 Importance of Construction to Irish Economy

Construction is one of the largest and most important economic sectors in Ireland. According to the Department of the Environment and Local Government, the total value of the Irish construction sector was €28,173 million in 2004, representing approximately 19.2% of gross domestic product (GDP) in that year. This is higher than in other EU countries, where on average construction activity accounted for 11% of the GDP[2]. In view of this it is important, in considering the impact of the property incentives, to review the trends in Irish construction and to evaluate the timing of any adjustments on this sector.

Despite the gains made in residential construction in recent years, Ireland's housing stock is just 391 units per 1,000 of the population, which is well below the EU average of 422 units per population and may still have a way to go to catch up.[3]

An analysis of the contribution of construction to Irish employment emphasises the importance of the sector to the Irish economy. In the second quarter of 2004, there were 206,000 people (11.2% of all employees) directly employed in construction. Construction accounts for a greater proportion of the Irish workforce than it does in other EU countries. Eurostat figures for 2003 indicate that direct employment in construction accounted for 8% of those working in the EU (-15), compared to 11% in Ireland.

These figures refer only to direct employment in the construction sector. They exclude 'off-site' or *indirect* employment such as employment in the manufacture and distribution of building materials, and plant hire. These figures also exclude employment in professional services related to construction (e.g. architects, engineers, quantity surveyors). When all indirect employment is accounted for, construction emerges as even more important to jobs in the Irish economy.

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2 58th Euroconstruct Conference Report.

3 The *Hooke and MacDonald Report on the Irish Property Market: Summer 2005* (p. 5).

It has been estimated by the Department of the Environment and Local Government (DOELG) that indirect employment by the Irish construction sector is 40% of direct employment. Using this figure, indirect employment in Irish construction can be estimated at 82,400 in the second quarter of 2004. This implies total employment of 288,000 (15.7% of total employment in the Irish economy).

2.2 Composition of the Irish Construction Sector

There are generally three principal components of construction as follows:

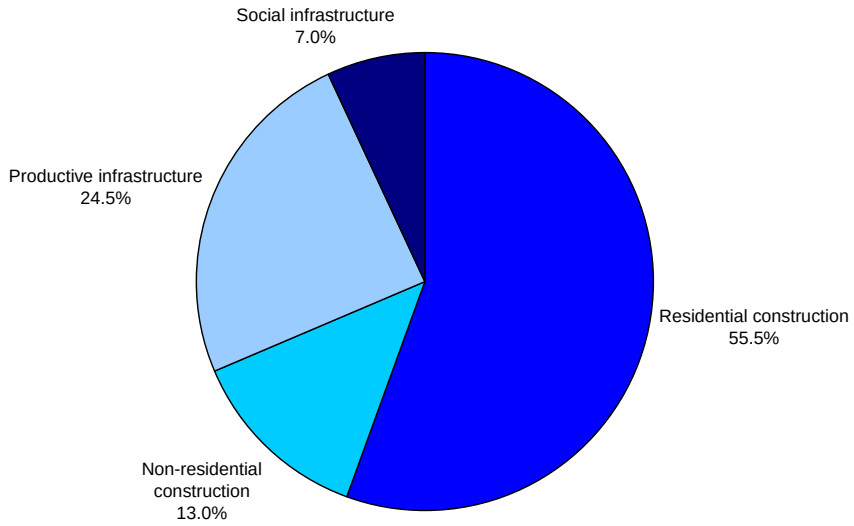
- Residential construction;
- Non-residential construction;
- Civil engineering construction.

Residential construction includes private and public housing. Non-residential construction includes both public and private construction. A diverse component, reflecting investment decisions by public authorities and private organisations, non-residential construction includes industrial and commercial buildings, agricultural buildings and town buildings. Civil engineering construction can be broken down into two categories, namely productive infrastructure and social infrastructure. The former includes roads, water services, energy and communications, while the latter includes education (including third-level educational buildings and student accommodation), health (including private hospitals, nursing homes and sports injuries clinics), public buildings (e.g. libraries) and other social buildings (including sports facilities).

The components just described can also be categorised according to whether construction activity is 'new' work or 'repair and maintenance' (R&M) work. New work includes all green-field building activity whereas R&M work involves renovation and modernisation of the existing built environment. According to Euroconstruct, new work is especially important in Ireland, where about 81% of all construction activity is devoted to new buildings.[4] The importance of new work also reflects the fact that the property tax incentives and other factors have contributed to a dramatic renewal and modernisation of our infrastructure in areas such as hotels and student accommodation.

In terms of the relative sizes of the components of the Irish construction sector, Figure 2.1 below shows that the largest component is residential (55.5%), followed by productive infrastructure (24.5%), non-residential (13.0%) and social infrastructure (7.0%).[5]

Figure 2.1: Relative Sizes of Principal Components of Irish Construction Sector. Estimates for value of 2004 output in each component at constant prices.



Source: Indecon analysis of DOELG data.

[4] According to Euroconstruct, in the 'big 4' (Germany, the UK, France and Italy), the ratio of new work to R&M work is about 50:50.

[5] Construction output valued in 1995 constant prices.

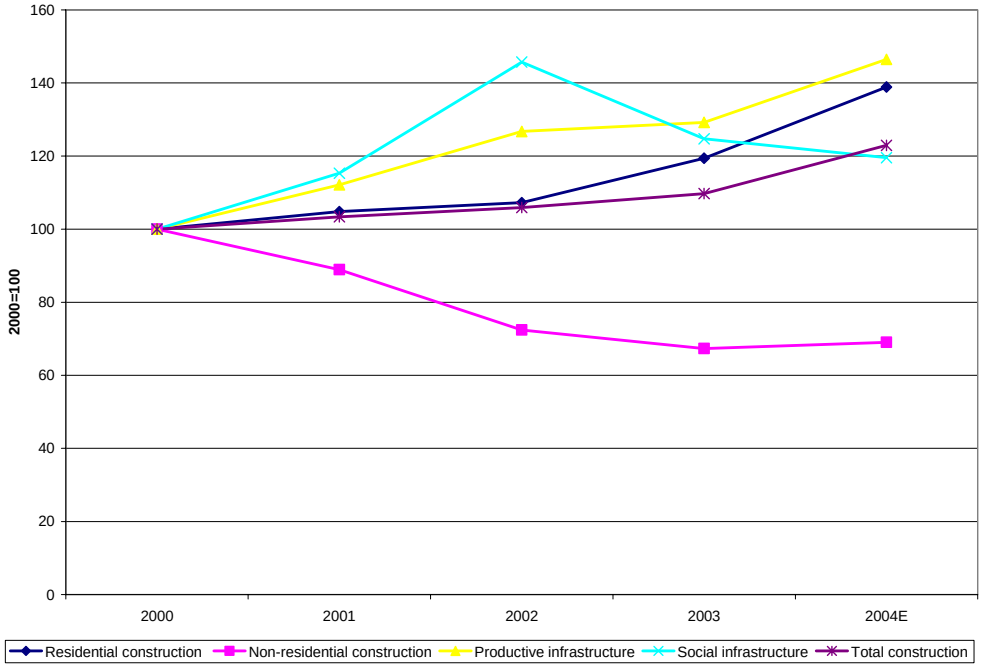
Within residential construction, private housing accounted for the vast majority of output value (91.5%) in 2004. Within non-residential construction, the two largest areas in 2004 were commercial (48.5%) and industrial (25.1%) while tourism accounted for 15.3% of output value in that year. Within social infrastructure, education accounted for 32.7% of output value in 2003 while health accounted for 27.7% and other social infrastructure (including sports and recreational buildings) accounted for 13.6% of the value of output.

2.3 Trends in the Relevant Components of Irish Construction

Figure 2.2 illustrates the trends in the principal components of Irish construction during the period 2000-2004.[6] Between 2000-2002, social infrastructure, which includes education, health and sports-related construction activity, grew more rapidly than the overall construction and indeed was the most rapidly growing of the construction components. On the other hand, the trend in non-residential construction exhibited a downward trend until 2003.

[6] 2004 figures are estimates.

Figure 2.2: Trends in Principal Components of Irish Construction Sector (2000-2004)

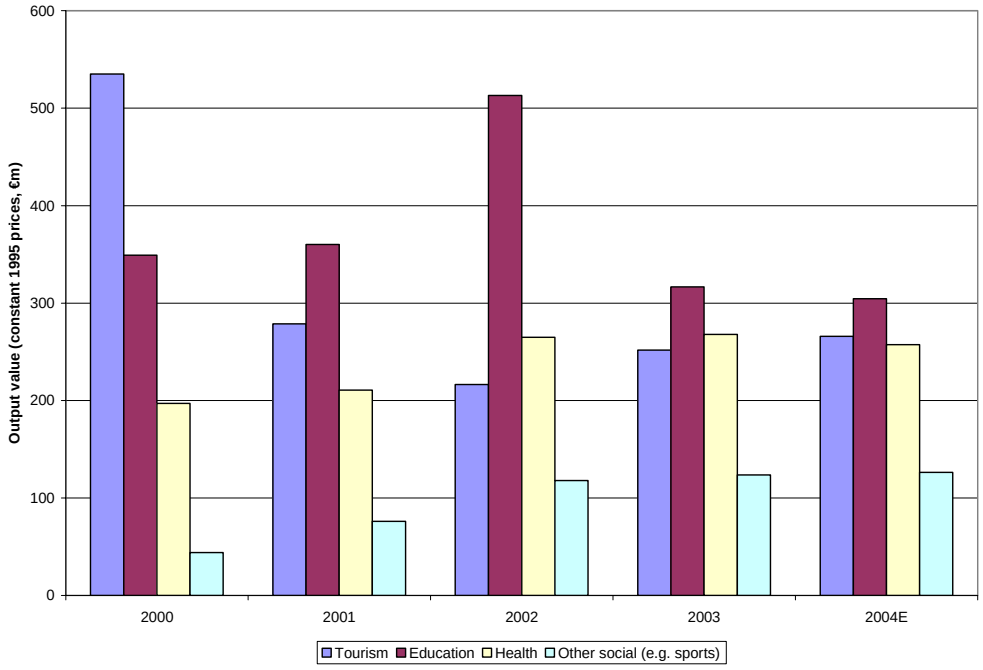


Source: Indecon analysis of DOELG data.

Looking more specifically at the sub-components of relevance to this study, Figure 2.3 below illustrates the trend during 2000-2004 for tourism, education, health and other social, which includes buildings for the purpose of sports and recreation.

According to our analysis, the value of construction output relating to tourism (in real 1995 prices) declined during 2000-2002 but recovered in 2003 and 2004 (latest available estimates). On the other hand, the value of construction output in education increased rapidly between 2000 and 2002 but declined in 2003. Construction activity in health rose steadily during 2000-2002 and appears to have peaked in 2003. This was largely due to public expenditure and investment in the health sector.

Figure 2.3: Trends in Construction Activity in Tourism, Education, Health and Other Social Infrastructure (2000-2004)



Source: Indecon analysis of DOELG data.

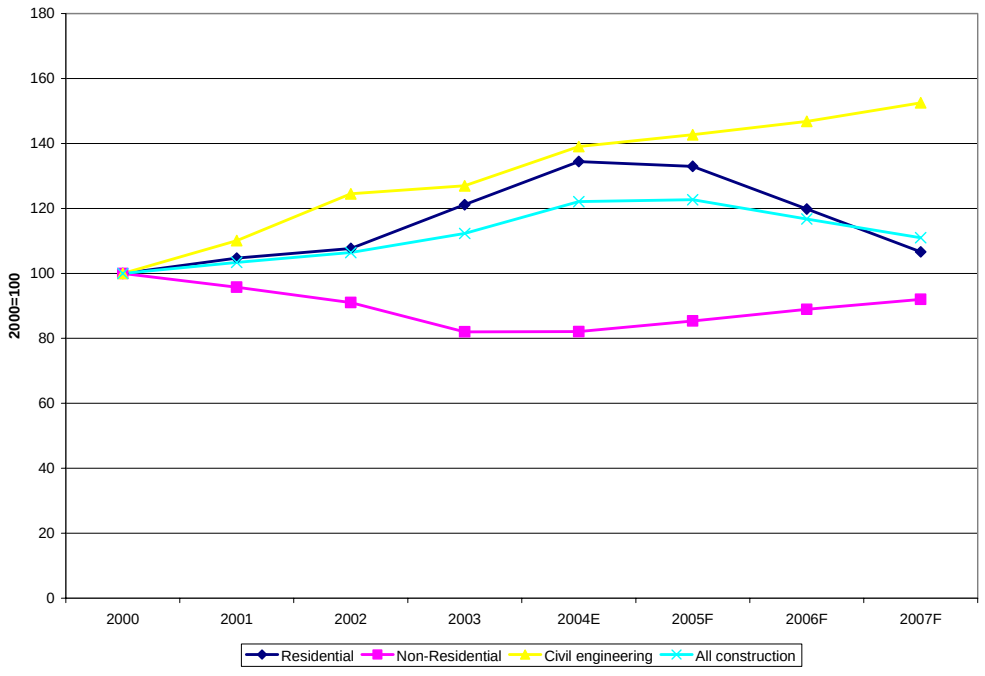
2.4 Forward Trends

We conclude our overview by providing scenarios for construction activity in the key areas of residential, non-residential and civil engineering going forward and comment on the specific categories relevant in the context of this study. The scenarios are based on Indecon analysis and take account of the following drivers, *inter alia*:

- Economic growth;
- Employment growth;
- Incomes growth;
- Interest rates;
- Population and migration trends;
- Other factors, including 'shocks', which may have more effect in certain cases (e.g. terrorist threats and tourism.).

It is expected that a slight downward trend in overall construction will be evident between the present and 2007, reversing the tendency since 2000 for construction activity to increase year on year. It is anticipated that there will be a significant fall in residential construction, which at present accounts for over half of the value of total construction in Ireland. The effect of this significant fall on the forward trend for total construction activity is tempered to an extent by the slight increases expected in non-residential and civil engineering construction. If, however, all of the approved projects which avail of the property tax incentives are required to be completed by mid-2006, we would anticipate a significant peaking of construction in these sub-sectors over the period to mid-2006 with a subsequent, more marked decline in activity.

Figure 2.4: Future Trends in Principal Components of Irish Construction Sector (2000-2007)



Source: Indecon analysis.

2.5 Planning Applications

In considering the impact on the construction section of the planned cessation of a number of the property tax schemes under review it is important to consider the recent trends in planning applications. Table 2.1 presents data on the number of planning applications for facilities for which a tax allowance can be claimed. With the notable exception of childcare facilities, applications declined between 2000 and 2002. Since 2002, there has been a substantial increase in applications for all of the above facilities, except in the case of nursing homes. The increase in applications for hotels nearly quadrupled between 2000 and 2004, the applications for holiday cottages nearly trebled, while in the case of childcare facilities, planning applications nearly doubled. Because of the certification schemes available for third level buildings and Section 50 student accommodation data on these schemes were not collected in the table below. Because of difficulties in identifying properties any projects included under the 'Refurbishment of Certain Rented Properties' schemes are also not included.

Table 2.1: Planning Applications for Projects for Selected Schemes for which Tax Relief is available

	2000	2001	2002	2003	2004
Hotels	138	124	102	220	403
Holiday Cottages	54	58	54	77	143
Private Hospitals	12	9	9	16	19
Sports Injury Clinics	10	10	10	9	14
Nursing Homes	89	77	87	85	81
Childcare Facilities	305	376	370	470	626
Park & Ride Facilities	4	3	3	4	7
Multi-Storey Car Parks	11	10	4	11	8

Source: Indecon Confidential Survey of Local Authorities

Comparison of the figures in Table 2.1 and Table 2.2 suggest that there is a very significant pipeline of projects which could qualify for tax incentives. Data on planning applications are presented in Table 2.2. This reflects the December 2004 deadline for many of the schemes. A key issue in terms of the impact on the construction sector is the timing of completion of these projects.

Table 2.2 displays the number of planning approvals between 2000 and 2004 for facilities for which tax relief can be claimed. In general, approvals have increased significantly over the time period under consideration, though the number of approvals for certain facilities fell between 2000 and 2002 before increasing substantially between then and 2004.

Table 2.2: Planning Approvals for Projects for which Tax Relief is available, 2000-2004

	2000	2001	2002	2003	2004
Hotels	98	94	70	176	174
Holiday Cottages	32	31	28	45	56
Private Hospitals	10	6	9	13	15
Sports Injury Clinics	7	10	7	6	8
Nursing Homes	50	56	72	53	53
Childcare Facilities	203	265	239	328	311
Park & Ride Facilities	2	2	0	3	1
Multi-Storey Car Parks	8	7	3	9	6

Source: Indecon Confidential Survey of Local Authorities

2.6 Impact on Property Market

2.6.1 Impact on Site Prices

One of the potential impacts of the property incentives relates to the impact on site prices. A recent newspaper report reviewed by Indecon during this study of an actual auction result of a site with planning and tax incentives indicated that the auctioneer reported that "because of the tax designation, a special premium was added on the price". Table 2.3 presents the results of Indecon's survey of financial institutions, auctioneers and accountancy/tax professionals in Ireland. All of the responding financial institutions, and very considerable majorities of auctioneers and accountancy/tax professionals, believed that the property-based tax incentives had led to an increase in site prices.

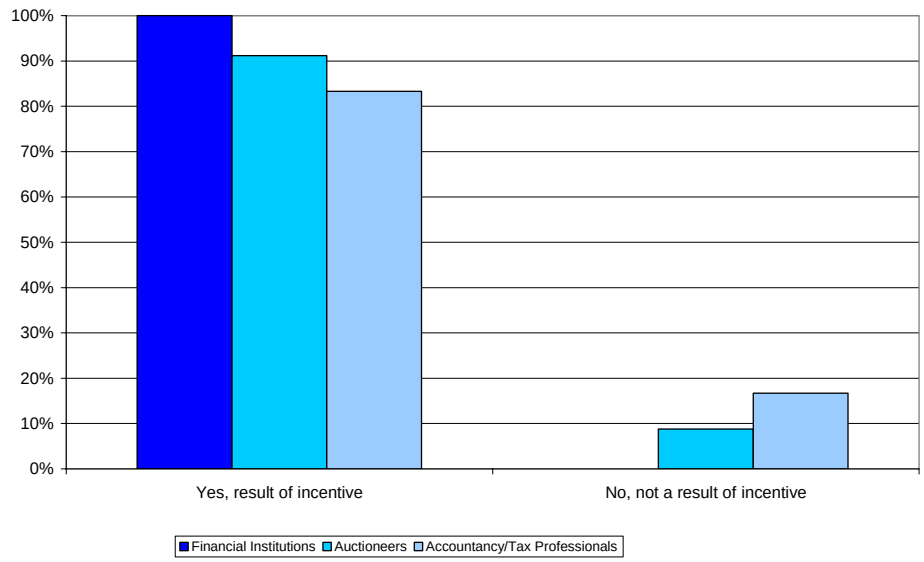
Table 2.3: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Higher Site Prices

Respondent Group	% of Survey Respondents	
	Yes, result of incentive	No, not a result of incentive
Financial Institutions	100.0%	0.0%
Auctioneers	91.2%	8.8%
Accountancy/Tax Professionals	83.3%	16.7%

Source: Indecon Confidential Surveys of Financial Institutions in Ireland.

Figure 2.5 summarises the opinions of financial institutions, auctioneers and accountancy/tax professionals consulted by Indecon. There is little doubt among all three categories that the tax incentives have led to higher site prices.

Figure 2.5: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Higher Site Prices



Source: Indecon Surveys

2.6.1.1 Comments from Submissions to Indecon

There is a general awareness of the fact that higher site prices have resulted from the incentives. Some submissions to Indecon however, while accepting this have suggested that most of the benefits have accrued to the investors.

"In general we would be of the view that, whilst property tax incentives would create some upward pressure to site prices this is balanced by the need to preserve a significant portion of the real value of the tax incentives for the investor. Therefore, it would appear to us that the larger proportion of the benefits of tax incentives is accruing to the intended recipient- the risk-bearing tax investor."

An alternative view was articulated in another submission which suggested that:

"Any incentive especially if within a given time frame, results in a rush to buy sites and complete construction at highly increased/ inflated prices. Comparisons are then (unfairly) made with these costs (land and buildings)"

2.6.2 Impact on Construction Costs

Table 2.4 presents results from Indecon's surveys of financial institutions, auctioneers and accountancy/tax professionals on the impact of the tax incentives on construction costs. While views differ on this issue, a significant minority were of the view that the property-based tax incentives had increased construction costs for relevant projects. Indecon has little doubt that if the current deadlines for project completion remain this will put pressure on inflation of construction prices.

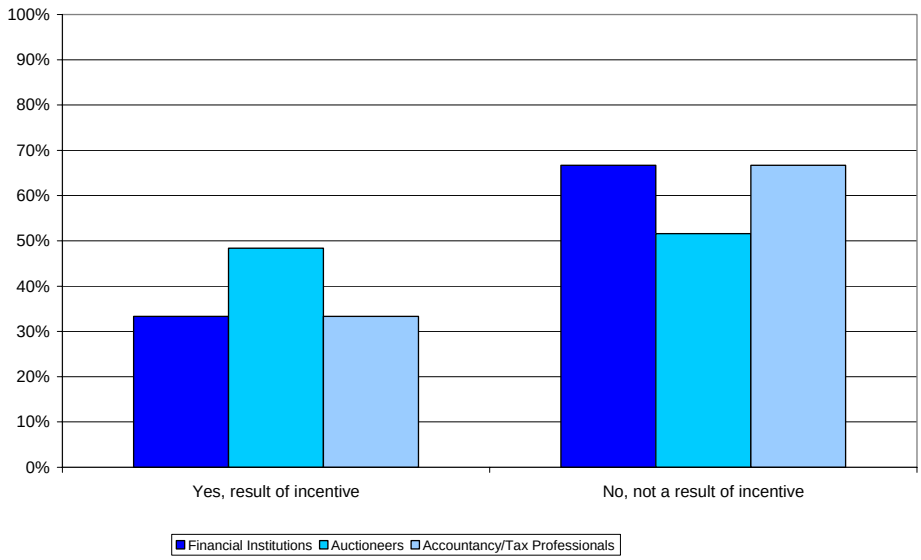
Table 2.4: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Higher Construction Costs

Respondent Group	% of Survey Respondents	
	Yes, result of incentive	No, not a result of incentive
Financial Institutions	33.3%	66.7%
Auctioneers	48.4%	51.6%
Accountancy/Tax Professionals	33.3%	66.7%

Source: Indecon Confidential Surveys of Financial Institutions in Ireland.

Figure 2.6 summarises the views of the Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the impact of the tax incentives on construction costs.

Figure 2.6: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Higher Construction Costs



Source: Indecon Surveys

2.6.3 Impact on Level of Investment in Projects

Table 2.5 presents results from Indecon's survey of financial institutions, auctioneers and accountancy/tax professionals regarding the effect of the property-based tax incentives on investment. Among financial institutions and accountancy/tax professionals, 100% of respondents considered the incentives to have led to increased investment, while over 90% of responding auctioneers shared that view.

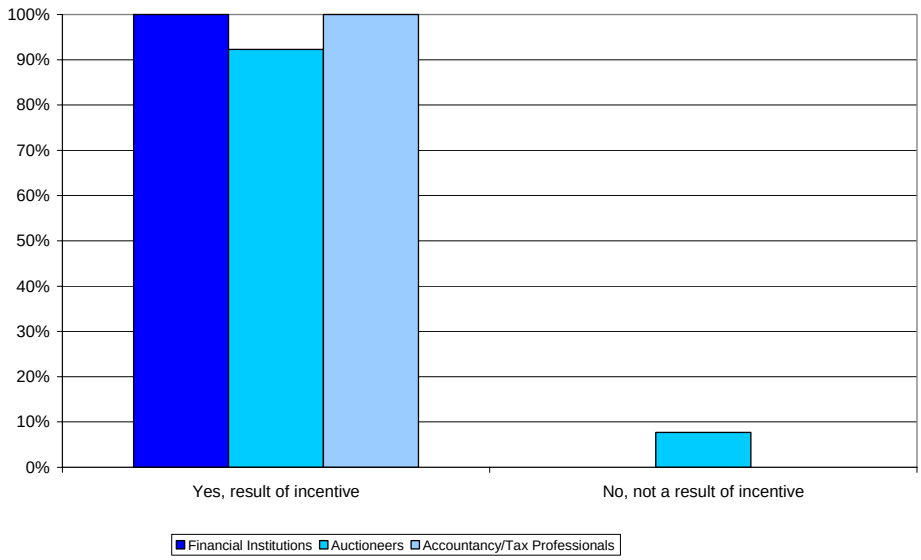
Table 2.5: Views of Financial Institutions on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Investment in Projects

Respondent Group	% of Survey Respondents	
	Yes, result of incentive	No, not a result of incentive
Financial Institutions	100.0%	0.0%
Auctioneers	92.3%	7.7%
Accountancy/Tax Professionals	100.0%	0.0%

Source: Indecon Confidential Surveys of Financial Institutions in Ireland.

Figure 2.7 illustrates the fact that there is little doubt among each respondent group surveyed by Indecon that the property-based tax incentive scheme has had the effect of increasing investment in projects for which tax relief is available. This supports other detailed evidence assembled by Indecon and summarised in the individual sectoral chapters of this report.

Figure 2.7: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Increased Investment in Projects



Source: Indecon Survey

2.6.3.1 Comments from Submissions to Indecon

It is clear from our analysis that the incentives have resulted in increased investment although the extent of this varies. Some views from submissions on this issue are presented below.

"Take up on the schemes has been patchy. A lot of Sect. 23 and hotel activity but very little in park and ride. Tax incentives were a significant factor in increasing the number of hotel beds in the country."

"Without the availability of the incentives in areas such as childcare, nursing homes etc., private equity provided by tax investors would simply not be made available. This would have the result of increasing the capital cost of providing these facilities to such an extent that many would not be developed as the economic case for doing so would be significantly altered."

2.6.4 Impact on Financial Returns to Promoters

Table 2.6 presents the views of the financial institutions, auctioneers and accountancy/tax professionals on the impact of the property-based tax incentives on the financial returns to promoters. Among financial institutions and accountancy/tax professionals, all respondents considered the incentives to have led to increased returns to promoters. Over 85% of auctioneers share this view.

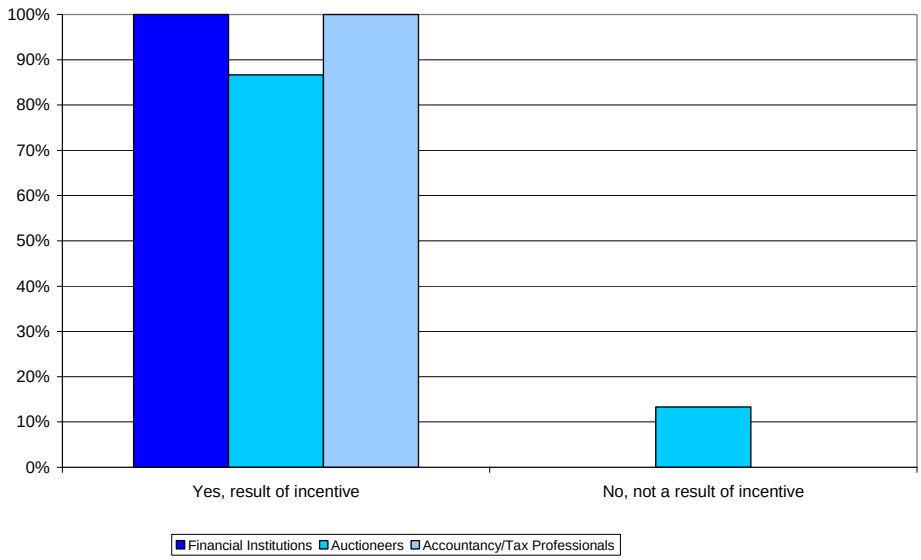
Table 2.6: Views of Financial Institutions on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Financial Return to Promoters

Respondent Group	% of Survey Respondents	
	Yes, result of incentive	No, not a result of incentive
Financial Institutions	100.0%	0.0%
Auctioneers	86.7%	13.3%
Accountancy/Tax Professionals	100.0%	0.0%

Source: Indecon Confidential Surveys of Financial Institutions in Ireland.

Figure 2.8 illustrates the views of those surveyed by Indecon on the effect of the schemes on financial returns to promoters.

Figure 2.8: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Increased Financial Returns to Promoters



Source: Indecon Confidential Surveys

2.6.4.1 Comments from Submissions to Indecon

While the incentives have increased supply Indecon's analysis suggests that the benefits have been distributed between different groups as follows:

- Site owners;
- Construction sector;
- Investors/Promoters.

"Some schemes are hugely inflated in value due to promoters taking large fees for putting up the scheme initially."

2.6.5 Impact on Property Prices

Table 2.7 presents a result from Indecon's survey of financial institutions, auctioneers and accountancy/tax professionals in Ireland. Respondents were asked to give their view as to whether the schemes had led to higher property prices for those facilities covered by the tax incentives compared to those facilities not covered. Among responding financial institutions and accountancy/tax professionals, it was believed that the incentives had had this effect, while over 85% of auctioneers consider property prices to be higher as a result.

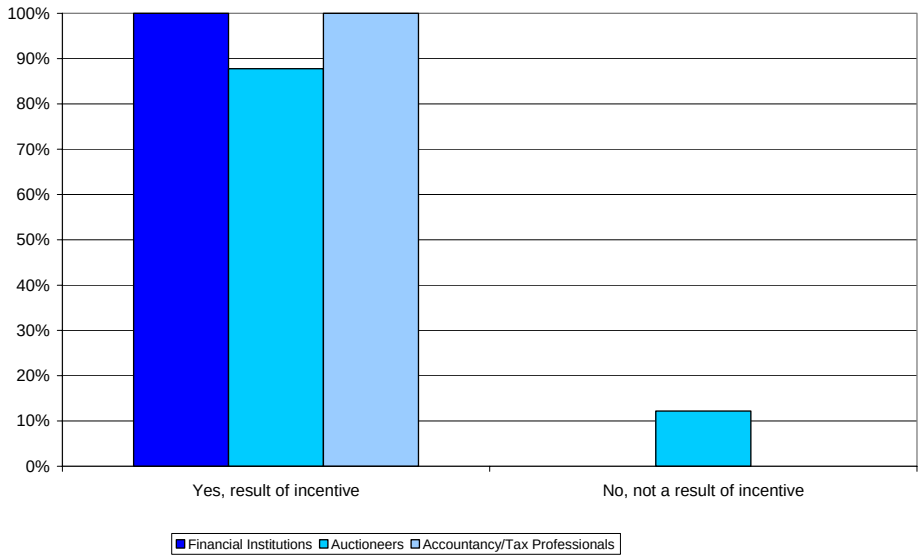
Table 2.7: Views of Financial Institutions on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has led to Higher Property Prices Compared to Non-Tax Incentive Properties

	% of Survey Respondents	
Respondent Group	**Yes, result of incentive**	**No, not a result of incentive**
Financial Institutions	100.0%	0.0%
Auctioneers	87.8%	12.2%
Accountancy/Tax Professionals	100.0%	0.0%

Source: Indecon Confidential Surveys of Financial Institutions in Ireland.

Figure 2.9 summarises the views of financial institutions, auctioneers and accountancy/tax professionals surveyed by Indecon on the effect of the property-based tax incentive scheme on property prices. There was considerable support for the contention that the schemes have had the effect of increasing property prices, with none of the financial institutions or accountancy/tax professionals and less than 13% of auctioneers disputing it.

Figure 2.9: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme - Proportion of Respondents believing that the Scheme has Resulted in Higher Property Prices Compared to Non-Tax Incentive Properties



Source: Indecon Confidential Surveys

2.7 Summary of Main Findings

In this section, we reviewed the recent trends in the Irish construction industry. The main issues of relevance are presented below:

- The importance of the construction sector to the Irish economy is indicated by the fact that it accounts for over 19% of GDP, and when indirect employment by the sector is included, provides nearly 16% of jobs in Ireland.
- Recent trends in construction activity are presented. Overall construction activity has been increasing for the last number of years. Indecon forecasts a slight reversal of this trend in the coming 3 years. There is potential for a significant fall in residential construction and if most of the approved projects proceed within the period to mid-2006, it will result in a significant peak in investment, with a more marked subsequent decline.

- Data on planning applications and approvals for projects of relevance to this study are presented. The figures indicate that there is a significant pipeline of projects that could qualify for property-based tax relief.
- The opinions of financial institutions, auctioneers, and accountancy/tax professionals regarding the effect on the property-market of the property-based tax incentives, as well as other analysis undertaken by Indecon suggest that, in addition to increasing investment in projects, the tax incentives had led to an increase in site prices, financial returns to promoters and property prices.

3 Capital Allowances for Hotels and Holiday Camps

3.1 Introduction and Background

In this section, we present our examination of the tax incentive for hotel and holiday camp properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability. As part of our research we surveyed a sample of the sector and received responses from 156 hotels.

3.2 Policy Context for the Tax Incentive

In September 2003, the Tourism Policy Review Group published their report to John O'Donoghue T.D., Minster for Arts, Sport and Tourism. The report reviewed the tourism sector and proposed a number of targets. This report forms the basis for tourism policy in Ireland and is an important context for the review of the tourism based tax incentives.

Table 3.1: Summary of Strategic Targets for Irish Tourism 2003 – 2012

Target	2002 Actual	2006 Target	2012 Target
Overseas visitor spend (€m 2002)	3,088	3,835	6,000
No. of visitors (m)	5.9	7.0	10.0
Promotable overseas visitors (m)	2.7	3.3	4.9
Domestic holiday trips (m)	3.0	3.6	4.3
Revenue from domestic holiday trips (€m)	600	800	1,000
Promotable tourists to BMW region (m)	0.8	1.0	1.6
BMW share of all promotable tourists (%)	30%	31%	34%

Source: Tourism Policy Review Group (2003) New Horizons for Irish Tourism - An Agenda for Action, A report to the Minister for Arts, Sport & Tourism.

In order to meet these targets, the Tourism Policy Review Group proposed a number of government policy actions that were required to achieve the targets. Each policy action was linked to one of the following key drivers of success:

- Business environment
- Competitiveness and value for money
- Access transport
- Information and communication technologies
- Product development and innovation
- Marketing and promotion
- People in tourism
- Government sector
- Information, intelligence and research.

In relation to the first key driver of success, business environment, the report proposed, inter alia, the following two actions:

- "promote reinvestment in maintaining the capital stock in Irish tourism at high standards through use of accelerated write-offs already available for plant and machinery
- Establish and publish annually information on investment in tourism facilities undertaken with the aid of capital allowances and other tax reliefs in order to monitor and assess investment in maintaining the quality of Ireland's tourism stock."

The first progress report of the Tourism Action Plan Implementation Group was published in August 2004. Their report on progress relating to capital allowances suggested the following:

- "The tourism accommodation sector has benefited in the past from generous tax incentives, in particular favourable treatment in respect of capital allowances. The 7-year capital allowance regime for investment in hotel projects as well as a number of other property-based reliefs were ended as a result of Budget 2003, as part of the policy of widening the tax base while keeping direct tax rates low. In response to concerns expressed by the industry, generous transitional arrangements, for the relief to apply in full, have been put in place for certain projects in the course of development provided expenditure is completed by end July 2006."

3.3 Description of Tax Incentive

Under certain transitional arrangements, capital expenditure incurred up to 31 December 2004 on any building or structure used as a hotel or holiday camp qualifies for capital allowances of 15% of the expenditure for the first six years and 10% in the seventh year. For expenditure incurred after 31 December 2004 the rate of capital allowances was due to reduce to 4 per cent per annum over 25 years. These transitional arrangements were amended by way of Section 25 of the Finance Act 2004. Section 25 of the 2004 Finance Act provided for an extension of the transitional arrangements for the scheme of capital allowances for hotels and holiday camps from 31 December 2004 to 31 July 2006, provided a full and valid planning application is received by a planning authority on or before 31 December 2004.

In cases where planning permission is not required, three conditions need to be met by 31 December 2004:

- A detailed development plan is prepared;
- A contract exists on which expenditure on the development is in occurred; and
- Work to the value of 5% of the development costs has been undertaken.

The section also provides that capital expenditure incurred on the construction or refurbishment of hotels and holiday camps will be treated as having been incurred on or before 31 July 2006 to the extent that such expenditure is attributable to work on the building or structure which is actually carried out on or before that date.

The writing down allowance is available to those persons who hold the relevant interest in relation to the capital expenditure incurred on the construction, or refurbishment, provided that the building/structure is in use as a hotel or holiday camp at the end of the chargeable period.

Capital allowances on hotels are ring fenced and may be set off only against rental income in the case of individual passive investors. (The ring-fence also applies in the case of passive partnerships. The issue of the impact of this ring-fencing on this and other sectors is considered in Indecon's recommendations). This restriction does not apply to owner operators, or to investors in certain hotels located in counties Cavan, Donegal, Leitrim, Mayo, Monaghan, Roscommon or Sligo.

3.4 Measure of Overall Level of Activity in Sector

3.4.1 Capacity in the hotel sector

Table 3.2 details the increase in the total number of hotels over the last decade. There were 853 hotels in Ireland in 2005 compared to 713 in 1996. There was a significant fall in the number of lower grade hotels accompanied by substantial increases in three- and four- star hotels[7].

Table 3.2: Number of Hotels: by Grade, 1996-2005

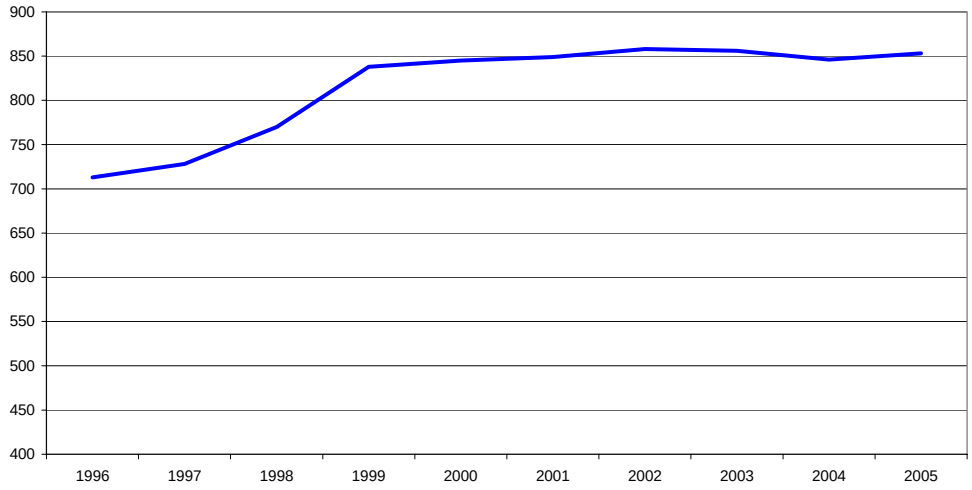
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
1*	155	137	127	80	77	71	68	57	53	49
2*	229	214	205	201	191	195	194	188	183	177
3*	203	244	258	293	290	303	314	316	311	308
4*	42	44	44	58	59	66	79	85	87	90
5*	16	16	16	18	18	18	20	21	21	20
I	0	0	3	0	0	0	0	0	0	0
U	14	26	50	49	56	104	101	117	116	130
N	9	15	22	24	26	48	48	36	35	46
R	45	32	40	83	92	20	11	14	10	9
X			5	32	36	24	23	22	30	24
Total	713	728	770	838	845	849	858	856	846	853

Source: Gulliver Database

Figure 3.1 illustrates the increase in the total number of hotels. There was a dramatic increase in the number of hotels between 1996 and 1999. Since then, there has been little variation in the total number of hotels, though as detailed in Table 3.2 there have been changes in the composition of this total.

[7] U = Unclassified; N = New, classification unassessed; R = Undergoing major redevelopment, classification to be reassessed upon completion of works, X = Classification assessment rescinded

Figure 3.1: Total Number of Hotels, 1996-2005



Source: Gulliver Database

Table 3.3 shows that the increase in the total number of hotel rooms was more significant than the increase in the number of premises which would indicate an increase in the average size of hotels over the last decade. The rate of increase was most substantial between 1997 and 1999, with nearly 10,000 new rooms created, a rise of 34% in two years.

Table 3.3: Total Hotel Rooms: by Grade, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
1*	1997	1844	1154	1101	1025	979	810	763	686
2*	4074	4087	4305	4076	4242	4277	4212	4113	4032
3*	13169	14485	17142	17417	18612	19568	20248	19955	19987
4*	3682	3804	4686	4970	5730	6675	7587	7877	8071
5*	1939	1985	2255	2255	2277	2742	2899	2862	2700
I	0	64	0	0	0	0	0	0	0
U	992	1204	3695	4170	4608	4609	5243	5346	6404
N	648	2079	1926	2510	2031	2028	1140	1294	2837
R	477	638	615	901	782	662	465	413	201
X		95	504	684	566	443	439	759	562
Ttl	26978	30285	36282	38084	39873	41983	43043	43382	45480

Source: Gulliver Database

Table 3.4 presents a breakdown of the number of single rooms by grade. While some large increase is evident, the analysis in the subsequent paragraph shows that this has been much lower than is the case for double rooms.

Table 3.4: Single Rooms: by Grade, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
1*	270	245	159	159	143	158	130	103	74
2*	477	439	415	377	371	373	337	338	333
3*	756	766	946	968	970	1,027	1,050	1,020	1,009
4*	180	153	137	165	173	208	251	258	258
5*	58	56	69	59	59	57	57	57	40
U	57	84	66	110	234	216	249	258	274
I	0	1	0	0	0	0	0	0	0
N	36	90	50	66	69	52	36	20	16
R	37	37	172	189	60	46	38	12	9
X		16	67	88	67	51	25	97	69
Ttl	1,871	1,887	2,081	2,181	2,146	2,188	2,173	2,165	2,082

Source: GulliverDatabase

The number of double rooms by grade is presented in Table 3.5, with the growth in double rooms accounting for much of the increase in the number of total rooms.

Table 3.5: Double Rooms: by Grade, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
1*	835	801	519	481	445	424	345	331	329
2*	1,239	1,266	1,405	1,283	1,402	1,421	1,459	1,505	1,478
3*	3,608	3,841	4,726	4,924	5,288	5,584	5,952	6,030	6,052
4*	1,141	1,202	1,748	1,909	2,138	2,395	2,998	3,162	3,167
5*	891	914	1,099	1,110	1,112	1,511	1,594	1,610	1,524
I	0	23	0	0	0	0	0	0	0
U	374	470	1,406	1,529	1,595	1,624	1,774	1,792	2,378
N	222	818	600	668	608	895	470	594	1,592
R	77	154	180	264	254	189	181	163	76
X		55	205	282	217	161	169	245	140
Ttl	8,387	9,544	11,888	12,450	13,059	14,204	14,942	15,432	16,736

Source: GulliverDatabase

Table 3.6 shows that the total capacity of the hotel sector increased by over 80% between 1997 and 2005. The rate of increase was most marked between 1997 and 1999. There was a significant fall in the total capacity of one-star hotels, with a substantial rise in four-star premises.

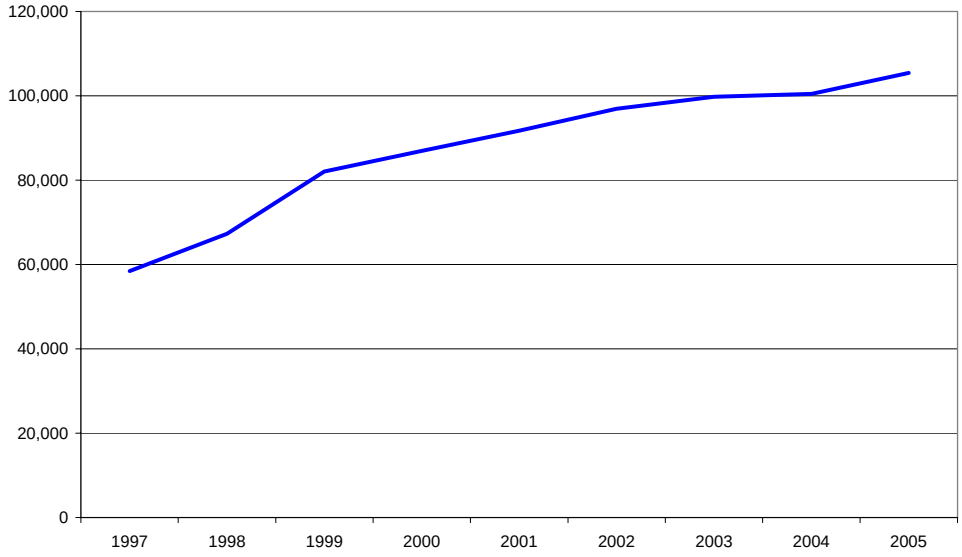
Table 3.6: Total Hotel Capacity (Bedspaces) - by Grade, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
1*	4,150	3,805	2,391	2,266	2,112	1,998	1,673	1,600	1,503
2*	8,756	8,789	9,417	9,039	9,512	9,591	9,564	9,257	8,953
3*	29,316	32,988	39,805	40,736	44,066	46,603	48,228	47,479	47,783
4*	7,737	8,031	10,177	10,797	12,738	15,153	17,063	17,823	18,427
5*	3,873	4,036	4,643	4,647	4,726	5,658	5,979	5,896	5,559
I	0	202	0	0	0	0	0	0	0
U	2,113	2,709	8,440	9,710	10,765	10,875	12,333	12,624	15,121
N	1,486	5,090	4,805	6,328	4,877	4,560	2,932	3,243	6,392
R	1,036	1,466	1,405	2,098	1,753	1,533	991	933	429
X		174	983	1,358	1,194	939	988	1,628	1,278
Ttl	58,467	67,290	82,066	86,979	91,743	96,910	99,751	100,483	105,445

Source: GulliverDatabase

Figure 3.2 illustrates the trend in total capacity since 1997. This suggests that the tax incentives and other factors have contributed to a dramatic growth in hotel capacity. This will increase further arising from projects which have been approved and our analysis suggests a very large pipeline of new hotel projects will proceed.

Figure 3.2: Total Hotel Capacity, 1997-2005



Source: Gulliver Database

Table 3.7 shows the extent of the increase in hotel size between 1997 and 2003. In all regions, the average size of hotels increased over the period 1997-2003. Significant regional differences remain however.

Table 3.7: Average Size of Property, by Region (Rooms)

	1997	1998	1999	2000	2002	2003
All	94	93	107	104	106	117
Dublin	140	146	161	137	134	160
Midlands & East	56	61	73	75	77	81
South-West	93	82	98	99	87	97
Western Seaboard	98	105	112	118	121	118
N. Ireland	69	72	85	85	102	98

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.8 indicates that the number of guests per room fell slightly between 1997 and 1999 but has since risen to just above the 1997 level.

Table 3.8: Number of Guests per room, by Hotel Size

	1997	1998	1999	2000	2002	2003
All	1.6	1.5	1.4	1.5	1.6	1.7
1-49 Rooms	1.7	1.6	1.4	1.5	1.6	1.7
50-99 Rooms	1.6	1.5	1.5	1.5	1.6	1.7
100+ Rooms	1.5	1.4	1.3	1.4	1.6	1.6

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

It can be seen from Table 3.9 that this fall and subsequent increase in the number of guests per room was most significant in the Dublin region, with very little variation elsewhere in the country.

Table 3.9: Number of Guests per Room, by Region

	1997	1998	1999	2000	2002	2003
All	1.6	1.5	1.4	1.5	1.6	1.7
Dublin	1.5	1.3	1.1	1.5	1.5	1.7
Midlands & East	1.7	1.5	1.4	1.5	1.6	1.6
South-West	1.7	1.7	1.7	1.6	1.6	1.7
Western Seaboard	1.7	1.7	1.7	1.5	1.7	1.7
N. Ireland	1.4	1.3	1.4	1.6	1.5	1.4

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

3.4.1.1 Level of capacity utilisation

Table 3.10 shows that Room Utilisation fell substantially throughout the country between 2000 and 2002. The level of utilisation has since risen but at 60%, it remains below its level in 2000. This has important implications for any future incentives to expand the stock of hotels. If most of the projects that are in the pipeline and have submitted planning applications proceed then, unless there is a very marked growth in tourism, pressure on room utilisation will intensify.

Table 3.10: Room Utilisation (%)

	2000	2001	2002	2003	2004
National	65	61	56	60	60
Dublin	75	69	66	68	69
Midlands East	58	52	54	52	50
South East	62	54	59	58	58
South West	67	63	60	61	62
Shannon	63	62	60	59	57
West	55	50	47	52	54
North West	57	54	51	54	51

Source :Fáilte Ireland Hotel Survey

Table 3.11 indicates that there has been a steady fall in the level of bed utilisation nationwide. The downward trend continued after 2002, in spite of the increase in room utilisation, indicating the existence of a greater number of partially filled larger rooms.

Table 3.11: Bed Utilisation (%)

	2000	2001	2002	2003	2004
National	47	46	45	44	44
Dublin	54	52	49	48	49
Midlands East	41	41	41	38	36
South East	46	40	47	45	42
South West	50	48	47	47	46
Shannon	42	46	46	43	42
West	40	39	37	37	39
North West	40	43	41	41	39

Source :Fáilte Ireland Hotel Survey

Table 3.12 shows that room occupancy did not vary to a great extent between 1997 and 2000 and has since fallen slight. The decrease in occupancy rates has been more significant in hotel with more than fifty rooms than in smaller ones.

Table 3.12: Annual Room Occupancy, by Hotel Size (%)

	1997	1998	1999	2000	2002	2003
All	66.7	65.1	65.2	66.1	62.8	64.8
1-49 Rooms	58.8	58	56.2	57	54.8	57.4
50-99 Rooms	68.5	65.9	65	68.4	63.3	64.3
100+ Rooms	70	69.5	68.2	68.6	64.6	66.3

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.13 indicates that there has been a fall in occupancy rates in every part of the country. The most substantial decrease was in the Midlands & East area where rates fell from 67.7% to 60.6%. In contrast, occupancy rates in Northern Ireland are roughly at their 1997 level, despite have fallen somewhat in 2002.

Table 3.13: Annual Room Occupancy, by Region (%)

	1997	1998	1999	2000	2002	2003
All	66.7	65.1	65.2	66.1	62.8	64.8
Dublin	75.8	72.2	72.7	72.4	70.9	72.7
Midlands& East	67.7	62.3	61	60.9	61.4	60.6
South-West	66.7	63.3	67.9	69.4	64.6	62.6
Western Seaboard	66.7	66.2	66	66.9	64.4	63.8
N. Ireland	57.9	56.7	58.1	58.8	54.1	57.1

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

3.4.1.2 Tourist activity

Table 3.14 shows that there was a slight fall in the number of nights spent by overseas visitors in Ireland. A small increase in the number of those nights spent in hotels was offset by a similar decrease in nights spent in guesthouses and B&Bs. The shares of other types of accommodation remained broadly the same between 2003 and 2004.

Table 3.14: Overseas Visits to Ireland by Non-Residents with at least one overnight in Ireland - Number of Bednights 000s

	2003	2004	2004 Jan-Mar	2004 Apr-Jun	2004 Jul-Sep	2004 Oct-Dec
Total	46,846	46,604	7,312	12,275	17,729	9,288
By Accommodation:						
Hotel	10,278	10,633	1,697	2,977	3,867	2,121
Guesthouse/B&B	7,740	6,979	747	2,150	3,031	1,051
Rented House	8,744	8,818	1,383	2,588	3,047	1,800
Caravan/Camping	1,077	970	3	256	676	35
Hostel	1,709	1,624	319	514	502	289
Friends/Relatives	13,122	13,031	2,529	2,855	4,392	3,255
Other	4,446	4,519	634	935	2,214	737

Source: CSO.

Table 3.15 illustrates that the majority of those spending time in hotels and guesthouses were holidaymakers. Rented accommodation was also significant for holidaymakers.

Table 3.15: Overseas Visits to Ireland by Non-Residents with at least one overnight in Ireland - Number of Bednights Classified by Type of Accommodation used and Reason for Journey, 2004

	Business	Holiday/ Leisure/ Recreation	Visits to Friends/ Relatives	Other	Total
Total	4,299	23,105	13,871	5,329	46,604
By Accommodation:					
Hotel	1,929	7,364	906	465	10,663
Guesthouse/B&B	475	4,981	963	560	6,979
Rented House/Apartment	963	4,677	1,572	1,606	8,818
Caravan/Camping	12	896	56	6	970
Hostel	76	1,196	166	186	1,624
Friends/Relatives	567	2,365	9,464	634	13,031
Other	277	1,626	744	1,872	4,519

Source :CSO

Expenditure by visitors to Ireland rose significantly from €2.6b in 2000 to €3.2b in 2004, as shown in Table 3.16. The expenditure by those coming to Ireland for business purposes, however, fell during that period. The increase was mainly due to extra expenditure by holidaymakers and those visiting friends and relatives.

Table 3.16: Visits to Ireland by Non-Residents – Estimated Expenditure (Excluding International Fares), € million

	2000	2001	2002	2003	2004
Total	2,617	2,893	3,045	3,198	3,204
Reason for Journey:					
Business	486	460	445	402	424
Holiday/Leisure/Recreation	1,386	1,594	1,696	1,779	1,774
Visits to Friends/Relatives	569	648	675	708	755
Other	175	191	230	309	251

Source: CSO

3.4.1.3 Profitability in the hotel sector

Table 3.17 shows that pre-tax profits as a percentage of sales rose between 1997 and 2003. The increase was evident across all sizes of hotels, but was most significant in the case of smaller premises, with profits in hotels with less than 50 rooms increasing from 7.4% of sales in 1997 to 13.9% in 2003. Profits in most types of hotel actually fell between 1997 and 2000, but have since recovered.

Table 3.17: Hotel Profits, by Hotel Size, Pre-tax profits as a percentage of total sales

	1997	1998	1999	2000	2002	2003
All	12.7	11.7	11.8	12.6	17.7	17.5
1-49 Rooms	7.4	7.5	7.3	8.8	14.5	13.9
50-99 Rooms	12.6	12.3	10.7	11.1	17.9	15.8
100+ Rooms	15.7	15.3	14.7	15.4	18.4	19.4

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.18 indicates that there has been a substantial increase in pre-tax profits per available room between 1997 and 2003. The increase was most substantial in smaller hotels with an 85% increase in pre-tax profits per available room in hotels with less than 50 rooms. Average pre-tax profits per available room increased from €5,509 to €8,853, an increase of nearly 61%.

Table 3.18: Hotel Profits, by Hotel Size, Pre-tax profits per available room (€)

	1997	1998	1999	2000	2002	2003
All	5,509	5,500	5,569	6,649	8,619	8,853
1-49 Rooms	3,978	4,338	4,559	5,876	7,083	7,395
50-99 Rooms	5,291	5,217	4,599	5,748	8,820	8,622
100+ Rooms	6,731	6,606	6,740	7,715	8,889	9,219

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.19 present pre-tax profits as a percentage of sales broken down by region. Profits are significantly higher in Dublin than elsewhere in the country. There have been nationwide increases in the level of profits since 1997, most significantly in the Midland & East and Western Seaboard regions.

Table 3.19: Hotel Profits, by Region, Pre-Tax Profits as a Percentage of Sales

	1997	1998	1999	2000	2002	2003
All	12.7	11.7	11.8	12.6	17.7	17.5
Dublin	16.3	18.6	16.3	16.4	21.8	20.7
Midlands& East	9.3	8	8.2	9.4	12.5	15.1
South-West	13.3	11.4	11	13.4	15.7	15.7
Western Seaboard	10.6	11.8	11.3	11.9	17.6	16.2
N. Ireland	10.5	9.6	10.9	10.2	17.4	16.2

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.20 presents data on the regional differences between hotel pre-tax profits per available room Profits are significantly higher in Dublin than in any other part of the country. There has been a nationwide increase in the level of profits since 1997, though the growth rate has varied substantially from region to region. This increase was most substantial in the Midland & East region where pre-tax profits more than doubled.

Table 3.20: Hotel Profits, by Region - Pre-Tax Profits per available room (€)

	1997	1998	1999	2000	2002	2003
All	5,509	5,500	5,569	6,650	8,619	8,853
Dublin	8,497	8,364	8,376	9,105	12,503	12,687
Midlands& East	4,575	4,511	4,307	5,533	6,881	9,275
South-West	4,877	5,085	5,070	6,483	6,833	6,751
Western Seaboard	3,752	3,889	3,731	4,676	6,996	5,743
N. Ireland	4,649	4,610	5,372	5,365	5,580	5,105

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.21 presents information on the change in achieved average room rate since 1997. Across all types of hotel the average rate has increased by a third. The growth rate was most significant for smaller hotels with the rate increasing by 40% between 1997 and 2003 compared with only 21% for hotels with more than 100 rooms.

Table 3.21: Achieved Average Room Rate, by Hotel Size (€)

	1997	1998	1999	2000	2002	2003
All	66.28	69.29	74.05	82.56	87.14	88.73
1-49 Rooms	51.59	55.92	55.94	63.56	69.03	72.37
50-99 Rooms	68.49	73.06	72.80	82.25	90.31	91.39
100+ Rooms	73.71	75.44	81.00	92.00	89.64	89.35

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

The achieved average room rate is also presented by region in Table 3.22. This analysis shows room rates in Dublin to be 27% higher than the State average.

Table 3.22: Achieved Average Room Rate, by Region (€)

	1997	1998	1999	2000	2002	2003
All	66.28	69.29	74.05	82.56	87.14	88.73
Dublin	80.25	81.58	93.35	101.65	102.94	112.71
Midlands & East	59.55	62.38	62.98	73.51	85.09	85.67
South-West	69.24	76.58	85.19	86.23	86.74	80.28
Western Seaboard	57.23	60.00	61.30	71.41	73.35	73.03
N. Ireland	62.11	61.70	62.81	66.42	51.59	49.37

Source: HBC Ireland and Northern Ireland Hotel Industry Surveys

Table 3.23 summarises the change in hotel prices between 2002 and 2005. There has been a significant decrease in the price of 5-star hotels over the past three years, with prices falling by over 25% in 2004 alone. There have been increases in the price of hotels rooms in all other categories.

Table 3.23: Average Hotel Price Increases, by Grade

Grade	2002/2003	2003/2004	2004/2005
1*	9.33	6.02	1.54
2*	12.46	4.13	2.52
3*	9.69	3.68	4.76
4*	2.35	-4.14	2.68
5*	10	-12.64	-25.13
N	49.24	8.5	14.2
U	11.15	-2.19	6.3
Total	10.43	0.22	2.73

Source: Fáilte Ireland

3.4.1.4 Level of Incentive Utilisation

Table 3.24 presents a result of the Indecon Survey of Hotels in Ireland. The survey found that 60% of hotels responding to the Indecon survey had availed of the tax incentive over the last five years. The fact that such a high percentage of hotels have utilised the incentives is indicative of the level of investment and the extent of modernisation of the Irish hotel sector.

Table 3.24: Proportion of Hotels that have Utilised the Tax Incentive over the past 5 years

Impact	% of Survey Respondents
Hotels that have availed of the tax incentive scheme over the past 5 years	59.7%
Hotels that have not availed of the tax incentive scheme over the past 5 years	40.3%
Total	100.0%

Source: Indecon Confidential Survey of Hotels in Ireland.

3.4.1.5 Number of Hotel Registrations

Table 3.25 shows that there has been a steady stream of hotel registrations since 2000. Registrations dipped in 2002 and 2003 but climbed again in 2004 when 30 new hotels, with a total of 2,251 new units, registered.

Table 3.25: Hotel Registrations 2000-2004

Detail	2000	2001	2002	2003	2004
Premises	39	39	19	21	30
Units	2,046	1,929	795	805	2,251

Source: Fáilte Ireland

3.4.1.6 Level of Construction Activity

Table 3.26 indicates that the average number of years since either the construction of the hotel (or the last major refurbishment) was 5 years for hotels that had availed of the tax incentive, and 17 years in the case of hotels that had not availed of the scheme. A very significant percentage of hotel stock has now been modernized and this represents an important base for the future development of this sector.

Table 3.26: Average Number of Years since Construction / Latest Refurbishment – Hotels With and Without Tax Incentive

Number of Hotel Bedrooms	Average Number of Years since Construction / Latest Refurbishment
Hotels that have availed of the tax incentive scheme over the past 5 years	5
Hotels that have not availed of the tax incentive scheme over the past 5 years	17

Source: Indecon Confidential Survey of Hotels in Ireland.

Table 3.27 presents the number of planning applications for hotels since 2000. The number of application fell somewhat between 2000 and 2002 but has since risen significantly with over 400 applications in 2004, four times the level in 2002. This highlights the potential significance of the pipeline for new hotel projects to come on stream.

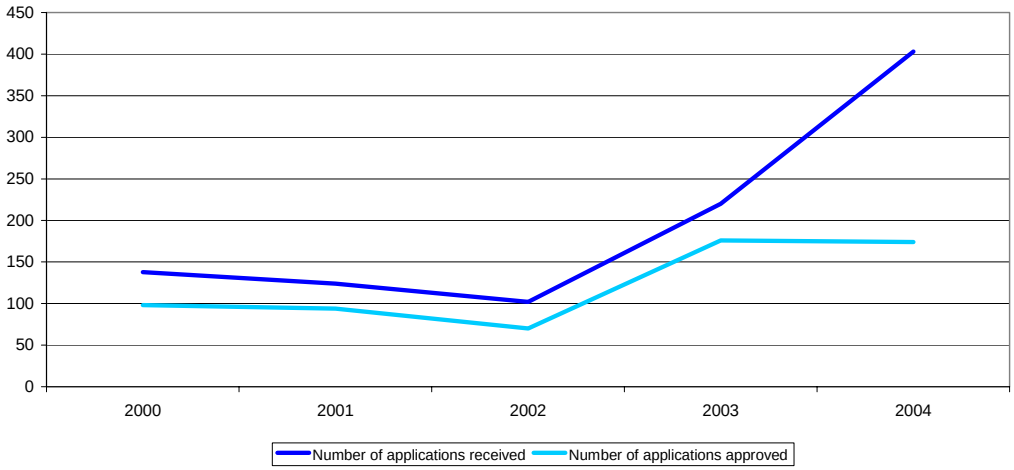
Table 3.27: Details of Planning Applications for Hotels and Holiday Camps - Total Number of Applications, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	138	124	102	220	403
Number of applications approved	98	94	70	176	174
Number of applications awaiting decision	11	6	6	5	185

Source: Indecon Confidential Survey of Local Authorities.

The trend in planning applications and approvals is illustrated in Figure 3.3.

Figure 3.3: Details of Planning Applications for Hotels and Holiday Camps - Total Number of Applications, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

3.5 Case Study

Before we examine the detailed impacts of the incentives, it is useful to consider a case study of a hotel investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

In this section, a case study of a hotel investment is used to examine the impact of tax relief. A cash flow to equity approach is used to measure the benefits of the investment. All tax incentives are discounted using the Euro par-yield curve as these amounts are known with certainty[8]. A ratio of the benefits of investing in a hotel project relative to the cost of the project is used to provide a measure of the impact of the tax incentive.

[8] This approach follows S.C. Myers 'Interactions of Corporate Financing and Investment Decisions: Implications for Capital Budgeting', *Journal of Finance*, 1974.

3.5.1 Investor Perspective

Our hotel case study is based on an investment in an additional 26 bedrooms at a cost of €2.88 million[9]. The hotel secures gross annual revenue of €2.055m. and annual earnings before interest, taxes, depreciation and amortization (EBITDA) of €387,000[10].

The investor has a 10 year horizon and a cost of equity of 28% (see Annex 1 for supporting computations). The investor finances 75% of the investment with a 25 year mortgage at a rate of 5.32%[11]. The investor pays taxes at a rate of 42%[12]. The investor is forecast to earn EBITDA of €387,000 per annum. This results in a yield of 13% on the original investment. EBITDA is expected to grow at a rate of 3% per annum (a growth rate that reflects the risk free interest rate and expected growth in Europe). Real estate asset prices are also assumed to grow at a rate of 3% per annum. The capital gains tax rate is 20% and it is assumed to be payable on the anticipated gain when the investor disposes of the Hotel property at the end of the 10th year. These assumptions are summarised in Table 3.28.

[9] *Tax Reliefs on Hotel Developments: Submission to the Department of Finance*, Irish Hotels Federation, March 2005, p20ff.

[10] This represents an EBITDA/Revenue ratio of 19%. The comparable ratio for Jurys Doyle is 29%.

[11] Jones Lang LaSalle estimate default spreads on hotel mortgages of 200 basis points. Using a 10 year par yield Euro rate of 3.32%, the cost of debt of 5.32%.

[12] This is the higher income tax rate in Ireland. It should be noted that additional PRSI at 5% is also likely to be payable.

Table 3.28: Key Assumptions

Item	Assumed Level
Investment ('000)	2880
Investment Term (years)	10
Cost of Equity	28%
Borrowing/Investment	75%
Cost of Debt	5%
Term of Loan (years)	25
Tax Rate	42%
Yield (EBITDA/Investment)	13%
Asset Growth Rate	3%
EBITDA Growth Rate	3%
Capital Gains Tax (CGT)	20%

Source: Indecon.

Using these assumptions, the forecasted cash flows for the proposed investment are presented in Table 3.29.

Table 3.29: Hotel Project Valuation

Period	0	1	2	3	4	5	6	7	8	9	10
Asset Cost	-2880										
Sale of Asset (net of CGT)											3870
EBITDA		386	397	409	421	434	447	460	474	489	503
Interest Expense		-115	-113	-110	-108	-105	-102	-99	-96	-93	-89
Taxes		-114	-120	-126	-132	-138	-145	-152	-159	-166	-174
Net Cash Flow		157	165	173	182	191	200	210	219	230	4111
Debt Service - Principal	2160	-43	-46	-48	-51	-53	-56	-59	-62	-66	-1676
Cash Flow to Equity (CFE)	-720	114	119	125	131	138	144	150	157	164	2434
			% Cost								
Present Value of CFE	-104		-4%								
PV Capital Allowance	1096		38%								
PV of Project + CA	992		34%								

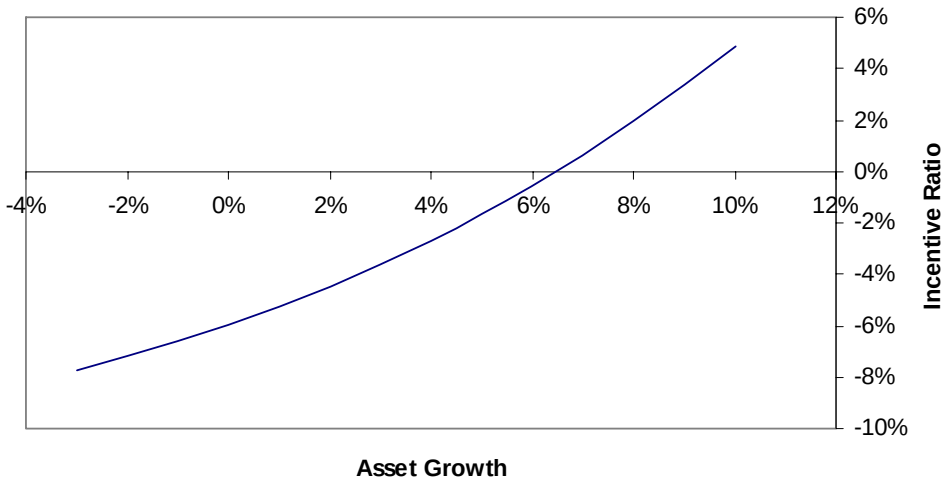
Source: Indecon.

From Table 3.29, it may be seen that the present value of the projected Cash Flow to Equity (CFE) is negative €104,000. Therefore, an investor would reject this proposal in the absence of capital allowances. If capital allowances are available (see Annex 1 for computations), the project will have a present value of €992,000. If however, the profitability of the hotel improves due to less pressure on utilisation levels, this position can be reversed.

3.5.2 Sensitivity Analysis

From an investor perspective, the rate of capital appreciation associated with the hotel property may also be critical. The analysis in the previous section assumes that the rate of capital appreciation will match the inflation rate (i.e. real growth of 0%). Figure 3.4 contains a plot of the Incentive Ratio against the nominal asset growth rate. From Figure 3.4, it is clear that an investor will not consider this investment unless the assumed asset growth rate exceeds 6.25%. Once the expected asset growth rate exceeds this amount, capital allowances may not be necessary to encourage investment.

Figure 3.4: Incentive Ratio vs. Asset Growth



Source: Indecon.

3.6 Impacts of Tax Incentive

3.6.1 Impact on the Supply of Hotel Accommodation

Table 3.30 presents a result from Indecon's survey of Hotels in Ireland. Among the responding hotels that have availed of the tax incentive, the number of bedrooms has increased by 41.2% since 2000. This compares to an increase of 11.4% in the case of responding hotels that have not availed of the tax incentive.

Table 3.30: Number of Hotel Bedrooms – Hotels With and Without Tax Incentive, 2000 and 2005

Number of Hotel Bedrooms	2000	2005	Growth Rate (%)
Hotels that have availed of the tax incentive scheme over the past 5 years	7,866	11,103	41.2%
Hotels that have not availed of the tax incentive scheme over the past 5 years	3,108	3,462	11.4%

Source: Indecon Confidential Survey of Hotels in Ireland.

Table 3.31 presents the views of the hotel sector on the impact of the tax incentive. Of major significance is that a majority of hoteliers consider that it has resulted in an over-supply of visitor accommodation. One of the largest hotel groups in Ireland was reported as indicating that "the rush by investors to avail of tax reliefs on offer for the construction of new hotels is undermining the industry". It is, however, important to note that the Tourism Policy Review Group has set high targets for an increase in visitor numbers and if official tourism targets are to be met an increase in supply will be needed. Also relevant is the fact that plentiful supply can have positive consumer spin-off with greater competition and lower prices. However, few would suggest that on-going incentives to encourage an over-supply outcome would represent an appropriate policy position.

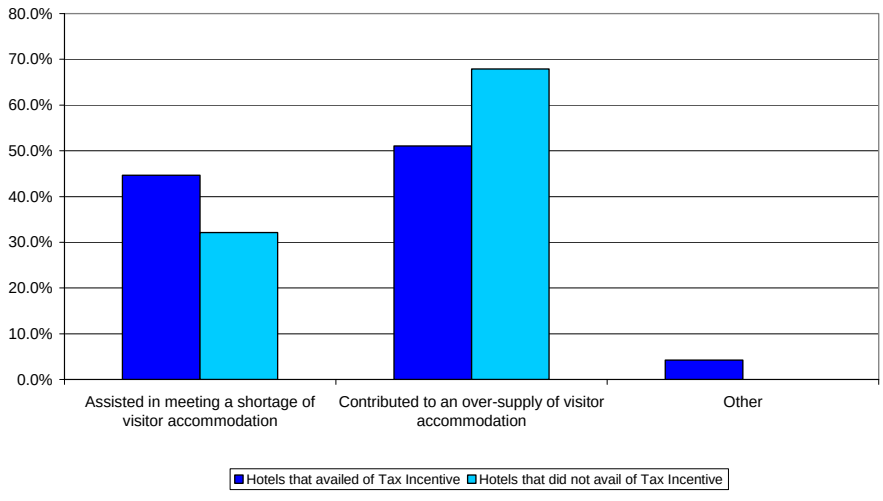
Table 3.31: Views of the Hotel Sector - Impact of Incentive Scheme on Supply Position of Hotels, Hotels With and Without Tax Incentive

View	% of Respondents	
	Hotels that availed of Tax Incentive	Hotels that did not avail of Tax Incentive
Assisted in meeting a shortage of visitor accommodation	44.7%	32.1%
Contributed to an over-supply of visitor accommodation	51.1%	67.9%
Other	4.3%	0.0%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Hotels in Ireland.

Figure 3.5 presents these results in chart form.

Figure 3.5: Views of the Hotel Sector - Impact of Incentive Scheme on Supply Position of Hotels, Hotels With and Without Tax Incentive



Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.2 Impact on the Tourism Sector

Table 3.32 presents the views of the hotel sector on the impact of the tax incentive on the tourism sector. Among hoteliers that have availed of the tax incentive, there is almost unanimity concerning the fact that the incentive has increased economic activity, created jobs and improved the quality of visitor accommodation. A smaller, but still significant majority, of hoteliers who have not availed of the tax incentive consider those statements to be true. 73.7% of the former category and 55% of the latter consider that the tax incentive has contributed to the extension of the tourist season.

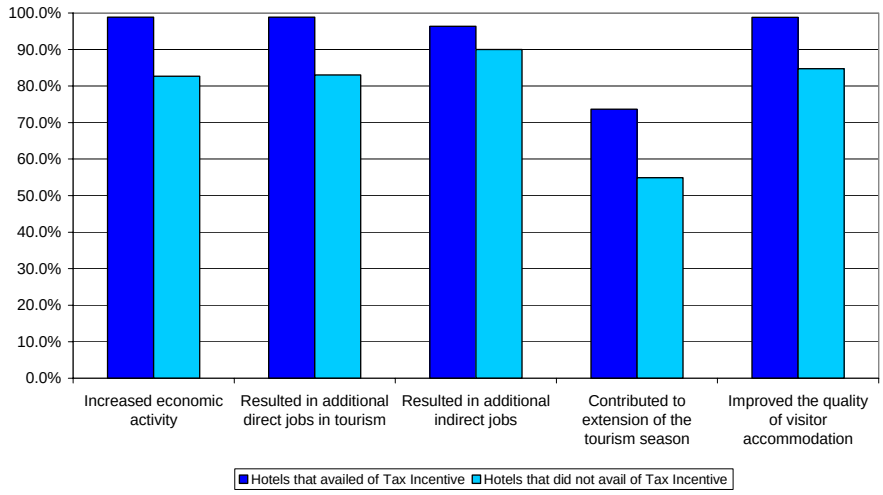
Table 3.32: Views of the Hotel Sector on the Impacts of the Property-based Tax Incentive Scheme on the Tourism Sector, Hotels With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Impact	**Hotels that availed of Tax Incentive**	**Hotels that did not avail of Tax Incentive**
Increased economic activity	98.9%	82.7%
Resulted in additional direct jobs in tourism	98.9%	83.0%
Resulted in additional indirect jobs	96.3%	90.0%
Contributed to extension of the tourism season	73.7%	54.9%
Improved the quality of visitor accommodation	98.8%	84.7%

Source: Indecon Confidential Survey of Hotels in Ireland.

Figure 3.6 illustrates the extent of agreement that exists among hoteliers on the positive effect the Tax Incentive Scheme has had on the Tourism Sector.

Figure 3.6: Views of the Hotel Sector on the Impacts of the Property-based Tax Incentive Scheme on the Tourism Sector, Hotels With and Without Tax Incentive



Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.3 Impact on Capital Expenditure

Table 3.33 presents further results of the Indecon survey of hotels in Ireland. A majority of hoteliers consider that the tax incentive has improved accommodation and facilities for both domestic and overseas holidaymakers. The proportion of those who consider this is greater in the case of hoteliers that have availed of the tax incentive than in the case of those who have not. However, only 34.8% of the former category and 23.2% of the latter consider that the tax incentive has attracted additional overseas visitors to Ireland.

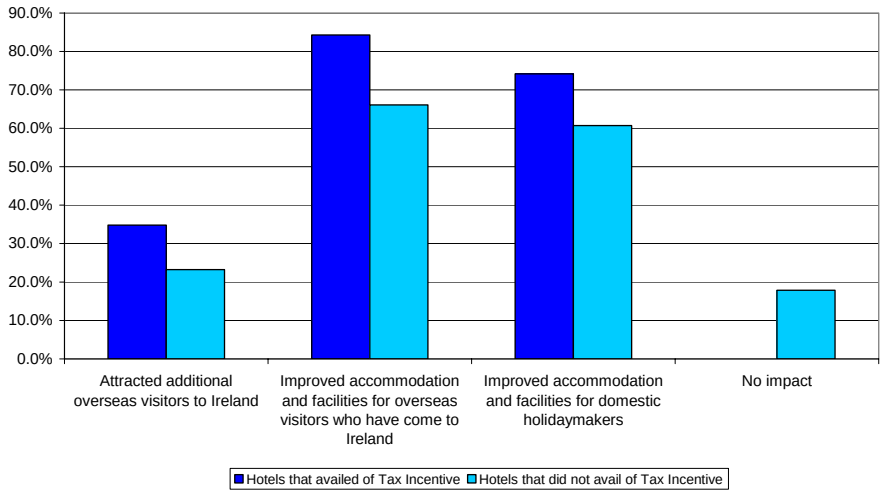
Table 3.33: Views of the Hotel Sector on the Impacts of the Property-based Tax Incentive Scheme for Capital Expenditure on Hotels

Impact	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Hotels that availed of Tax Incentive	Hotels that did not avail of Tax Incentive
Attracted additional overseas visitors to Ireland	34.8%	23.2%
Improved accommodation and facilities for overseas visitors who have come to Ireland	84.3%	66.1%
Improved accommodation and facilities for domestic holidaymakers	74.2%	60.7%
No impact	0.0%	17.9%

Source: Indecon Confidential Survey of hotels in Ireland.

Figure 3.7 presents these results in chart form.

Figure 3.7: Views of the Hotel Sector on the Impacts of the Property-based Tax Incentive Scheme on for Capital Expenditure on Hotels



Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.4 Impact on Site Prices

Table 3.34 is derived from Indecon's survey of Hotels in Ireland. A significant majority of hotel owners consider that the tax incentive has contributed to higher site prices.

Table 3.34: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Resulted in Higher Site Prices, Hotels With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Respondent Group	**Hotels that availed of Tax Incentive**	**Hotels that did not avail of Tax Incentive**
Hotels	79.7%	81.8%

Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.5 Impact on Construction Costs

Table 3.35 presents a result from Indecon's Survey of hotels in Ireland. 73.7% of hoteliers that had availed of the tax incentive, and 84.9% of those who had not, considered that the tax incentive had resulted in an increase in construction costs.

Table 3.35: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Construction Costs, Hotels With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Hotels that availed of Tax Incentive	Hotels that did not avail of Tax Incentive
Hotels	73.7%	84.9%

Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.6 Impact on Level of Investment in Projects

Table 3.36 highlights the fact that nearly all hotel owners consider that the tax incentive has increased investment in hotels and holiday camps. In the case of those who have availed of the tax incentive the proportion of respondents who responded positively was nearly 99%, while in the case of those who have not availed of it, the proportion was 92.5%. The dramatic increase over the past number of years in investment in new hotels and in the refurbishment of existing hotels has undoubtedly been stimulated by the level of tax incentives available. The significance of the tax incentives was illustrated in the case study presented in this chapter.

Table 3.36: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Investment in Hotels and Holiday Camps, Hotels With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Hotels that availed of Tax Incentive	Hotels that did not avail of Tax Incentive
Hotels	98.8%	92.5%

Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.7 Impact on Financial Returns to Promoters

Table 3.37 shows that a majority of hotelier considered that the hotel tax incentives have increased financial returns to promoters. The proportion of those who believe this is greater in the case of those who have not availed of the tax incentive.

Table 3.37: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Financial Return to Promoters, Hotels With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Hotels that availed of Tax Incentive	Hotels that did not avail of Tax Incentive
Hotels	68.6%	74.5%

Source: Indecon Confidential Survey of Hotels in Ireland.

3.6.8 Impact on Property Prices

Table 3.38 presents the views of hotel owners regarding the impact of the property-based tax incentives on property prices. 78% of hotel owners who have availed of the tax incentive believe that it has contributed to higher property prices compared to non-tax incentive properties.

Table 3.38: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has led to Higher Property Prices Compared to Non-Tax Incentive Properties

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Respondent Group	**Hotels that availed of Tax Incentive**	**Hotels that did not avail of Tax Incentive**
Hotels	77.9%	83.3%

Source: Indecon Confidential Survey of Hotels in Ireland.

3.7 Evaluation of the Tax Incentive

3.7.1 Displacement, Deadweight and Opportunity Cost

Table 3.39 gives the views of the hotel sector on the likelihood that developments would have proceeded in the absence of a tax relief. Just over half of hoteliers who have not availed of the tax incentive and just under half of those who have believe that a majority of project would not have proceeded without the tax incentive. The remainder in each category are nearly evenly divided between those who believe that projects would have proceeded over a longer timeframe and those who believe a minority would not have proceeded. Very few hoteliers in either category believe that all projects would have proceeded in the absence of the tax incentive. This suggests that there is some deadweight associated with the incentives but the results, combined with the trends in overall investment levels, suggests that the extent of the deadweight has been low.

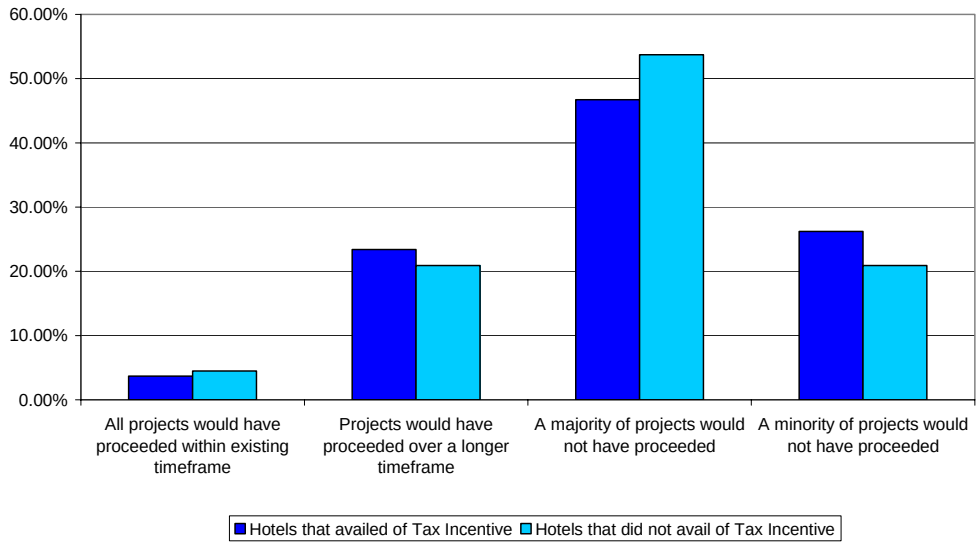
Table 3.39: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Expenditure on Hotel Developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme, Hotels With and Without Tax Incentive

View	% of Survey Respondents	
	Hotels that availed of Tax Incentive	**Hotels that did not avail of Tax Incentive**
All projects would have proceeded within existing timeframe	3.7%	4.5%
Projects would have proceeded over a longer timeframe	23.4%	20.9%
A majority of projects would not have proceeded	46.7%	53.7%
A minority of projects would not have proceeded	26.2%	20.9%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Hotels in Ireland.

Figure 3.8 presents these results in chart form.

Figure 3.8: Views of the Hotel Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Expenditure on Hotel Developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme, Hotels With and Without Tax Incentive



Source: Indecon Confidential Survey of Hotels in Ireland.

Table 3.40 presents the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood investments in hotels would have proceeded in the absence of the tax incentive. Between 40% and 60% of each category contend that a majority of projects would not have taken place, while few or none in each category believe that all projects would have proceeded.

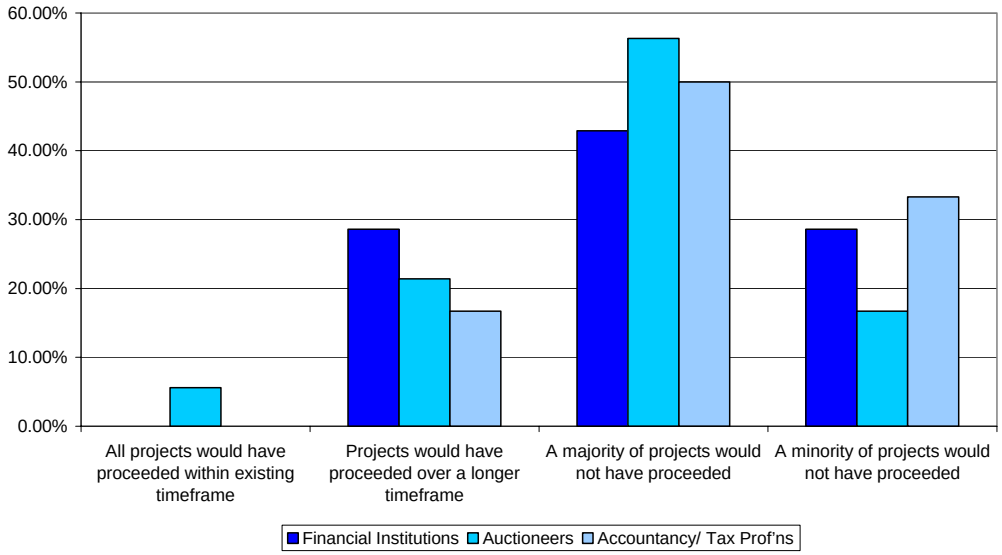
Table 3.40: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Hotel Developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	Auctioneers	Accountancy/ Tax Prof'ns
All projects would have proceeded within existing timeframe	0.0%	5.6%	0.0%
Projects would have proceeded over a longer timeframe	28.6%	21.4%	16.7%
A majority of projects would not have proceeded	42.9%	56.3%	50.0%
A minority of projects would not have proceeded	28.6%	16.7%	33.3%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 3.9 emphasises that the most prevalent opinion among those surveyed was that the majority of projects would not have gone ahead, had there been no tax incentive.

Figure 3.9: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Hotel Developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

3.7.2 Estimated Investment in the Sector

3.7.2.1 Level of Certified Capital Expenditure

Table 3.41 shows the value of Hotel Capital Allowance Certificates issued by Fáilte Ireland in 2004 and 2005. Certificates to the value of €226m have been issued in 2005, the vast majority for the construction of new hotels rather than for improvements to existing premises. Over €110m worth of certificates were issued in 2004, with just over half of that allocated to new developments.

Table 3.41: Value of Hotel Capital Allowance Certificates Issued under Section 268(12) TCA 1997 (€)

Category	2004	2005
New Hotel Developments	59,514,000	202,539,766
Improvements to existing hotels	53,901,432	23,453,091
Total	113,415,432	225,992,857

Source: Fáilte Ireland

Table 3.42 presents a regional breakdown of the value of the Hotel Capital Allowance Certificates. Certificates granted to hotels located in Dublin accounted for nearly 50% of the total value of those issued since 2003. Certificates granted to hotels in the South West made up over 25% of the total value over the last three years and nearly half the value in 2005, whereas the Shannon and West Regional Tourist Authority Areas over the last five years accounted for only 2% and 1.5% respectively of the total value.

Table 3.42: Value of Hotel Capital Allowance Certificates by Regional Tourist Authority Area (€)

Region	2004	2005
Dublin	71,816,432	43,340,000
Midlands/East	14,185,000	10,990,000
North-West	9,314,000	58,165,000
Shannon	3,000,000	2,100,000
South-East	11,200,000	0
South West	0	105,147,857
West	3,900,000	6,250,000
Total	113,415,432	225,992,857

Source: Fáilte Ireland

Table 3.43 presents results from the Indecon Confidential Survey of Hotels in Ireland. The total cumulative value of eligible capital expenditure by hotel groups that responded was nearly €600m on hotels and nearly €45m on holiday cottages. Nearly €3m was spent by hotels that did not utilise the available tax incentive.

Table 3.43: Total Cumulative Value of Eligible Capital Expenditure on Hotels and Holiday Camps incurred over the past 5 years

Total Cumulative Value of Eligible Capital Expenditure	Hotels (€'000s)	Holiday Cottages (€'000s)
Hotels that have availed of the tax incentive scheme over the past 5 years	592,968	44,400
Hotels that have not availed of the tax incentive scheme over the past 5 years	2,950	0

Source: Indecon Confidential Survey of Hotels in Ireland.

3.7.2.2 Lending Advanced by Financial Institutions

Table 3.44 presents the results of the Indecon confidential survey of Financial Institutions in Ireland. Total lending to hotel groups was just €223m in 2003 and €386m in 2004. The financial institutions estimate total capital expenditure on hotels and holiday cottages (including promoter's equity) to have been €288m in 2003 and €486m in 2004. The estimated lending data for this and other sectors provided by financial institutions represented best estimates, however, caution must be exercised in interpreting these figures and in some cases detailed data on sectoral lending was not held in the form requested by responding financial institutions.

Table 3.44: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimated Total Capital Expenditure on Hotels and Holiday Camps including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	223,505	386,500
Total capital expenditure on Hotels and Holiday Camps including promoter's equity	288,291	485,950

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

3.7.3 Estimated Gross and Net Cost of Tax Incentive

3.7.3.1 Capital Expenditure

Indecon's estimate of capital expenditure under the tax incentive scheme from 2001-2005 is based on our analysis of Fáilte Ireland's data on certificates issued and on the results of our new survey evidence. The Fáilte Ireland figures were analysed by the projects' year of completion gives us complete capital expenditure data for the years 2003 and 2004, and indicate a figure of €282m over the 2 years. Taking the 2003 figure as being equal to the average capital expenditure for the previous three years, we calculate the total capital expenditure for the period to be €664,351,000. However, if we take the 2004 figure as representing the average expenditure in the previous three years, we arrive at a figure of €747,109,000. As there is some evidence to suggest that the capital expenditure in the years for which we do not have complete data was lower than in 2004, we adopt the lower of these figures and estimate total capital expenditure at €664,351,000. This gives an average annual spend of €132,870,200.

While there is likely to be variance in annual investment levels we believe this figure of €664m to be the best estimate of expenditure over the period. This compares with an estimate of nearly €600m from the Indecon survey although some hoteliers who availed of the incentive may not be included in this figure. While the results from financial institutions would suggest a higher level of capital investment we believe that some of this may relate to investments which will occur in future years and some may relate to expenditure outside of Ireland. Indecon accepts that if one aggregated the results on the assumption that hotels not included in our survey responses had the same level of capital spend as those included, this would also suggest a higher level of spend. However, based on a careful examination of Fáilte Ireland data and data from other sources we believe these are the best estimates feasible.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. In order to calculate the future uptake of the tax incentive under this scheme we have estimated future planning permission approvals based on outstanding applications and historic approval rates[13].

[13] This data comes from the Indecon survey of county councils.

Given that applications for qualifying developments had to be received by the end of 2004, and that Indecon's survey received responses from all county councils, this data gives all of the developments which can now qualify for the scheme. If we were to assume that 50% of these schemes will avail of the tax incentive, the total remaining investment under this scheme would total €1,302,404,000, based on average capital expenditure per hotel as per the Fáilte Ireland figures. If, however, only 25% of the projects were to proceed then the total expenditure would be half the figure stated above i.e. and estimated capital expenditure of the order of €651,202,000. For the purposes of our analysis we assume a mid-point of €977m although the figure could be in excess of this level.

Table 3.45: Estimate of Total Eligible Capital Expenditure on Hotels and Holiday Camps under the Tax Incentive Scheme

Detail	Value (€'000)
Total Cumulative Capital Expenditure to date	664,351
Forecast for Future Capital Expenditure	651,202 – 1,302,404

Source :Indecon Calculations

3.7.3.2 Impact of the Capital Expenditure

The increased levels of investment arising from the existence of the scheme have had wider benefits for the economy. In order to take this into account in our model we include a 'multiplier' effect, which estimates the increase in economic activity due to the increased level of investment. For the period 2001-2005, we have estimated that the level of investment outlined above will give rise to €833,761,000 of expenditures to the Irish economy. However, this figure must be adjusted for the opportunity cost of resources. Given the fact that the Irish economy is operating at full employment, we believe it is appropriate to assume a high opportunity cost of 95%, suggesting an increase in economic benefit of the order of €41,688,000. Indecon accepts that some investors in these and other schemes might have invested in overseas properties in the absence of these incentives but we do not believe this impacts on the overall estimate of opportunity costs.

3.7.3.3 Impact on Exchequer Revenues

In order to calculate the impact on Exchequer revenues of the estimated Capital Expenditure, Indecon developed a model based on the workings of the tax incentive scheme. This integrates the fact that the tax allowance is calculated over 7 years with a 15% allowance in the first 6 years and a 10% allowance in the final year. Allowances which will be claimed after 2005 are subject to a net present value (NPV) calculation, in order to reflect the current value of the future deductions. Current corporate and income tax rates are applied and the investor profile is based on responses to the Indecon survey of hotels. We therefore calculate the gross cost of the tax allowances to the Exchequer, in terms of tax revenue foregone. With regards to the hotel scheme, we calculate this gross cost to be of the order of €195,762,000. Of this amount, €102,726,000 relates to tax foregone which will be claimed between 2006 and 2011.

In order to calculate a net cost of the tax incentive we estimate the gross figure for increased tax revenues resulting from the higher levels of economic activity due to the initial investment, as outlined above. We estimate the tax contribution of this extra expenditure to equal €300,988,000 or 25% of expenditures. This is consistent with other estimates of the percentage tax contributions of expenditure and is used throughout this report although the actual amounts will differ. For comparison purposes it is interesting to note that the effective tax multiplier implied in the Budget estimates for 2005 amounted to 29.7% based on net effect on tax projections of budget changes. We believe that the impact of the investments funding under these schemes may have a slightly low tax impact than the measures in the Budget and that it is prudent to use a figure of the order of 25%. However, this figure must be adjusted to reflect the opportunity cost of tax revenues. It is difficult to estimate what percentage of these tax revenues would accrue from alternative economic activity. For modelling purposes, we assume only 25% of tax revenues represent net tax revenues, giving a tax contribution of €75,247,000. Deducting this figure from the gross cost to the Exchequer of the scheme, we calculate a net cost of €120,515,000. If it was assumed that the opportunity cost was 95%, as we assume for the economic benefit, this would reduce the figure significantly.

It should be pointed out that the investor profile used for the above figures is based on averages taken from Indecon's survey of hotels and holiday camps. Changing the assumptions on how to determine the investor profile can have an impact on the calculation of the gross tax cost figure. For example, were we to use the weighted average of investments to determine the investor profile, a larger proportion of investors would be taxed at the upper PAYE rate and the tax cost would go up. The figure for gross tax foregone in this case would be €205,919,000. We have decided, however, to use our earlier assumption of a simple arithmetic average of investors.

Table 3.46: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Hotels

Estimate	€'000
Capital Expenditure to Date	664,351
Gross Tax Revenue Foregone	195,762
Tax contribution adjusted for Indirect Tax Revenues	75,247
Net Tax Revenue Foregone	120,515
Future Capital Expenditure	651,202 – 1,302,404

Source: Indecon Confidential Surveys of Hotels and County Councils, Fáilte Ireland.

The above figures must be further adjusted to take account of deadweight. This is due to the fact that in the absence of the tax incentive, some of the construction projects would have gone ahead anyway. Based on analysis of the trends in investment and our surveys of hotels, financial institutions and tax practices, we estimate deadweight under this tax incentive to be of the order of 6%. This is a minimum figure and there is uncertainty regarding the extent of deadweight in this and other schemes. We discuss below the implications of using a higher estimate of deadweight. The figure 'Tax contribution adjusted for opportunity cost' must be adjusted to take this into account. We therefore estimate a tax contribution of €70,732,000, reflecting deadweight of about €4,500,000 associated with this tax incentive. This means that the net tax foregone will be of the order of €125,030,000.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we increase this figure to 1.35 the net tax revenue foregone decreases to €114,820,000, a fall of around €6.3m. Additionally, we have assumed a deadweight figure of 6%. If we adjust this to 10% (holding the multiplier figure at 1.255) the net tax forgone figure increases to €128,040,000, an increase of around €3m. If we were to further increase the deadweight figure to 15% the net tax forgone figure would be of the order of €131,803,000.

3.7.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 3.47 summarises the profile of claimants who have availed of the hotel property-based tax incentive. Nearly 35% of claimants responding to the Indecon survey were companies. Just over a third described themselves as 'passive investors', while the remainder were individuals in business.

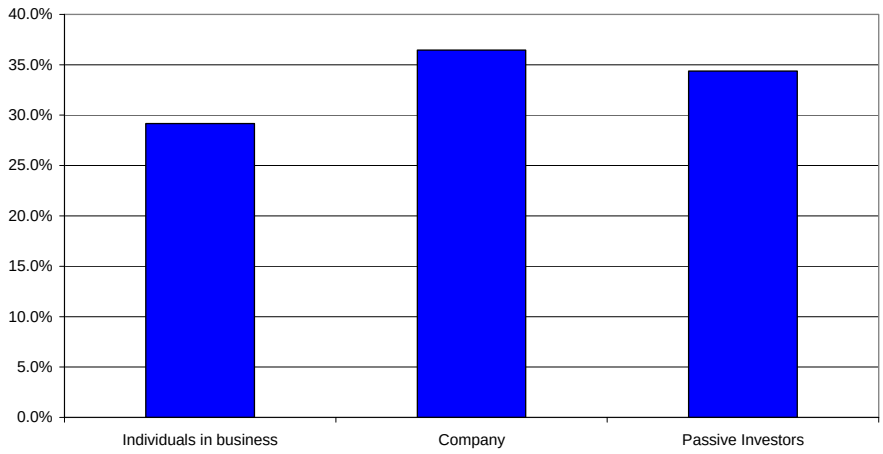
Table 3.47: Profile of Claimants of the Capital Allowances in the case of Hotels which have Utilised the Tax Incentive Scheme

Claimant	% of Survey Respondents
Individuals in business	29.2%
Company	36.5%
Passive Investors	34.4%
Total	100.0%

Source: Indecon Confidential Survey of Hotels in Ireland.

Figure 3.10 presents these results in chart form. The chart shows that the majority of investors were likely to claim tax at personal tax rates which increases the cost to the Exchequer. The significance of passive investors is also noteworthy, as project financing was structured in a way to maximise the tax benefits.

Figure 3.10: Profile of Claimants of the Capital Allowances in the case of Hotels which have Utilised the Tax Incentive Scheme



Source: Indecon Confidential Survey of Hotels in Ireland.

Table 3.48 summarises the views of accountancy/tax professionals on the profile of those using or likely to be using the hotel tax incentive. All respondents felt that investors would be likely to be earning over €100,000, while two-thirds believed that investors were likely to be earning in excess of €200,000 per year. It should be noted that detailed individual data was not provided by accountancy/tax professionals and in many cases, such information is not collected. The figures therefore represent indicative views based on their judgement and expertise.

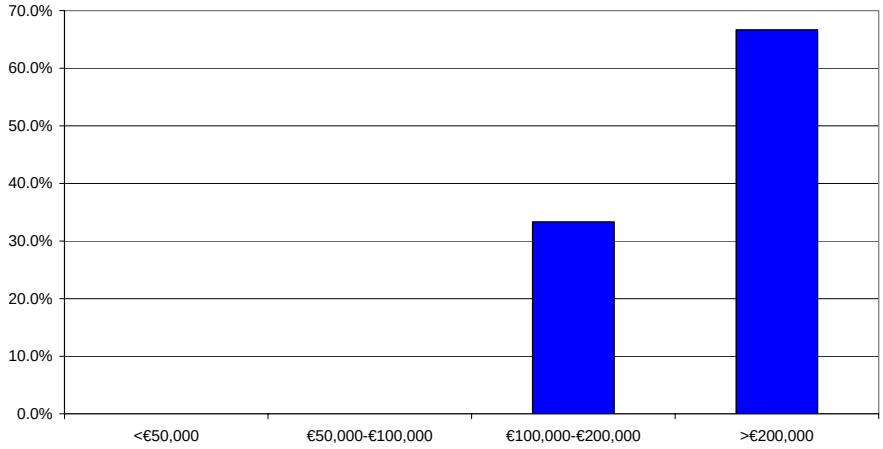
Table 3.48: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Hotel Tax Incentive.

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	66.7%
Majority of investors were likely to be earning between €100,000 and €200,000	33.3%
Majority of investors were likely to be earning between €50,000 and €100,000	0.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 3.11 presents these results in chart form. This clearly shows that, as expected, the incentives have been used as a mechanism by high income earners to reduce their tax liabilities.

Figure 3.11: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Hotel Tax Incentive.



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

3.7.5 Overall Effectiveness in Achieving Policy Objective

In considering the merits of extending the hotel incentives beyond the agreed period or not a number of issues are relevant. Firstly, it is important to consider separately whether any extension is appropriate for projects which have been approved and this is dealt with in our recommendations.

For projects which have missed approval deadlines arguments have been made that the incentives have been effective in increasing supply and we consider this issue below. It has also been suggested that extending incentives to such projects could support regional tourism development or support quality upgrading or permit projects of particular ecological or aesthetic criteria. There is also the issue of whether the existing and pipeline projects would be sufficient to meet the ambitious visitor targets set by the Tourism Policy Review Group.

Indecon has fully taken account of all of these factors and accepts that extending incentives could have some of the impacts referred to above. However, the extent of oversupply in the sector is significant and this will be acerbated by the very large pipeline of projects which have already secured approval.

In the absence of these incentives we would expect on-going investment in projects and in upgrading based on normal commercial criteria. If tourism demand increases, it will be in the interest of investors to expand supply where this is likely to provide a financial return. Against this background it is useful to review in more detail the overall effectiveness of the incentives in achieving policy objectives.

Table 3.49 presents the views of the hotel sector on the effectiveness of the tax incentive in increasing the quantity of tourist accommodation. 94.3% of hotel owners that had availed of the incentive and 80.6% of those who had not believed that the incentive had been effective in increasing the quantity of Irish tourism accommodation.

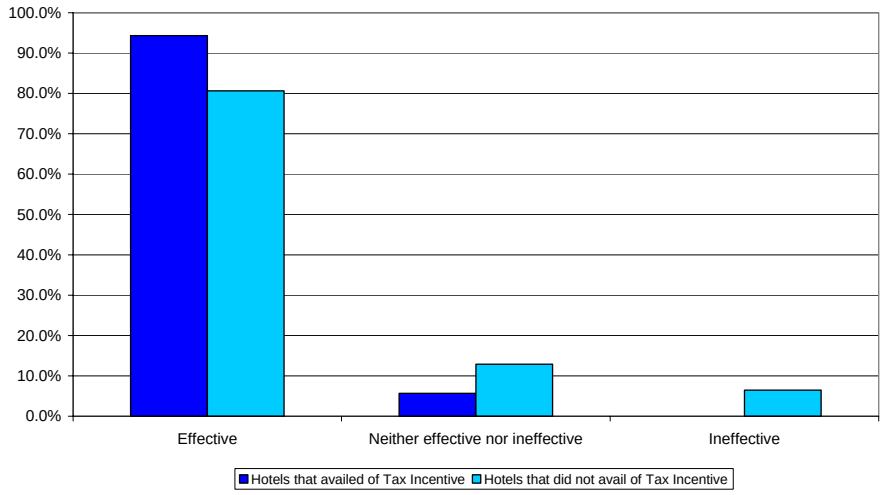
Table 3.49: Views of the Hotel Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Quantity of Irish Tourism Accommodation, Hotels With and Without Tax Incentive

Level of Effectiveness	% of Respondents	
	Hotels that availed of Tax Incentive	Hotels that did not avail of Tax Incentive
Effective	94.3%	80.6%
Neither effective nor ineffective	5.7%	12.9%
Ineffective	0.0%	6.5%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Hotels in Ireland.

Figure 3.12 summarises these views in chart form. The significance of the incentives in expanding the hotel accommodation was also illustrated by Indecon's analysis of the trends in investment levels in the sector.

Figure 3.12: Views of the Hotel Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Quantity of Irish Tourism Accommodation, Hotels With and Without Tax Incentive



Source: Indecon Confidential Survey of Hotels in Ireland.

Table 3.50 presents the views of the hotel sector on the effectiveness of the tax-incentive in increasing the quality of Irish Tourism accommodation. A large proportion of hotel owners considered that the measure had been successful in this regard. This proportion was greater in the case of those who had availed of the tax incentive (86.4%) than those who had not (69.4%), however, a clear majority of all hoteliers judged the incentives as effective in improving the quality of the hotel stock. In comparing this table with Table 3.49 it can be seen that, according to hotel owners, the tax incentive was successful in increasing both the quantity and quality of accommodation.

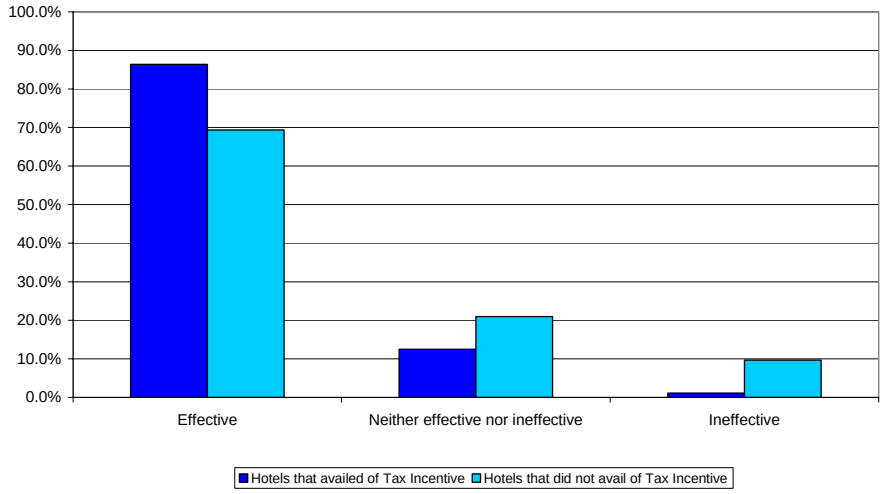
Table 3.50: Views of the Hotel Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Quality of Irish Tourism Accommodation, Hotels With and Without Tax Incentive

	% of Respondents	
Level of Effectiveness	**Hotels that availed of Tax Incentive**	**Hotels that did not avail of Tax Incentive**
Effective	86.4%	69.4%
Neither effective nor ineffective	12.5%	21.0%
Ineffective	1.1%	9.7%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Hotels in Ireland.

Figure 3.13 presents these results in chart form.

Figure 3.13: Views of the Hotel Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Quality of Irish Tourism Accommodation, Hotels With and Without Tax Incentive



Source: Indecon Confidential Survey of Hotels in Ireland.

Table 3.51 presents the views of Local Authorities on the Effectiveness of the Hotel Tax Incentive Scheme. The majority of local authorities also considered it to be effective.

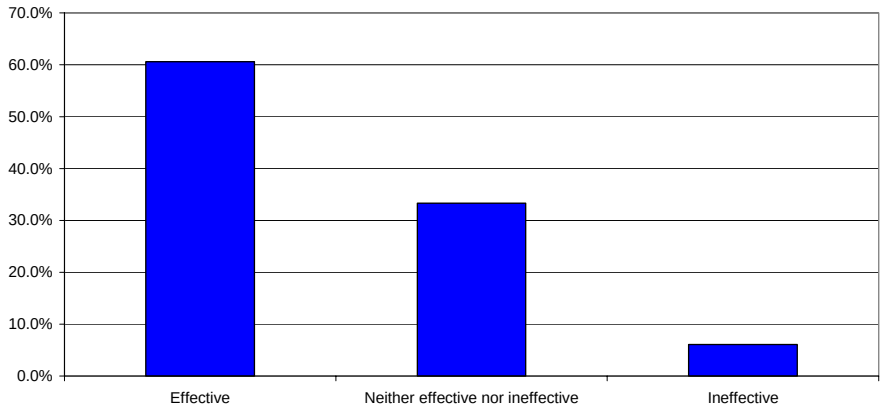
Table 3.51: Views of Local Authorities on the Effectiveness of the Hotel Tax Incentive Scheme

Level of Effectiveness	% of Local Authorities
Effective	60.6%
Neither effective nor ineffective	33.3%
Ineffective	6.1%
Total	100.0%

Source: Indecon Confidential Survey of Local Authorities.

Figure 3.14 presents these results in chart form.

Figure 3.14: Views of Local Authorities on the Effectiveness of the Hotel Tax Incentive Scheme



Source: Indecon Confidential Survey of Local Authorities.

3.8 Summary of Main Findings

In this section, we have reviewed the property-based tax incentive for hotels, and outlined its effect, both on the supply of hotel accommodation, as well as its impact on Exchequer returns. The key findings from our analysis are as follows:

- There have been a number of significant changes in the hotel sector in recent years:
  - There has been a considerable increase in the supply of hotel rooms in Ireland since 1997.
  - Room and bed utilisation rates have fallen since 2000.
  - The average size of hotels has increased.
  - There has been an increase in average profits throughout the sector.
- There has been a considerable increase in the number of planning applications for hotel developments since 2002. A majority of hoteliers consider that the tax incentive has led to over-supply in the sector.

- It is generally felt by those operating within the sector that the tax incentive has increased both the quality and quantity of hotel accommodation available. However, less than a third of hotel operators felt that the property-based tax incentive had attracted additional overseas visitors to Ireland. It is, however, clear that the incentives have helped this important sector to dramatically modernise the hotel infrastructure in Ireland.
- Most of those experts consulted by Indecon felt that much of the recent investment in hotels would either not have taken place in the absence of the tax incentive or would have proceeded over a longer time-frame. However, according to hotel owners, the tax incentive, in addition to increasing investment, it has increased site prices, construction costs, financial return to promoters and property prices.
- We have estimated the total capital expenditure undertaken to date, and have provided a forecast for future eligible capital expenditure. After taking account of the beneficial effects of extra investment as a result of the scheme, allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive to the Irish Exchequer as €125 million in terms of tax revenue foregone.
- The hotel tax incentive has been widely used by high income earners to reduce their tax liability.
- Indecon's survey of accountancy/tax professionals indicated that the tax incentive provided a means for high earners to reduce their tax liability. It was felt by most respondents that those availing of the tax incentive were likely to be earning in excess of €200,000 per year.

4 Capital Allowances for Registered Holiday Cottages

4.1 Introduction and Background

In this section, we present our examination of the tax incentive for group-registered holiday cottage properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability. As part of our research in addition to securing responses from 156 hotels we also received responses from 13 holiday cottage operators.

4.2 Description of Tax Incentive

Under certain transitional arrangements, capital allowances are available for expenditure incurred up to 31 December 2004 on holiday cottages registered with Fáilte Ireland. In order to be registered, a minimum of 9 units is required in each scheme, including one unit to serve as a booking office.

Capital allowances are ring-fenced and are only available for set-off against either rental income generally or trading income (if any) which may be arising from the holiday cottage. In addition, the capital allowances cannot be used to create or augment a loss for set off against other income. The capital allowances are granted at the rate of 10% of qualifying expenditure per annum over a 10 year period.

Section 25 of the 2004 Finance Act provided for an extension of the transitional arrangements for the scheme of capital allowances for hotels, holiday camps and holiday cottages from 31 December 2004 to 31 July 2006, provided a full and valid planning application is received by a planning authority on or before 31 December 2004. The extension also applies, as with the capital allowances for hotels and holiday camps, in relation to exempted development where the same conditions are satisfied by 31 December 2004. Finally, the section provides that capital expenditure incurred on the construction or refurbishment of holiday cottages will be treated as having been incurred on or before 31 July 2006 to the extent that such expenditure is attributable to work on the building or structure which is actually carried out on or before that date.

4.3 Measure of Overall Level of Activity in Sector

4.3.1 Supply of Self-Catering Accommodation

Table 4.1 gives details on the number of group registered self-catering premises by county. The total number of premises in 2005, at 179 was slightly higher than the total in 2001, though is down on its peak of 190 in 2002.

Table 4.1: Group Registered Self-Catering Premises by County, 2001-2005

County	2001	2002	2003	2004	2005
Carlow	0	2	2	2	2
Cavan	2	2	2	2	2
Clare	17	20	19	21	21
Cork	37	40	38	35	34
Donegal	6	7	8	8	8
Dublin	5	6	6	6	6
Galway	17	22	23	22	19
Kerry	35	39	33	41	42
Kildare	1	1	1	1	1
Kilkenny	0	0	0	0	0
Laois	0	0	0	0	0
Leitrim	2	2	2	2	2
Limerick	6	4	4	4	4
Longford	0	0	0	0	0
Louth	0	0	0	0	0
Mayo	7	6	5	5	6
Meath	0	0	0	0	0
Monaghan	0	0	0	0	0
Offaly	1	1	1	1	1
Roscommon	0	0	0	0	0
Sligo	1	1	0	0	0
Tipperary	3	3	3	3	5
Waterford	14	15	13	10	11
Westmeath	1	3	3	3	3
Wexford	9	11	10	8	7
Wicklow	4	5	6	5	5
Total	168	190	179	179	179

Source: Gulliver Ireland

Table 4.2[14] gives a regional breakdown of the number of group registered self-catering premises. The total in 2005 is somewhat greater than the total in 2001, though is down slightly on its peak of 189 in 2002.

Table 4.2: Group Registered Self Catering Premises, by Region, 2001-2005

Region	2001	2002	2003	2004	2005
Dublin	3	6	6	6	6
Midlands East	6	9	10	9	9
South East	20	29	26	21	22
South West	48	69	64	68	76
Shannon	30	36	31	35	27
Ireland West	23	28	28	27	25
North West	9	12	12	12	12
Total	139	189	177	178	177

Source: Gulliver Ireland

Table 4.3 gives data on the number of group-registered self-catering units in the years between 2001 and 2005. There has been a steady increase in the total number of units nationally over the last five years, though the extent of the increase has varied significantly in different counties.

[14] The apparent inconsistency between the regional and county figures in the Gulliver Ireland data arises from the fact that some counties are split in the configuration of tourism regions. In addition to this, some cottage schemes span several counties within the same region, so will be only counted once in the regional data but several times in the country data. This problem affects Table 4.1, Table 4.2, Table 4.3, Table 4.4, Table 4.5 and Table 4.6.

Table 4.3: Group Registered Self-Catering Units by County, 2001-2005

County	2001	2002	2003	2004	2005
Carlow	0	28	28	40	52
Cavan	58	58	58	58	58
Clare	227	249	254	255	302
Cork	578	540	569	615	576
Donegal	89	97	157	157	150
Dublin	54	55	55	53	59
Galway	196	236	270	280	239
Kerry	486	500	472	597	779
Kildare	8	8	8	8	8
Kilkenny	0	0	0	0	0
Laois	0	0	0	0	0
Leitrim	21	21	18	24	22
Limerick	133	54	54	61	55
Longford	0	0	0	0	0
Louth	0	0	0	0	0
Mayo	65	54	46	46	49
Meath	0	0	0	0	0
Monaghan	0	0	0	0	0
Offaly	8	8	8	8	2
Roscommon	0	0	0	0	0
Sligo	17	17	0	0	0
Tipperary	33	44	44	44	104
Waterford	245	225	347	344	340
Westmeath	14	47	47	47	34
Wexford	111	111	105	93	79
Wicklow	89	109	117	87	92
Total	2,424	2,461	2,657	2,817	3,000

Source: Gulliver Ireland

Table 4.4 gives a regional breakdown of the nationwide steady increase in number of group registered self catering units. The most significant change has been in the South West where the number of units has more than doubled from 603 in 2001 to 1,355 in 2005. The number of units fell slightly in Shannon, the only region where this occurred.

Table 4.4: Group Registered Self Catering Units, by Region, 2001-2005

Region	2001	2002	2003	2004	2005
Dublin	33	55	55	53	59
Midlands East	111	164	172	142	134
South East	245	378	494	491	545
South West	603	915	945	1,055	1,355
Shannon	425	425	442	511	389
Ireland West	253	290	316	326	288
North West	132	193	233	239	230
Total	1,802	2,240	2,657	2,817	3,000

Source: Gulliver Ireland

Table 4.5 details the number of group-registered self-catering rooms nationally between 2003 and 2005. There has been a small increase (+10%) over that time period.

Table 4.5: Group Registered Self-Catering Rooms by County, 2001-2005

County	2003	2004	2005
Carlow	98	140	182
Cavan	165	165	165
Clare	749	745	872
Cork	1,456	1,501	1,408
Donegal	434	377	363
Dublin	113	117	128
Galway	709	732	658
Kerry	1,382	1,719	2,160
Kildare	16	16	16
Kilkenny	0	0	0
Laois	0	0	0
Leitrim	38	60	54
Limerick	141	158	143
Longford	0	0	0
Louth	0	0	0
Mayo	170	170	179
Meath	0	0	0
Monaghan	0	0	0
Offaly	24	24	6
Roscommon	0	0	0
Sligo	0	0	0
Tipperary	130	130	175
Waterford	791	792	769
Westmeath	117	117	84
Wexford	279	249	223
Wicklow	321	246	258
Total	7,133	7,458	7,843

Source: Gulliver Ireland

Table 4.6 gives a regional breakdown of the number of group-registered self-catering rooms in Ireland between 2001 and 2005. There has been a substantial nationwide increase, most significantly in the South West where the number of rooms in 2005 was nearly twice its level in 2001.

Table 4.6: Group Registered Self Catering Rooms, by Region, 2001-2005

Region	2001	2002	2003	2004	2005
Dublin	99	165	113	117	128
Midlands East	333	492	453	378	358
South East	735	1,134	1,210	1,222	1,261
South West	1,809	2,745	2,597	2,795	3,568
Shannon	1,275	1,275	1,243	1,439	1,109
Ireland West	759	870	879	902	837
North West	396	579	637	602	582
Total	5,406	7,260	7,132	7,455	7,843

Source: Gulliver Ireland

4.3.2 Level of Incentive Utilisation

Table 4.7 presents the results from the Indecon Survey of Holiday Cottages in Ireland. 46.2% of those who responded had utilised the tax incentive in the last five years.

Table 4.7: Proportion of Holiday Cottages that have Utilised the Tax Incentive over the past 5 years

Impact	% of Survey Respondents
Holiday cottages that have availed of the tax incentive scheme over the past 5 years	46.2%
Holiday cottages that have not availed of the tax incentive scheme over the past 5 years	53.8%
Total	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.8 presents results from the Indecon Survey of Holiday Cottages. Two thirds of those responding who had availed of the tax incentive described themselves as 'individuals in business', while one third described themselves as 'passive investors'. None of the respondents indicated company investors using the scheme. While this may reflect the low levels of profitability in many of the schemes, it means that the costs to the Exchequer are likely to be higher, as investors will be claiming relief from rental income at marginal personal tax rates.

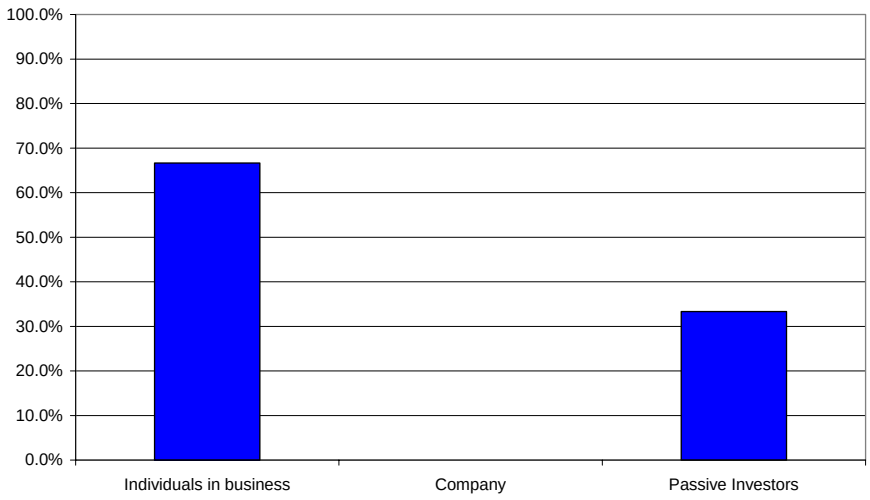
Table 4.8: Profile of Claimants of the Capital Allowances in the case of Holiday Cottages which have Utilised the Holiday Cottages Tax Incentive Scheme

Claimant	% of Respondents
Individuals in business	66.7%
Company	0.0%
Passive Investors	33.3%
Total	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

These findings are also presented graphically in Figure 4.1.

Figure 4.1: Profile of Claimants of the Capital Allowances in the case of Holiday Cottages which have Utilised the Holiday Cottages Tax Incentive Scheme



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.3.3 Level of Construction Activity

Table 4.9 details the number of planning applications for the construction of holiday cottages between 2000 to 2004. There was a significant increase in the number of application (with an associated increase in the number of approvals) in 2003 and 2004.

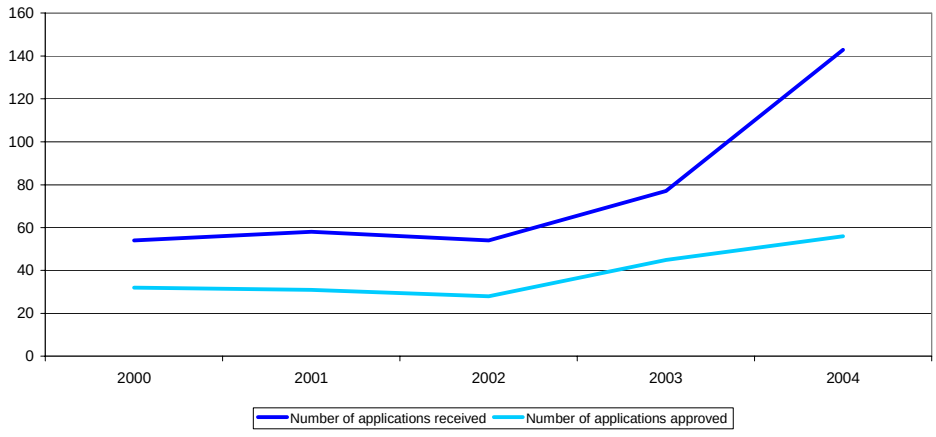
Table 4.9: Details of Planning Applications for Holiday Cottages - Total Number of Applications, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	54	58	54	77	143
Number of applications approved	32	31	28	45	56
Number of applications awaiting decision	6	4	5	2	61

Source: Indecon Confidential Survey of Local Authorities.

The increasing trends in applications over time can be clearly seen in Figure 4.2.

Figure 4.2: Details of Planning Applications for Holiday Cottages- Total Number of Applications, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

Table 4.10 presents the average number of years since the construction or last major refurbishment of the holiday cottages survey by Indecon. In the case of those that holiday cottage groups that had availed of the tax incentive, the number of years was 7. In the case of others, the number of years was 17.

Table 4.10: Average Number of Years since Construction / Latest Refurbishment –Holiday Cottages With and Without Tax Incentive

	Average Number of Years since Construction / Latest Refurbishment
Holiday Cottages that have availed of the tax incentive scheme over the past 5 years	7
Holiday Cottages that have not availed of the tax incentive scheme over the past 5 years	17

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.4 Case Study

Before we examine the detailed impacts of the incentives, it is useful to consider a case study of a holiday cottage investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

The case study in this section assumes that the registered holiday cottage is purchased and operated as a holiday cottage for a 10 year period and subsequently resold as residential property/individual holiday home. Indecon believes that this is the likely outcome for many schemes as the tax incentives end. This suggests the need to renew the clawback period in any future investments to avoid a significant withdrawal of these premises from the tourism supply.

4.4.1 Investor Perspective

An investor is considering a €180,000 investment in residential accommodation. The investor can choose either a property that qualifies as a holiday home or a residential property that does not qualify for this relief. Current annual rental revenue is estimated to be €10,000. Management charges are assumed to be 40% for holiday homes and 10% for residential property[15]. Finally, a risk free interest rate is used to discount the differential cash flows as the differential is assumed to be known with certainty. These assumptions are summarised in Table 4.11[16].

Table 4.11: Key Assumptions

Item	Assumed Level
Investment ('000)	180
Net Yield – Residential Property	5%
Net Yield - Holiday Home	3.3%
Tax Rate	42%
Assumed Revenue Growth	4%
Risk Free 10 Year Bond	3.3%

Source: Indecon.

Using these assumptions, it may be shown (Table 4.12) that the net loss associated with operating holiday homes is 10% of the construction cost. However, in this case study example the current capital allowances for Holiday Homes have a present value of 36%. In this case study, the absence of capital allowances, investors would not choose a Holiday Home. In the presence of capital allowances, investors *should* secure a cumulative present value return equal to 26% of the investment cost (€47,000). However, this analysis assumes that the investor captures the entire benefit of the capital allowances. In practice, it is equally possible that the developer captures this benefit and that holiday homes sell at a €47,000 premium or that some of this is secured in an increased premium by the original site owner.

[15] These yields are based on an examination of estate agents' web sites.

[16] Three simplifying assumptions have been made. First, fixtures and fittings are ignored since they will apply in both cases. Second, land costs are assumed to be immaterial. Third, VAT is ignored. Holiday schemes may involve a claim for VAT on construction costs and subsequent collections of VAT on revenues.

Table 4.12: Investment in Holiday Homes

Period	0	1	2	3	4	5	6	7	8	9	10
Loss - Holiday Home		-3	-3	-3	-4	-4	-4	-4	-4	-4	-4
Taxes		1	1	1	1	2	2	2	2	2	2
After Tax Loss		-2	-2	-2	-2	-2	-2	-2	-2	-2	-3
			%								
			Cost								
Present Value of CFE	-104		-4%								
PV Capital Allowance	1096		38%								
PV of Project + CA	992		34%								

Source: Indecon.

4.5 Impacts of Tax Incentive

4.5.1 Impact on Site Prices

Table 4.13 gives the views of the holiday cottage sector on the effect of the incentive on site prices. Approximately 85% of respondents felt that the scheme had resulted in higher site prices with little difference between the opinions of those who had availed of the tax incentive and those who had not.

Table 4.13: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme- Proportion of Respondents believing that the Scheme has Resulted in Higher Site Prices, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Resulted in higher site prices	83.3%	85.7%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.5.2 Impact on Construction Costs

Table 4.14 gives the views of the holiday cottage sector on the effect of the tax incentive on construction costs. One half of operators who had availed of the tax incentive and 57% of those who had not done so considered that the scheme had led to an increase in construction costs.

Table 4.14: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme- Proportion of Respondents believing that the Scheme has Resulted in Increased Construction Costs, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Resulted in increased construction costs	50.0%	57.1%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.5.3 Impact on Level of Investment in Projects

Table 4.15 presents the views of the holiday cottage sector on the effect of the tax incentive on investment. Every respondent felt that the scheme had led to an increase in investment in holiday cottages. Given the potential significance of the capital allowances in increasing investor returns as illustrated in our case study, this is not surprising.

Table 4.15: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme- Proportion of Respondents believing that the Scheme has Resulted in Increased Investment in Projects, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Resulted in increased investment in projects	100.0%	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.5.4 Impact on Financial Returns to Promoters

Table 4.16 presents the views of the holiday cottage sector on the impact of the tax incentive on financial returns to promoters. Nearly 60% of respondents believed that it has resulted in an increase in returns with no significant difference between the views of those who had availed of the tax incentive and those who had not.

Table 4.16: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme- Proportion of Respondents believing that the Scheme has Resulted in Increased Financial Return to Promoters, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Resulted in increased financial return to promoters	60.0%	57.1%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.5.5 Impact on Property Prices

Table 4.17 gives details on the views of the holiday cottage sector with regard to the effect of the tax incentive on property prices. Two thirds of respondents who had availed of the tax incentive and over 85% of those who had not felt that the scheme had resulted in an increase in property prices.

Table 4.17: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme- Proportion of Respondents believing that the Scheme has Resulted in Property Prices Compared to Non Tax-Incentive Properties, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Resulted in higher property prices compared to non tax-incentive properties	66.7%	85.7%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

4.6 Evaluation of the Tax Incentive

4.6.1 Displacement, Deadweight and Opportunity Cost

Table 4.18 presents the views of the Holiday Cottage sector on the likelihood of projects proceeding in the absence of the tax incentive. A very substantial majority of operators felt that the majority of projects would not have proceeded had the tax incentive not been in existence. The majority is more significant in the case of operators who had not availed of the tax incentive.

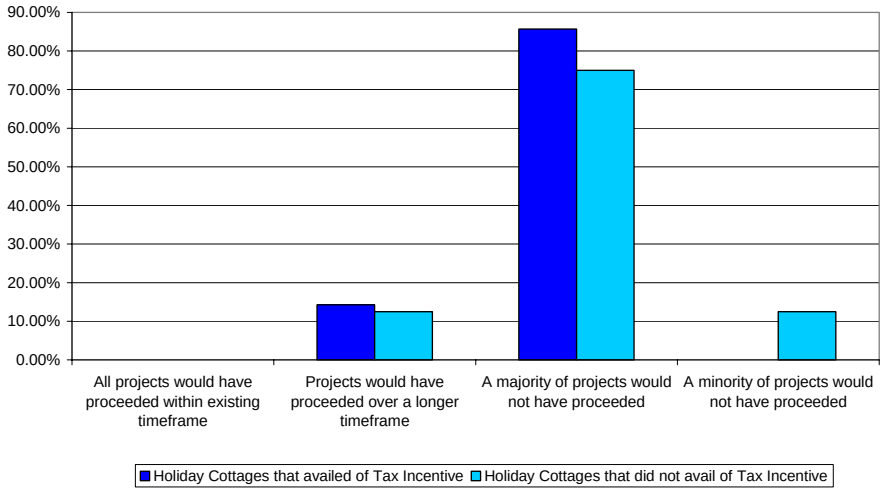
Table 4.18: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Investment in Holiday Cottage developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents	
	Holiday Cottages that availed of Tax Incentive	**Holiday Cottages that did not avail of Tax Incentive**
All projects would have proceeded within existing timeframe	0.0%	0.0%
Projects would have proceeded over a longer timeframe	14.3%	12.5%
A majority of projects would not have proceeded	85.7%	75.0%
A minority of projects would not have proceeded	0.0%	12.5%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

The extent of the agreement on this issue among holiday cottage operators can be seen in Figure 4.3.

Figure 4.3: Views of the Holiday Cottage Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Investment in Holiday Cottage developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.19 presents the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood of capital investment in holiday cottage developments being undertaken in the absence of the tax incentive. All of the responding accountants/tax professionals and a significant majority of the financial institutions and the auctioneers felt that a majority of projects would not have proceeded had the tax incentive not been in existence.

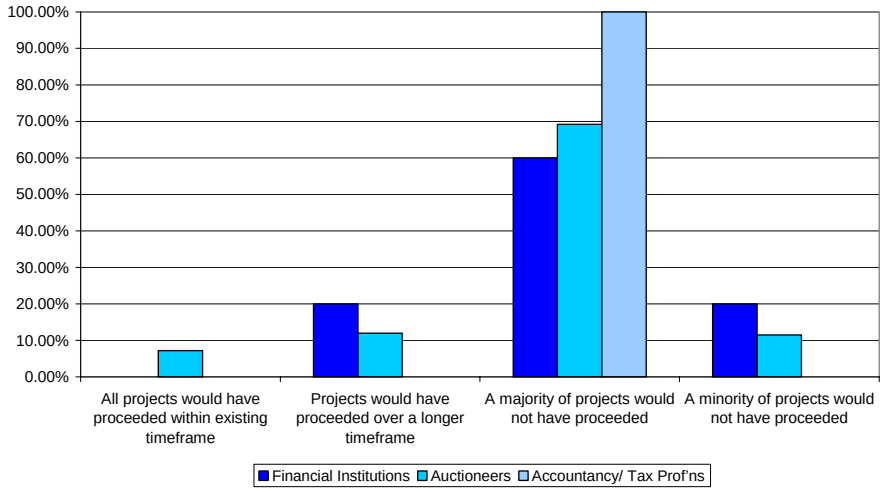
Table 4.19: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Investment in Holiday Cottage developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	Auctioneers	Accountancy/ Tax Prof'ns
All projects would have proceeded within existing timeframe	0.0%	7.2%	0.0%
Projects would have proceeded over a longer timeframe	20.0%	12.0%	0.0%
A majority of projects would not have proceeded	60.0%	69.2%	100.0%
A minority of projects would not have proceeded	20.0%	11.5%	0.0%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 4.4 also shows the common belief that the majority of projects would not have proceeded in the absence of the tax incentive.

Figure 4.4: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Investment in Holiday Cottage developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

4.6.2 Estimated Investment in the Sector

4.6.2.1 Capital Expenditure

Table 4.20 presents details on the total cumulative value of eligible capital expenditure (€4.75 million) by holiday cottage groups and hotel groups that have availed of the tax incentive scheme over the last 5 years. This suggests a capital spend of €49m by respondents to our surveys, but this does not include all the projects. The results suggest that a significant number of hotel groups have been involved with holiday cottage schemes, some on hotel grounds and others independently.

Table 4.20: Total Cumulative Value of Eligible Capital Expenditure incurred over the past 5 years, Holiday Cottages With Tax Incentive

	Total Cumulative Value of Eligible Capital Expenditure (€'000s)
Holiday Cottages that have availed of the tax incentive scheme over the past 5 years	4,750
Hotel Groups that Have Availed of the Holiday Cottage Tax Incentive Scheme	44,400

Source: Indecon Confidential Survey of Holiday Cottages and Hotels in Ireland.

4.6.2.2 *Lending Advanced by Financial Institutions*

Table 4.21 presents a result from Indecon's survey of Financial Institutions in Ireland. Lending advanced by respondents for the construction or refurbishment of holiday cottages amounted to €76.2m in 2003 and €86.6m in 2004. The total capital expenditure on projects including promoter's equity was estimated by the responding financial institutions at just over €101m in 2003 and just over €107m in 2004.

Table 4.21: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimated Total Capital Expenditure on Holiday Cottages including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	76,200	86,600
Total capital expenditure on projects including promoter's equity	101,600	107,100

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

4.6.3 Estimated Gross and Net Cost of Tax Incentive

4.6.3.1 Capital Expenditure

Indecon has based it estimate of total capital expenditure under the registered holiday cottages scheme on responses to our survey and on our estimate of total number of schemes in operation[17]. Based on average spend per development and the total number of registered schemes in the country[18], we estimate a total capital expenditure of €103,000,000 for the period 2001-2005. This gives an annual average expenditure of €20,600,000.

While there is some uncertainty regarding total investment levels we believe this figure of €103m to be the best estimate of expenditure over the period. This compares with an estimate of €49m spent by respondents to the Indecon survey. While the results from financial institutions would suggest a higher level of capital investment, we believe that some of this investment may occur in future years.

It is important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. In order to calculate future uptake of the tax incentive under this scheme, we have estimated future planning permission approvals based on outstanding applications and historic approval rates[19]. Given that applications for qualifying developments had to be received by the end of 2004, we can be confident that this data gives all of the developments which can now qualify for the scheme. If we were to assume that 50% of these schemes will avail of the tax incentive, the total remaining investment under this scheme could total €28,870,000, based on average expenditure per scheme from our survey. However, our survey a somewhat higher potential uptake on the tax incentive scheme, so we estimate that future investment will be of the order of €38,494,000. If all of the projects which have lodged planning applications before the deadline were to secure the incentive, the future capital spend would be of the order of €58m.

[17] Indecon confidential survey of holiday cottages

[18] Fáilte Ireland

[19] All of this data comes from the Indecon survey of county councils

Table 4.22: Estimate of Total Eligible Capital Expenditure on Holiday Cottages under the Tax Incentive Scheme

Detail	Value (€)
Total Cumulative Expenditure to date	103,000,000
Total Eligible Capital Expenditure Per annum	20,600,000
Estimate of Future Expenditure	38,494,000

Source :Indecon calculations

4.6.3.2 *Impact of the Capital Expenditure*

The increased levels of investment arising from the existence of the scheme will give rise to increased economic activity, such as increased employment and service requirements in the holiday cottage sector. In order to take this into account in our model we include a 'multiplier' effect, which estimates the increase in economic activity due to the increased level of investment. For the period 2001-2005, we have estimated that the level of investment outlined above will give rise to expenditure of the order of €129,265,000. However, this figure must be adjusted for the opportunity cost of the investment, reflecting the fact that had this money not been invested in the holiday cottage sector it could have been invested in other sectors of the economy. We assume an opportunity cost of 95%, which gives us an economic benefit of €6,463,000.

4.6.3.3 *Impact on Exchequer Revenues*

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the method of calculating allowances of each scheme. In the case of holiday cottages, this is based on the method of deducting the capital allowance over 10 years, in equal amounts. The tax revenue forgone is then calculated using current corporate and income tax rates, while the investor profile is based on information from the Indecon survey of holiday cottage operators. The tax foregone relating to years after 2005 is subject to a net present value (NPV) calculation, which reflects the current value of the future tax foregone.

Using this method, we have estimated a gross cost to the Exchequer of €37,863,000. However, this figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to Exchequer tax revenues. Indecon has estimated that gross tax revenues arising from the economic activity will be of the order of €46,665,000. Adjusting this figure to reflect the opportunity cost of the investment (i.e. the fact that the money could have been invested in other sectors of the economy), we calculate a net tax contribution of €11,666,000. In other words, we assume that 75% of Exchequer revenues from indirect taxes such as VAT and other taxes would have occurred in any case. Deducting this figure from the gross cost to the Exchequer, we calculate a net cost of €26,197,000.

Table 4.23 presents a summary of Indecon's estimates for this scheme.

Table 4.23: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Holiday Cottages

Estimate	€'000
Capital Expenditure to Date	103,000
Gross Tax Revenue Foregone	37,863
Tax contribution adjusted for Indirect Tax Revenues	11,666
Net Tax Revenue Foregone	26,197
Future Capital Expenditure	38,494

Source: Indecon Confidential Surveys of Holiday Cottage Schemes and County Councils, Fáilte Ireland.

The above figures must be adjusted to account of the deadweight. This is due to the fact that in the absence of the tax incentive, some of the holiday cottage schemes would have gone ahead anyway. Based on Indecon's surveys of holiday cottage schemes, auctioneers, financial institutions and the accounting profession, we believe that deadweight is low for this incentive and estimate this deadweight to be of the order of 5%. The figure 'Tax contribution adjusted for Indirect Tax Revenues' must be adjusted to take this into account. We therefore get a net tax contribution of €11,083,000, reflecting deadweight of about €583,000. This means that the net tax foregone due to the tax incentive scheme is actually of the order of €26,781,000.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we increase this figure to 1.35 the net tax revenue foregone decreases to €25,314,000, a fall of around €0.88m, and adjusting this figure for deadweight gives us a net figure of €25,942,000, representing a decrease of around €0.84m on the base case scenario. If we decrease the multiplier to 1.1, the net tax revenue foregone increases to €27,638,000, an increase of around €1.44m, and adjusting this figure for deadweight gives us a net figure of €28,149,000, representing an increase of around €1.37m on the base case scenario. Additionally, we have also assumed a deadweight figure of 5%. If we adjust this to 10%, holding the multiplier figure at 1.255, the net tax forgone figure increases to €27,364,000, an increase of around €1.75m.

4.6.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 4.24 presents the opinions of the accountancy/tax professionals with regard to the profile of those likely to avail of the holiday cottages tax incentive scheme. Two-thirds believed that those investing would be likely to be earning over €100,000 a year.

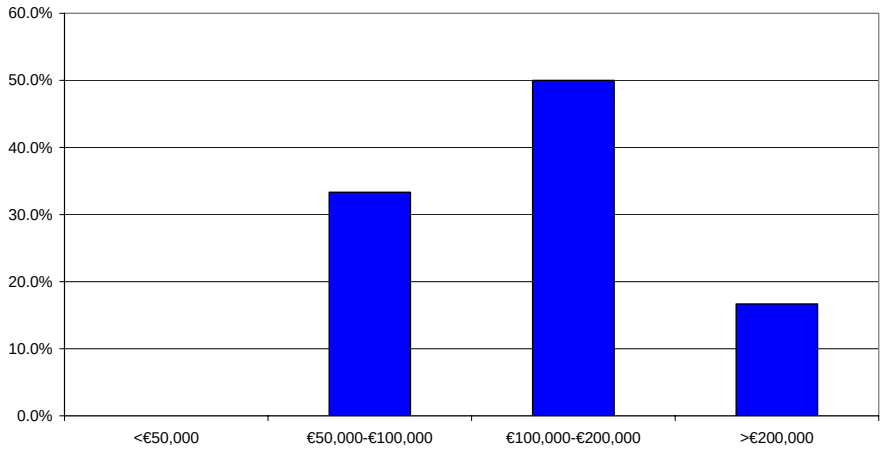
Table 4.24: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising The Holiday Cottages Tax Incentive Scheme

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	16.7%
Majority of investors were likely to be earning between €100,000 and €200,000	50.0%
Majority of investors were likely to be earning between €50,000 and €100,000	33.3%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 4.5 presents the opinions of the accountancy/tax professionals in chart form. Our research of the sector indicated that nearly all of the allowances were claimed by individuals.

Figure 4.5: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Average Estimates of which Gross Annual Income Category accounted for the Majority of Investors Utilising the Holiday Cottages Tax Incentive Scheme



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

4.6.5 Overall Effectiveness in Achieving Policy Objective

Table 4.25 presents the views of the holiday cottage sector on the impact of the tax incentive on Irish tourism. Two thirds of operators who have availed of the tax incentive and one third of those who did not considered it to have improved visitor accommodation. Very few respondents considered it to have attracted additional visitors to Ireland.

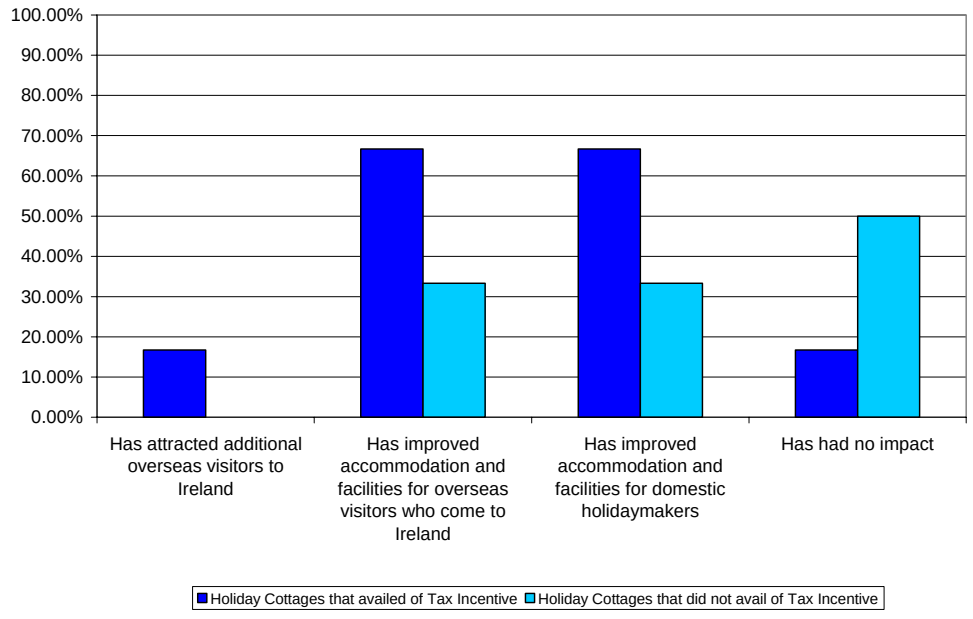
Table 4.25: Views of the Holiday Cottage Sector on the Impacts of the Property-based Tax Incentive Scheme, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Has attracted additional overseas visitors to Ireland	16.7%	0.0%
Has improved accommodation and facilities for overseas visitors who come to Ireland	66.7%	33.3%
Has improved accommodation and facilities for domestic holidaymakers	66.7%	33.3%
Has had no impact	16.7%	50.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

This pattern can also be seen in Figure 4.6.

Figure 4.6: Views of the Holiday Cottage Sector on the Impacts of the Property-based Tax Incentive Scheme, Holiday Cottages With and Without Tax Incentive



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.26 presents the views of the Holiday Cottage sector on the impact of the tax incentive on the supply of holiday cottages. Half of those operators who have availed of the tax incentive and over 70% of those who have not believed that the incentive has led to an oversupply of visitor accommodation. During our consultation programme a number of individual operators indicated their concerns regarding the issue of over-supply and the extent of utilisation levels within this sector.

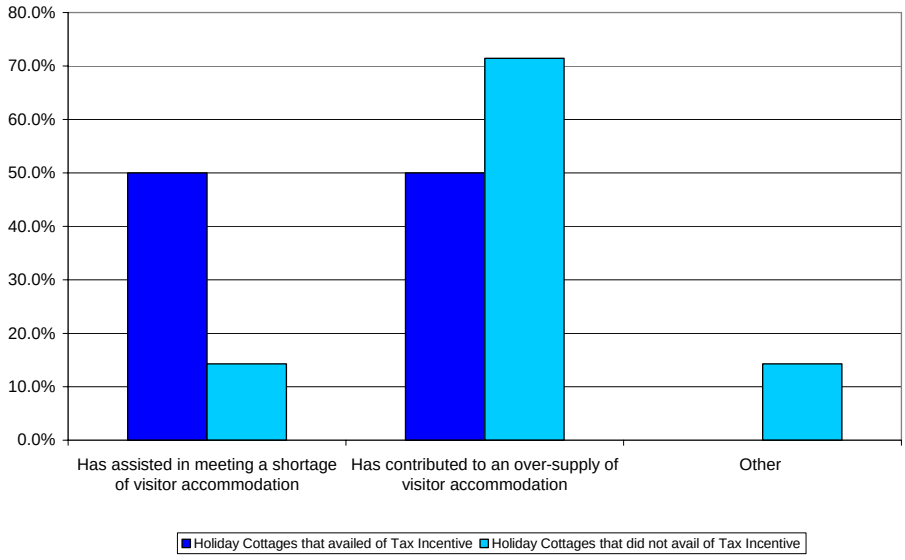
Table 4.26: Views of the Holiday Cottage Sector on the Impacts of the Property-based Tax Incentive Scheme on the Supply of Holiday Accommodation, Holiday Cottages With and Without Tax Incentive

	% of Survey Respondents	
Impact	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Has assisted in meeting a shortage of visitor accommodation	50.0%	14.3%
Has contributed to an over-supply of visitor accommodation	50.0%	71.4%
Other	0.0%	14.3%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

These views are also presented graphically in Figure 4.7.

Figure 4.7: Views of the Holiday Cottage Sector on the Impacts of the Property-based Tax Incentive Scheme on the Supply of Holiday Accommodation, Holiday Cottages With and Without Tax Incentive



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.27 presents the views of the holiday cottage sector on the effectiveness of the tax incentive scheme in increasing the quantity of Irish tourism accommodation. A substantial proportion (83.3%) of those who availed of the tax incentive considered it to have been successful in this regard.

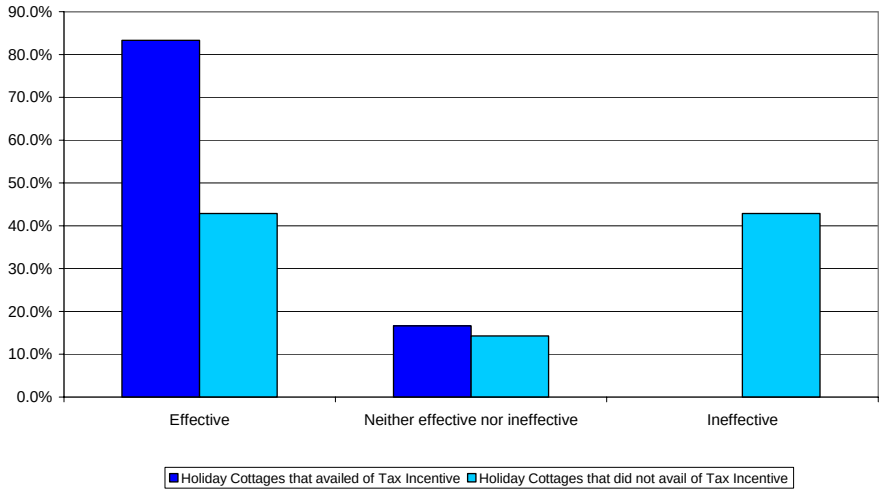
Table 4.27: Views of the Holiday Cottage Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Quantity of Irish Tourism Accommodation, Holiday Cottages With and Without Tax Incentive

	% of Respondents	
Level of Effectiveness	**Holiday Cottages that availed of Tax Incentive**	**Holiday Cottages that did not avail of Tax Incentive**
Effective	83.3%	42.9%
Neither effective nor ineffective	16.7%	14.3%
Ineffective	0.0%	42.9%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

The survey findings are presented in chart form in Figure 4.8.

Figure 4.8: Views of the Holiday Cottage Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Quantity of Irish Tourism Accommodation, Holiday Cottages With and Without Tax Incentive



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.28 presents the views of the Holiday Cottage Sector on the effectiveness of the tax incentive scheme in improving the quality of Irish visitor accommodation. A significant majority of those who had availed of the tax incentive considered it to have been effective in this regard.

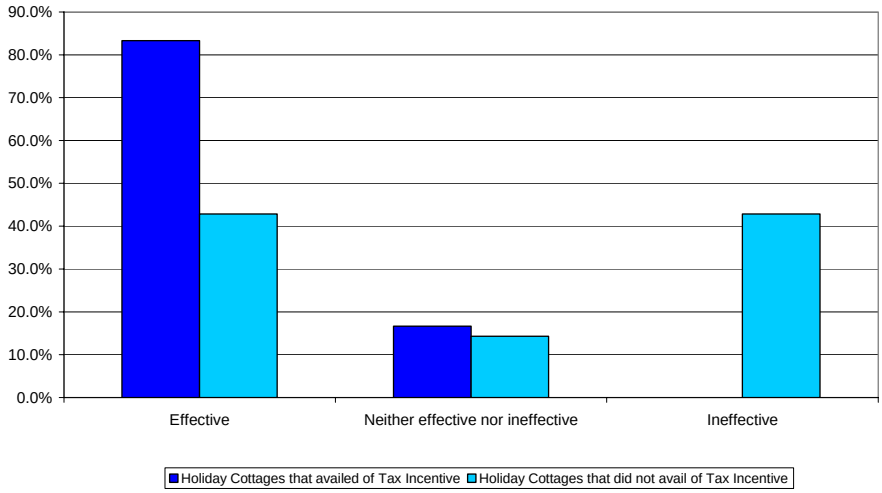
Table 4.28: Views of the Holiday Cottage Sector on the Effectiveness of Property-based Tax Incentive Scheme in Improving the Quality of Irish Tourism Accommodation, Holiday Cottages With and Without Tax Incentive

Level of Effectiveness	% of Respondents	
	Holiday Cottages that availed of Tax Incentive	Holiday Cottages that did not avail of Tax Incentive
Effective	83.3%	42.9%
Neither effective nor ineffective	16.7%	14.3%
Ineffective	0.0%	42.9%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Figure 4.9 contains an alternative presentation of the views of the Holiday Cottage Sector on the effectiveness of the tax incentive scheme in improving the quality of Irish visitor accommodation.

Figure 4.9: Views of the Holiday Cottage Sector on the Effectiveness of Property-based Tax Incentive Scheme in Improving the Quality of Irish Tourism Accommodation, Holiday Cottages With and Without Tax Incentive



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.29 presents the views of the views of the holiday cottage sector on the many impacts of the tax incentive on the Irish economy. Those who had availed of the tax incentive were positive about its effects, with all considering it to have improved the quality of visitor accommodation, most considering it to have increased economic activity and slightly over half consider it to have resulted in the creation of jobs. Those who had not availed of the incentive were less positive with only half of respondents considering it to have had positive effects on the Irish economy

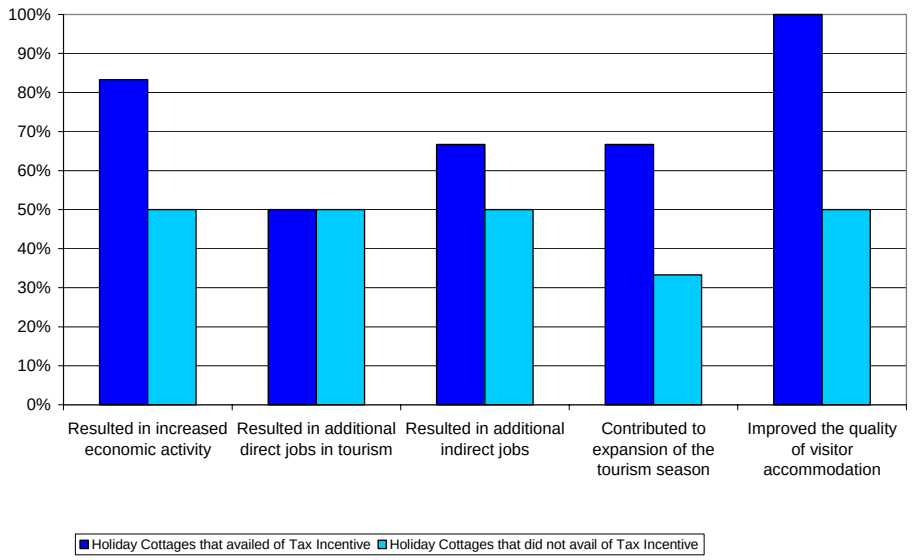
Table 4.29: Views of the Holiday Cottage Sector on Other Impacts of the Property-based Tax Incentive Scheme, Holiday Cottages With and Without Tax Incentive

Impact	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Holiday Cottages that availed of Tax Incentive	Holiday Cottages that did not avail of Tax Incentive
Resulted in increased economic activity	83.3%	50.0%
Resulted in additional direct jobs in tourism	50.0%	50.0%
Resulted in additional indirect jobs	66.7%	50.0%
Contributed to expansion of the tourism season	66.7%	33.3%
Improved the quality of visitor accommodation	100.0%	50.0%

Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Again, a chart of these results is also provided, in Figure 4.10.

Figure 4.10: Views of the Holiday Cottage Sector on Other Impacts of the Property-based Tax Incentive Scheme, Holiday Cottages With and Without Tax Incentive



Source: Indecon Confidential Survey of Holiday Cottages in Ireland.

Table 4.30 presents the views of the Local Authorities on the effectiveness of the tax incentive scheme. 60% consider it to have been effective.

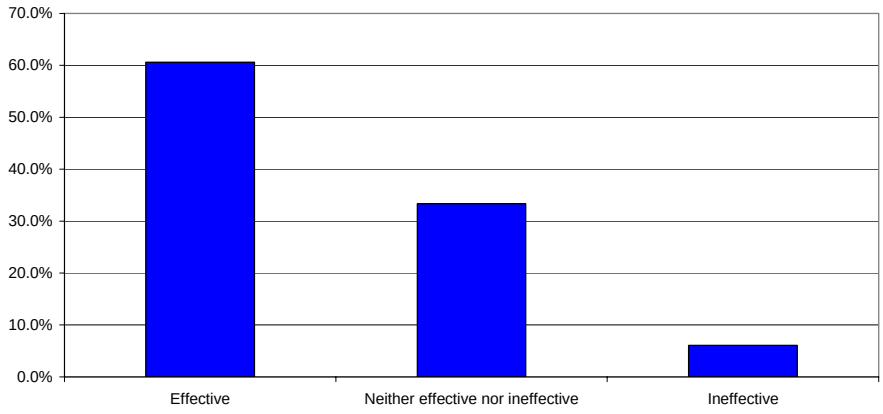
Table 4.30: Views of Local Authorities on the Effectiveness of Holiday Cottages Tax Incentive Scheme

Level of Effectiveness	% of Local Authorities
Effective	60.6%
Neither effective nor ineffective	33.3%
Ineffective	6.1%
Total	100.0%

Source: Indecon Confidential Survey of Local Authorities.

This is again illustrated in Figure 4.11.

Figure 4.11: Views of Local Authorities on the Effectiveness of Holiday Cottages Tax Incentive Scheme



Source: Indecon Confidential Survey of Local Authorities.

4.7 Summary of Main Findings

In this section, we have reviewed the property-based tax incentive for holiday cottages, and outlined its impact both on the supply of self-catering visitor accommodation as well as its impact on Exchequer returns. The key findings from our analysis are as follows:

- Just under half of those groups responding to Indecon's survey had availed of the incentive. There has been a significant increase in the supply of self-catering accommodation since 2000. According to those operating in the sector, the tax incentive has had the effect of increasing investment in projects. It was generally felt both by holiday cottage operators and by those experts consulted by Indecon that, in the absence of the tax incentive, the majority of recent developments would not have proceeded.
- In addition to increasing investment, it is likely that the incentive had led to increased site prices, greater financial returns to promoters and higher property prices.
- There was considerable sentiment among those operating it the sector that the tax incentive had led to over-supply. This position is likely to be intensified if pipeline projects proceed.
- The tax incentive scheme has been effective in increasing both the quantity and quality of visitor accommodation, however, few respondents to Indecon's surveys considered that the property-based tax incentive had had the effect of attracting additional overseas visitors to Ireland.
- We have estimated the total capital expenditure undertaken to date and have provided a forecast of future eligible capital expenditure. After taking account of the beneficial effect of extra investment as a result of the scheme, allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive to the Irish Exchequer as nearly €27 million in terms of tax revenue foregone.
- There is some evidence to support the contention that the scheme provides a means for high earners to reduce their tax liability. Most respondents to Indecon's survey of accountancy/tax professionals felt that those availing of the tax incentive were likely to be earning in excess of €100,000.

5 Capital Allowances for Private Hospitals

5.1 Introduction and Background

In this section, we present our examination of the tax incentive for private hospital properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability.

5.2 Description of Tax Incentive

A scheme of capital allowances is available for expenditure incurred on or after 15 May 2002 on the construction or refurbishment of buildings used as private hospitals. The hospital must have the capacity to afford medical or surgical services all year round; provide a minimum of 70 in-patient beds, out-patient services, operating theatres and on-site diagnostic and therapeutic services and have facilities to provide at least 5 specialist services, ranging from accident & emergency to oncology and cardiology, etc. Section 24 of the Finance Act 2003 extended this relief, with effect from 28 March 2003, to private hospitals providing acute services on a day-case basis with accommodation for such services of not less than 40 beds.

Annual allowances in respect of qualifying expenditure are available at the rate of 15 per cent for the first 6 years with the balance of 10 per cent being written off in year 7. There is no termination date currently for this relief, and in our recommendations, we consider the merits of the continuation of this relief.

While the hospital provides services to those patients with private health insurance, 20% of the bed capacity must be available for public patients, and the hospital must provide a discount of at least 10% to the State in respect of the fees to be charged in respect of the treatment of public patients. Rooms used exclusively for the assessment or treatment of patients qualify for the capital allowances but consultants' rooms or offices are excluded. Fulfilment of the conditions necessary for qualification for the allowances has to be certified annually by the appropriate health board.

A company, a property developer (where the property developer or a connected person incurred the capital expenditure), an individual involved in the operation or management of the hospital and the trustees of a trust do not qualify for the capital allowances whether the relevant interest in the capital expenditure is held by any such person in a sole capacity or jointly or in partnership with another person or persons.

5.3 Measure of Overall Level of Activity in Sector

5.3.1 Level of Construction Activity

Table 5.1 present the results regarding planning applications for private hospitals from Indecon's survey of Local Authorities. There was an average of 13 applications per year between 2000 and 2004 with an average of nearly 11 approvals per year. However, Indecon's analysis suggests that most of these projects have not proceeded and we are aware of two projects which are underway or completed.

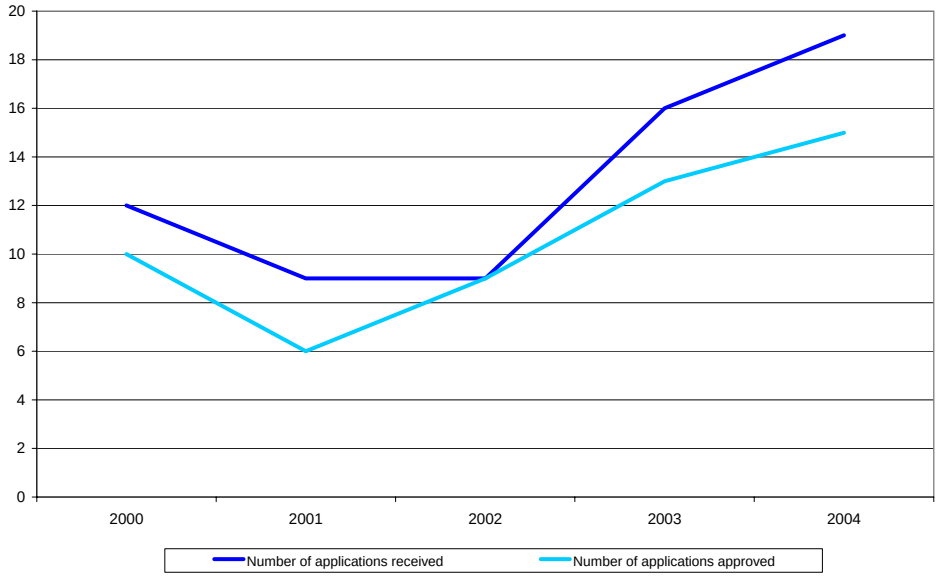
Table 5.1: Details of Planning Applications - Total Number of Applications for Private Hospitals, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	12	9	9	16	19
Number of applications approved	10	6	9	13	15
Number of applications awaiting decision	1	2	0	0	2

Source: Indecon Confidential Survey of Local Authorities.

The number of applications, and approvals, has risen considerably since 2001 as illustrated in Figure 5.1.

Figure 5.1: Details of Planning Applications for Private Hospitals- Total Number of Applications for Private Hospitals, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

5.4 Case Study

It is useful to consider a case study of a private hospital investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work. Unlike many other classes of incentive, no non-confidential data was available concerning the operating performance of private hospitals due to the very small number of relevant projects completed or underway. In the absence of such data, a generalized valuation model is developed that may be applied to the private hospital sector. In addition, US data on medical Real Estate Investment Trusts (REITs) is used to arrive at an estimate of the incentives that may be necessary.

5.4.1 Investor Perspective

From an investor perspective, the valuation model is identical to the valuation model that was used for the hotels case study. Using data from US medical REITs, the average EBITDA/Value ratio is 7.2% while the average Revenue/EBITDA ratio is 11.23%. Therefore, 7.2% represents a first approximation of the yield from medical real-estate investments.

The current provisions require that a 10% discount must be offered to 20% of patients. Two methods (Low and High) were used to estimate the impact of these provisions:

- The *Low* method adjusts the EBITDA/Revenue multiple for a 10% discount to 20% of patients. This has the effect of decreasing the EBITDA/Value multiple from 7.2% to 6.98%.
- The *High* method uses financial statement data from HCA, a for-profit US hospital organisation, to compute the EBITDA impact of a 10% discount to 20% of customers. This resulted in a reduction in the EBITDA/Value ratio from 7.2% to 6.25%.

We assume for this case study an investment of €100 million in a new hospital. We also assume the investor intends to dispose of the hospital after 10 years and the cost of equity is 24% (See Annex 1 for computations). The investor finances 75% of the cost using a 25 year mortgage at 200 points above the Euro par yield for 10 year bonds. The investor is subject to income taxes at 42% and capital gains taxes at 20%. The EBITDA/Cost yield on the investment is 6.98% and EBITDA is expected to grow at 6% per annum (reflecting medical cost inflation that exceeds general inflation rates). The value of the asset is expected to grow at a rate of 3% reflecting projected price changes for the economy more generally. These assumptions are summarised in Table 5.2.

Table 5.2: Key Assumptions

Item	Assumed Level
Investment ('000)	100,000
Investment Term (years)	10
Cost of Equity	24%
Borrowing/Investment	75%
Cost of Debt	5%
Term of Loan (years)	25
Tax Rate	42%
Assumed Yield	7%
Assumed Asset Growth	3%
Assumed Revenue Growth	6%
Capital Gains Tax (CGT)	20%

Source: Indecon.

Applying these assumptions, three Incentive Ratios are computed. Firstly, an Incentive Ratio is computed using an EBITDA/Value multiple of 6.98% (the 'low' method. This results in an Incentive Ratio of -10%. Second, the results are re-estimated to include an investment in land of €10 million. This results in a decrease in the Incentive Ratio to -11% and increase the cost of the investment to €110 million. Finally, the cost of land is combined with the 'high' method of computing the discount to public patients. This lowers the Incentive Ratio to -13%. These results are reported in Table 5.3.

Table 5.3: Analysis of Hospital Investment (€ millions)

Period	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Asset Cost	-100										
Sale of Asset (net of CGT)											143
EBITDA		7	8	8	9	9	10	10	11	12	13
Interest Expense		-4	-4	-4	-4	-4	-4	-3	-3	-3	-3
Taxes		-1	-2	-2	-2	-2	-3	-3	-3	-4	-4
Net Cash Flow		2	2	3	3	3	4	4	5	5	149
Debt Service - Principal	75	-2	-2	-2	-2	-2	-2	-2	-2	-2	-58
Cash Flow to Equity (CFE)	-25	0	1	1	1	1	2	2	2	3	91

		% Cost (Low)	% Cost (10% Land/Low)	% Cost (10% Land/High)
Present Value of CFE	-10	-10%	-11%	-13%
PV Capital Allowance	38	38%	35%	35%
PV of Project + CA	28	28%	24%	22%

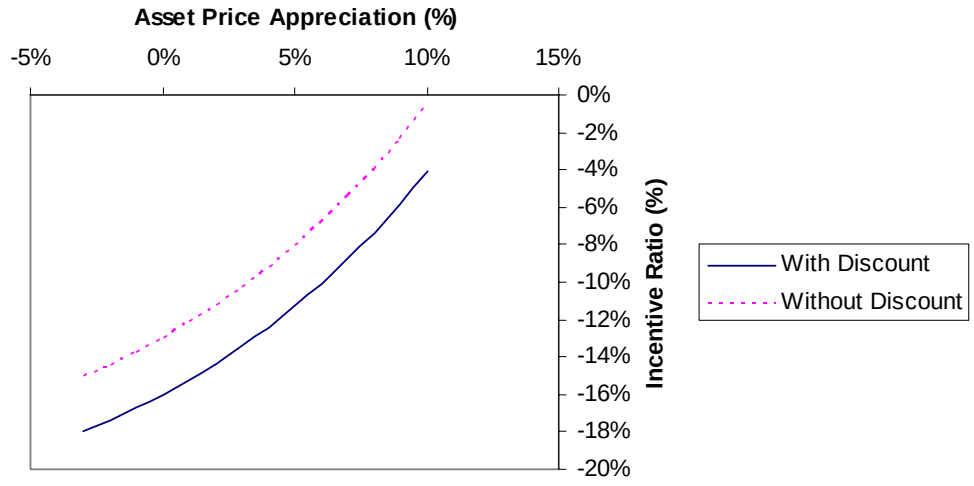
Source: Indecon.

5.4.2 Sensitivity Analysis

In the previous section it was assumed that the value of the real estate asset would increase at 3% per annum (a real return of zero). If it is assumed that land constitutes 10% of the investment and the 'high' method is used to compute the discount to public patients, then the Incentive Ratio is -13%.

Figure 5.2 summarises the impact of varying the asset growth assumption and also includes the impact of a discount to public patients. It may be seen from Figure 5.2 that a private sector investor is unlikely to consider a hospital investment unless asset price appreciation is expected to be 10% per annum and it is not necessary to offer a discount to public patients. This highlights the significance of the tax incentives in encouraging supply of private hospitals.

Figure 5.2: Investment Ratio Vs. Asset Prices



Source: Indecon.

5.5 Evaluation of the Tax Incentive

5.5.1 Displacement, Deadweight and Opportunity Cost

Table 5.4 summarises the views of financial institutions, auctioneers and accountancy/tax professionals regarding the likelihood that capital expenditure in private hospitals would have proceeded in the absence of the tax incentive. While most of the financial institutions contend that projects would have proceeded over a longer timeframe, most accountancy/tax professionals feel that a majority of projects would not have proceeded. Nearly half of auctioneers believed that most projects would not have proceeded in the absence of the tax incentive.

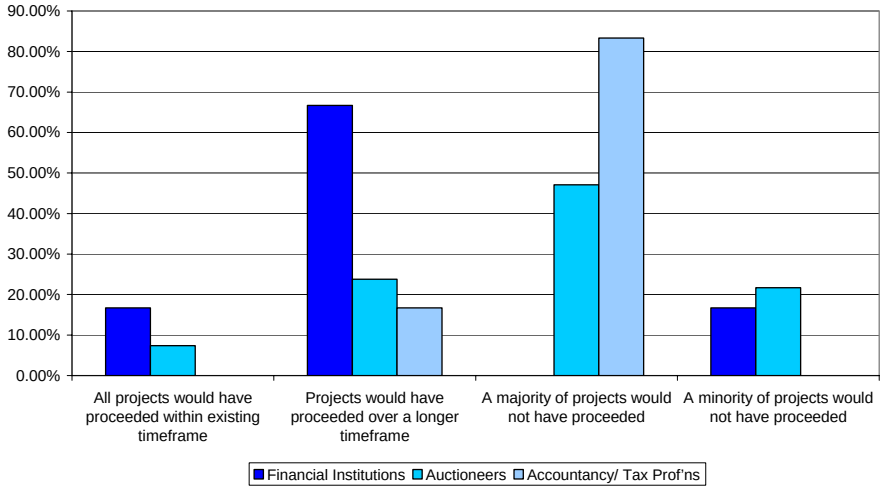
Table 5.4: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Private Hospitals) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	Auctioneers	Accountancy/ Tax Prof'ns
All projects would have proceeded within existing timeframe	16.7%	7.4%	0.0%
Projects would have proceeded over a longer timeframe	66.7%	23.8%	16.7%
A majority of projects would not have proceeded	0.0%	47.1%	83.3%
A minority of projects would not have proceeded	16.7%	21.7%	0.0%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 5.3 emphasises that although there are differences of opinion between the various categories of expert consulted by Indecon, very few respondents of any type considered that all, or, most, projects would have proceeded within the same timeframe.

Figure 5.3: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Private Hospitals) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

5.5.2 Estimated Investment in the Sector

5.5.2.1 Lending Advanced by Financial Institutions

Table 5.5 presents a result from Indecon's survey of Financial Institutions in Ireland. The total capital expenditure on relevant projects estimated by responding financial institutions was nearly €17m in 2003 and nearly €56m in 2004. We believe however that responding institutions may not have financed all of the relevant projects and so the figures represent an underestimation of capital spend (figures have been rounded).

Table 5.5: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimate Total Capital Expenditure on Private Hospitals including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	14,000	42,000
Total capital expenditure on projects including promoter's equity	17,000	56,000

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

5.5.3 Estimated Gross and Net Cost of Tax Incentive

5.5.3.1 Capital Expenditure

Initial uptake on the tax allowance scheme has been low, with one hospital complete and another under construction[20]. For confidentiality reasons, specific figures are not provided in this report but for illustrative purposes, it is useful to consider the impact assuming total eligible capital expenditure of €154,000,000.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. Data on this sector suggests that there are currently 7 projects which will come on line in the coming years. The total capital expenditure of these projects is estimated to be of the order of €810,000,000. However, this figure must be adjusted to reflect the fact that the tax allowance scheme does not allow for site-acquisition costs. We therefore estimate future capital expenditure under this scheme to be of the order of €453,600,000.

[20] This information comes from Indecon's survey of private hospitals

Table 5.6: Estimate of Total Eligible Capital Expenditure on Private Hospitals under the Tax Incentive Scheme

Detail	Value (€)
Assumed Capital Expenditure	154,000,000
Forecast for Future Expenditure	453,600,000

Source :Indecon Calculations

5.5.3.2 Impact of the Capital Expenditure

The increased levels of investment arising from the existence of the scheme will give rise to increased economic activity. In order to take this into account in our model we include a 'multiplier' effect, which estimates the increase in economic activity due to the increased level of investment. For the period 2001-2005, we have estimated that the level of investment outlined above will give rise to €193,270,000 of expenditure in the Irish economy. However, this figure must be adjusted for the opportunity cost of the investment, reflecting the fact that had this money not been invested in the private hospitals sector it could have been invested in other sectors of the economy. We assume an opportunity cost of 95%. However, in the case of private hospitals, there is likely to be a wider benefit to the economy, arising from the role which these hospitals play in reducing demands on the public health sector, and this is estimated to be equivalent to 10% of the total capital spend. The net economic benefit is therefore estimated to be of the order of €28,991,000. As indicated subsequently, this is greater than the estimated net tax revenue foregone (€23,278,000 adjusted for deadweight). The impact of capital expenditure in private hospitals needs to be seen in the context of government plans for the sector. There is a commitment in the Government's Health Strategy to encourage the private sector to provide more treatment for public patients.

The Government's plan for private hospitals in the grounds of public hospitals is designed to be a cost effective way of expanding supply. There are nearly 13,000 beds in public hospitals. Of these, 2,500 are for private patients. The Government initiative aims to move 1,000 of these beds into new private hospitals on the campuses of public hospitals and thereby expanding supply of new public beds. The 1,000 new public beds is aimed at improving services for patients and alleviating pressure on A&E departments.

The Government's plans for strategic reform of our hospital services has the following objectives:

- Increasing bed capacity for public patients in public hospitals;
- Encouraging the participation of the private sector in generating extra capacity;
- Maximising the potential use of public hospital sites;
- Promoting efficiency among public and private acute service providers;
- Promoting greater competition in the supply of hospital services;
- Offering improved quality and choice to all patients.

Against the background of these plans investment in private hospital if properly managed will increase supply and competition. The private hospital will also be required to offer at least 20 per cent of its capacity to the public sector at a discount of 10% or more.

The issue of how to ensure cost effectiveness in the Irish health sector is critical in the context of ensuring that any increase in the supply of private hospitals leads to a reduction in overall costs. This raises issues such as supply constraints of medical personnel (which has implications for the higher education sector) as well as the overall level of price competition in the private hospital sector. The overall cost implications will also be influenced by the contractual arrangements between the state and investors concerning the supply of land as well as the contractual details concerning the costs of service provision.

The level of competition between private health insurers and how they interact with the private hospital sector as well as the impact of supply changes in the hospital sector on demand for health insurance is also relevant. While suggestions for changes on these fundamental health policy issues are outside the scope of this review it is important that associated measures as well as the proposed continuation of the tax incentives are considered by policymakers to ensure that the development of private hospitals assists in providing the highest standards and most cost effective services to patients in the overall health sector. Simply constructing private hospitals will not necessarily result in a reduction of demand on the public health sector but the resultant increase in supply has the potential combined with other initiatives to reduce pressures on the public health sector and to reduce costs.

One potential amendment to the scheme which was suggested to Indecon in order to enhance the impact of the capital spend related to some form of regional other needs assessment. This issue also applies to a range of other schemes. While Indecon understands the rationale for such proposals, our view is that there is a danger of the public sector attempting to second guess specific private sector decisions and a danger of creating local monopolies or supporting existing suppliers at the expense of new entrants. Similar issues applied in relation to pharmacies. We therefore would not be in favour of specific need assessments but of course the overall need for and justification of any tax incentives would be evaluated at a scheme level.

5.5.3.3 Impact on Exchequer Revenues

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the method of calculating allowances under each scheme. In the case of private hospitals, this is based on the method of calculating the capital allowance over 7 years, allowing for a 15% deduction during the first 6 years and a 10% deduction in the final year. In our model, the tax foregone relating to years after 2005 are subject to a net present value (NPV) calculation, which reflects the current value of the future tax foregone.

Using this method, we have estimated a gross cost to the Exchequer of €37,232,000 for the period 2001-2005. However, this figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €69,770,000. Adjusting this figure to reflect the opportunity cost of the investment (i.e. the fact that the money could have been invested in another sector of the economy), we calculate a net tax contribution of €17,443,000. Deducting this figure from the gross cost to the Exchequer, we calculate a net cost of €19,789,000. This figure may overestimate the Exchequer costs as it does not take account of the Exchequer savings on health costs arising from the projects. We have, however, taken this into account in the economic benefits discussed previously.

Table 5.7 below gives a summary of Indecon's estimates for this scheme.

Table 5.7: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Private Hospitals

Estimate	€'000
Future Capital Expenditure	453,600
Gross Tax Revenue Foregone	37,232
Tax contribution allowing for Opportunity Cost Factor	17,443
Net Tax Revenue Foregone	19,789
Assumed Capital Expenditure	154,000

Source: Indecon Confidential Surveys of Private Hospitals and County Councils.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Based on Indecon's survey of private hospitals, auctioneers, financial institutions and the accountancy profession, we estimate deadweight under this tax incentive to be of the order of 20%, although it may be less than this and given the scale of investment needed projects might not proceed without the incentives. The 'Tax contribution allowing for opportunity cost factor' figure must be reduced to reflect this. We therefore get a tax contribution figure of €13,954,000 reflecting deadweight of around €3,500,000. This results in net tax revenue foregone of €23,278,000.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we increase this figure to 1.35 the net tax revenue foregone decreases to €18,469,000, a fall of around €1.3m, and adjusting this figure for deadweight gives us a net figure of €22,221,000, representing a decrease of around €1m on the base case scenario. Additionally, we have also assumed a deadweight figure of 20%. If we adjust this to 10%, holding the multiplier figure at 1.255, the net tax forgone figure decreases to €21,533,000, a fall of around €1.7m.

5.5.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 5.8 presents the views of accountancy/tax professionals on the income category into which those who avail of the private hospitals tax incentive are likely to fall. One half of those surveyed felt that investors were likely to be earning between €50,000 and €100,000 per year with the other half considering their likely income to be over €200,000. Indecon believes that, given the scale of the investments required by individuals, most if not all are earning in excess of €200,000 although it is clearly difficult to be definitive on this issue.

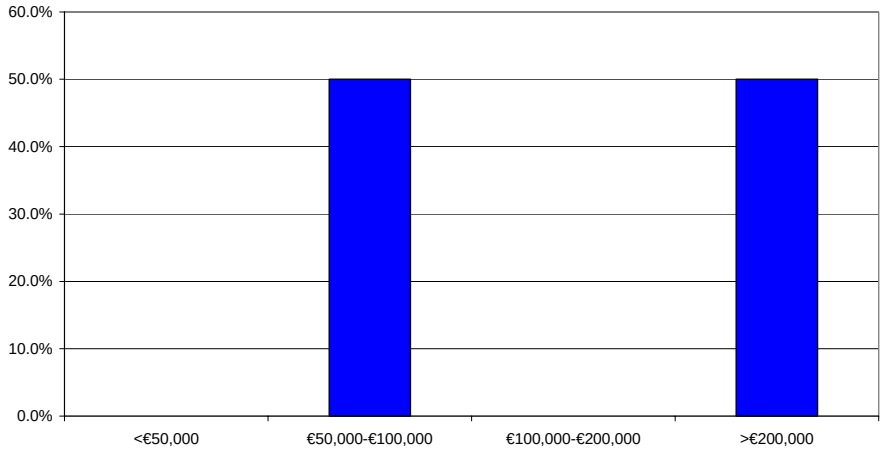
Table 5.8: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Private Hospitals Tax Incentive Scheme.

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	50.0%
Majority of investors were likely to be earning between €100,000 and €200,000	0.0%
Majority of investors were likely to be earning between €50,000 and €100,000	50.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 5.4 illustrates these views by way of a chart.

Figure 5.4: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Private Hospitals Tax Incentive Scheme.



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

5.5.5 Overall Effectiveness in Achieving Policy Objective

The objective of the scheme was to increase the supply of private beds and it is clear that some progress has been made in achieving this. The objective of the scheme was to increase the supply of private beds and it is clear that when projects which are under construction or in planning are completed, they will clearly assist in achieving this objective. While perhaps not an explicit objective of the scheme, it is also important to consider the potential role of the scheme in either reducing Exchequer costs or in reducing costs. The terms of reference for this study recognised this and specifically referred to the concentration that the scheme has made to an increase in the supply and costs of hospital beds. The effectiveness of the tax incentive scheme in reducing the cost of private hospital beds cannot be established as yet due to the early stage of this scheme. However, unlike many tax incentives, a cost reduction is built into the eligibility requirements, whereby the hospital must provide at least a 10% discount for the treatment of public patients. Indecon therefore believe that the scheme has potential to reduce the costs of private hospital beds used by private patients. By increasing the supply and competition for private patients the scheme also has the potential to reduce costs for these patients.

While actual costs will be influenced by how supply and demand interact and the framework for and effectiveness of negotiations between health investors and private hospitals and the Exchequer and private hospitals, an expansion of supply will facilitate more competitive pricing.

An issue going forward is whether the scheme could encourage private hospitals which would subsequently prove not to be viable. This is an issue which applies to all tax incentives for private investment and we believe this should be addressed by claw back provision in the tax legislation. We are not, however, in favour of civil servants attempting to second guess the viability of projects prior to permitting the tax incentives. Such initiatives could lead to pressures to maintain local monopolies with the private hospital sector with resultant loss of consumer benefits.

5.6 Summary of Main Findings

In this section, we have reviewed the property-based tax incentive for private hospitals, and outlined its effect both on the supply and cost of private hospital beds as well as the impact on Exchequer returns. The key findings from our analysis are as follows:

- There has been an overall increase in planning applications and approvals for private hospitals since 2000 but most have not proceeded to date.
- Most of the extra investment in the sector would either not have been undertaken, or would have taken longer to come on-line in the absence of the tax incentive scheme.
- After taking account of the beneficial effects of extra investment as a result of the scheme allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive to the Irish Exchequer at €23.3 million in terms of tax revenue foregone.
- While it is too early to provide detailed estimates of the impact of the scheme on the supply and on the costs of hospital beds, Indecon believes the scheme has the potential to address supply shortages in the sector and to reduce costs.

6 Capital Allowances for Sports Injury Clinics

6.1 Introduction and Background

In this section, we present our examination of the tax incentive for sports injury clinic properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability.

6.2 Description of Tax Incentive

Capital allowances are available in respect of capital expenditure incurred on or after 15 May 2002 on the construction or refurbishment of buildings used as private sports injury clinics. In order to qualify for the allowances, the sole or main business of the clinic must be the diagnosis, alleviation and treatment of sports-related injuries.

Fulfilment of the qualifying criteria will be certified annually by the appropriate health board. Any annual allowances given will be subject to a balancing charge if the clinic is sold within 10 years. A company, a property developer (where the property developer or a connected person incurred the capital expenditure), an individual involved in the operation or management of the clinic and the trustees of a trust do not qualify for the capital allowances whether the relevant interest in the capital expenditure is held by any such person in a sole capacity or jointly or in partnership with another person or persons.

Annual allowances in respect of qualifying expenditure are available at the rate of 15 per cent for the first 6 years with the balance of 10 per cent being written off in year 7. There is no termination date for this relief.

6.3 Measure of Overall Level of Activity in Sector

6.3.1 Level of Construction Activity

Table 6.1 details the number of planning applications made for sports injury clinics since 2000. There have been an average nearly 11 applications per year with an average of nearly 8 approvals. It is our understanding however that most of sports injury clinics have not availed of the tax incentives.

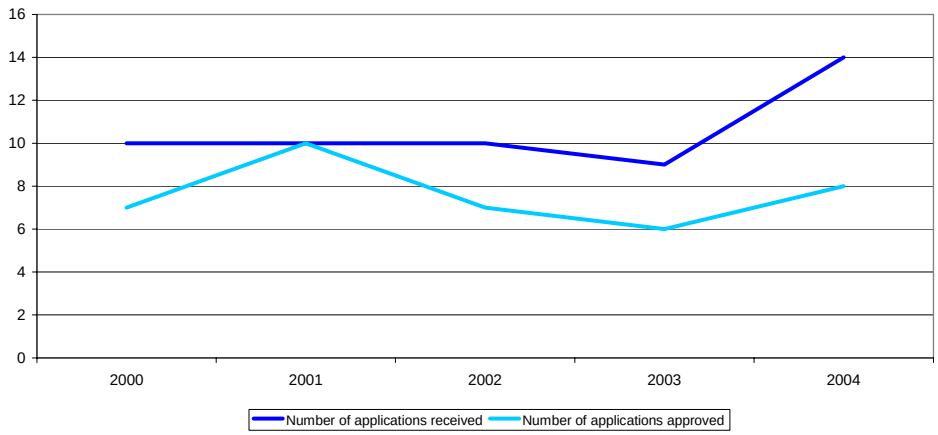
Table 6.1: Details of Planning Applications - Total Number of Applications for Sports Injury Clinics, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	10	10	10	9	14
Number of applications approved	7	10	7	6	8
Number of applications awaiting decision	2	0	1	0	3

Source: Indecon Confidential Survey of Local Authorities.

Figure 6.1 illustrates the number of applications in a line chart.

Figure 6.1: Details of Planning Applications - Total Number of Applications for Sports Injury Clinics, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

6.4 Case Study

It is useful to consider a case study of a sports injury clinic investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

No data were available on the yields from sports injury clinics. Assuming that a sports injury clinic is a *de facto* investment in commercial property, it is possible to develop a case study by applying a methodology similar to the approach used for holiday homes.

6.4.1 Investor Perspective

An Investor makes an investment in a sports clinic at a cost of €500,000. Rental income for the Sports Injury Clinic is assumed to be 3% per annum, while commercial rents are 5.5% per annum. Management charges for both sports clinics and commercial property are 0.5% per annum. The ten year euro rate is used to discount the differential cash flows as this differential is known with certainty. The assumptions are summarized in Table 6.2.

Table 6.2: Key Assumptions

Item	Assumed Level
Investment	500
Gross Yield	5.5%
Net Yield – Commercial	5%
Net Yield – Sports	2%
Tax Rate	42%
Assumed Revenue Growth	3%
Ten Year Euro Bond Rate	3.3%

Source: Indecon.

Using these assumptions, in this case study example (Table 6.3), the net loss associated with operating sports clinics is 11% of the construction cost, without capital allowances. The current capital allowances for Clinics have a present value of 38%. In the presence of capital allowances, investors receive a present value of cumulative return of 27%.

Table 6.3: Return on Sports Clinics

Period	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Ebitda - Commercial		26	27	27	28	29	30	31	32	33	34
Ebitda – Sports		13	13	14	14	14	15	15	16	16	17
Loss – Sports		-13	-13	-14	-14	-14	-15	-15	-16	-16	-17
Taxes		5	6	6	6	6	6	7	7	7	7
After Tax Loss		-7	-8	-8	-8	-8	-9	-9	-9	-9	-10

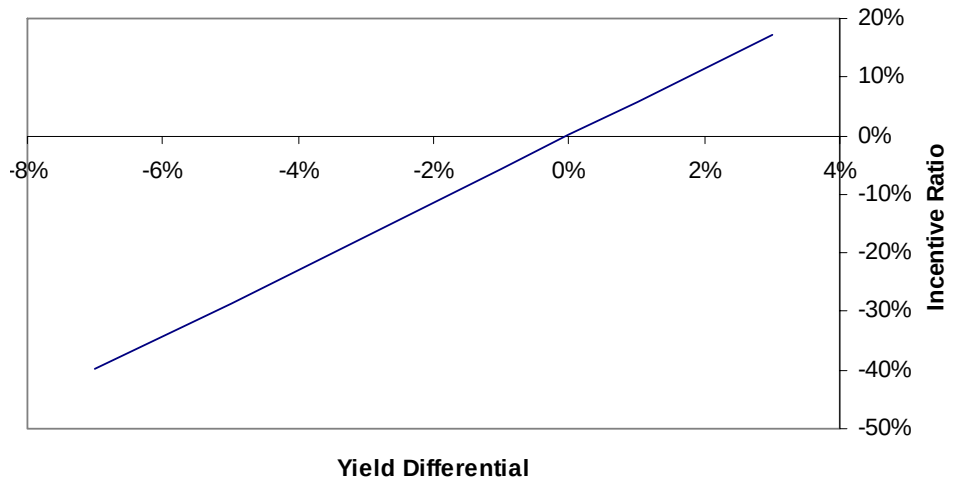
		% of Cost
Present Value of Losses	-71	-14%
PV (Capital Allowances)	190	38%
PV (Losses+ Allowance)	119	24%

Source: Indecon.

6.4.2 Sensitivity Analysis

The differential between rental yields on Sports Clinics and Commercial properties is the key driver of the Incentive Ratio. The impact of differential yields is summarized in Figure 6.2. For example, if the net yield on a sports clinic is 1% and the net yield on commercial property is 6%, then the yield differential is -5%. From Figure 6.2, it may be seen that a yield differential of -5% gives rise to an Incentive Ratio of -29%. Stated differently, an investor would require capital allowances equal to 29% of the capital cost to consider an investment in a sports injury clinic, under this example. However if revenues or rental yields are higher than the very low levels assumed the clinic could be viable without any tax incentives.

Figure 6.2: Incentive Ratio Vs. Yield Differential



Source: Indecon.

6.5 Evaluation of the Tax Incentive

6.5.1 Estimated Investment in the Sector

6.5.1.1 Lending Advanced by Financial Institutions

Precise information on lending for sports injury clinics was not available from a representative sample of financial institutions. However, indicative estimates developed by Indecon suggest capital expenditure of the order of €10m per annum but these may only be taken as illustrative and do not relate to those clinics that secured the tax incentive.

6.5.2 Scope for High-Income Individuals to Reduce Tax Liabilities

Our analysis suggests very modest levels of investment in the sector and most of this is believed not to have benefited from the tax incentives. While there is potential economic benefits of sports injury claims diverted patients from the public health sector at weekends we do not believe the incentives as structured would achieve this. Furthermore we believe there would be high levels of deadweight and displacement. If the sports injury incentives were utilized our analysis suggests that most of the investors would be high income earners.

6.6 Summary of Main Findings

In this section we outlined the working of the property-based tax incentive for sports injury clinics introduced in 2002. The key findings of our analysis are as follows:

- Indecon's survey of sports injury clinics revealed that most operators either did not know of the scheme's existence or were unsure as to its details.
- There appears to be fairly modest investment in sports injury claims and most have not benefited from the tax incentives.
- The existing incentives do not in our view address any causes of market failure and we believe would be characterised by high level if deadweight and displacement impacts.

7 Capital Allowances for Nursing Homes

7.1 Introduction and Background

In this section, we present our examination of the tax incentive for nursing home/convalescent facility properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability. As part of our research we received survey responses from 66 nursing homes.

7.2 Description of Tax Incentive

Capital allowances are available for capital expenditure incurred on or after 3 December 1997 on the construction, extension or refurbishment of buildings used as private, registered nursing homes and for such expenditure on the conversion of an existing building into such a nursing home. The capital allowances are granted at 15% per annum for the first 6 years and 10% in year 7. Similar allowances apply for capital expenditure incurred on or after 2 December 1998 on a building used as a private convalescent facility for which approval has been received from the relevant health board. There is currently no termination date for these reliefs and in our recommendations we advise on whether the reliefs should continue. Allowances are also available for qualifying residential units where the capital expenditure is incurred in the five year period from 25 March 2002.

7.3 Measure of Overall Level of Activity in Sector

7.3.1 Supply of Nursing Homes

Table 7.1 presents a regional break-down of the 427 Nursing Homes in Ireland. Over a quarter are situated in the Eastern Regional Health Authority Area.

Table 7.1: Total Number of Nursing Homes, 2004

Health Authority	Number of Nursing Homes Registered
Eastern Regional Health Authority	121
Midland Health Board	22
Mid-Western Health Board	41
North Eastern Health Board	38
North Western Health Board	19
South Eastern Health	50
Southern Health Board	68
Western Health Board	68
Total	427

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Table 7.2 presents a regional breakdown of the number of nursing home beds in Ireland in 2004. There are 16,461 beds in total, nearly a third of which are located with the Eastern Regional Health Authority area.

Table 7.2: Total Number of Private Beds in Nursing Homes 2004

Health Authority	Number of Private Beds
Eastern Regional Health Authority	5,392
Midland Health Board	830
Mid-Western Health Board	1,628
North Eastern Health Board	1,500
North Western Health Board	901
South Eastern Health	1,709
Southern Health Board	2,167
Western Health Board	2,334
Total	16,461

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Table 7.3 presents data on the number of individuals aged over 65 per registered bed in each of the regional health board areas. The ratio is broadly similar in the Midlands, Mid-West, North West, South East and South, with a greater number of beds per population in the East, South East and West. Beds are most plentiful in the Western Health Board area with 21 individuals aged over 65 per bed.

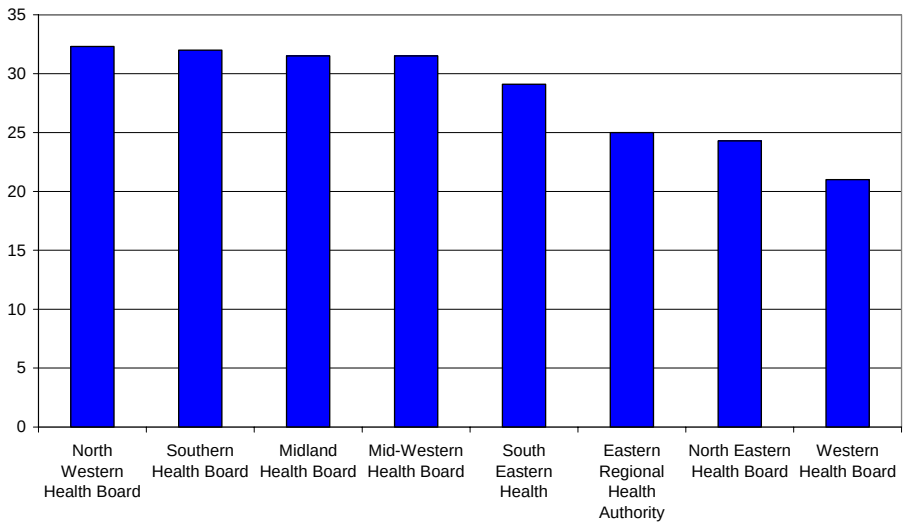
Table 7.3: Population over 65 per Registered Bed

Health Authority	Number of Persons >65 years of age per Registered Bed
Eastern Regional Health Authority	25.3
Midland Health Board	31.5
Mid-Western Health Board	24.2
North Eastern Health Board	24.3
North Western Health Board	32.3
South Eastern Health	29.1
Southern Health Board	32.0
Western Health Board	21.1

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Figure 7.1 emphasises the fact that there is considerable regional variation in the number of elderly people per private nursing home bed.

Figure 7.1: Population over 65 per Registered Bed



Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

7.3.2 Occupancy Rates

Table 7.4 illustrates the fact that there are significant differences between occupancy rates in different Health Board areas. Occupancy rates are highest in the Eastern Regional Health Authority area at 92.2%. At 70%, rates are significantly lower in the Midland Health Authority Area than anywhere else in the country.

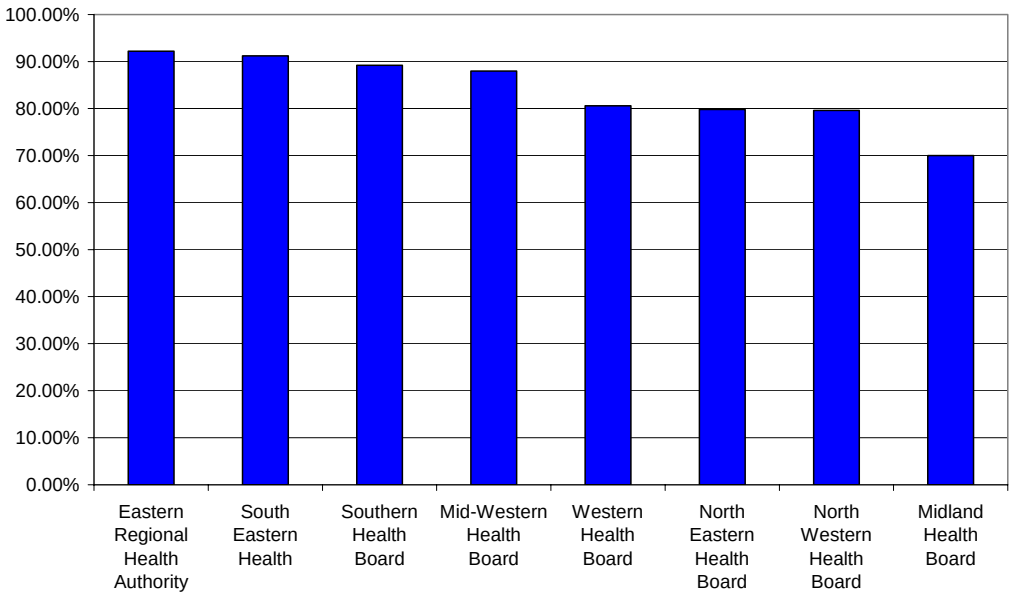
Table 7.4: Average Occupancy Rates

Health Authority	
Eastern Regional Health Authority	92.2%
Midland Health Board	70%
Mid-Western Health Board	88%
North Eastern Health Board	79.8%
North Western Health Board	79.6%
South Eastern Health	91.2%
Southern Health Board	89.2%
Western Health Board	80.6%

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Figure 7.2 illustrates these figures.

Figure 7.2: Average Occupancy Rates



Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

7.3.3 Cost of Nursing Home Beds

The results in Table 7.5 show that there are significant regional differences in the average rate paid for private nursing home beds. Rates for the Midland, Mid-Western, North Western and Western areas are broadly similar, at between €464 and €495 per week. There are higher rates in the North East, South East, South and in particular in the Eastern Regional Health Authority Area, with a bed in this area costing on average nearly €700 per week.

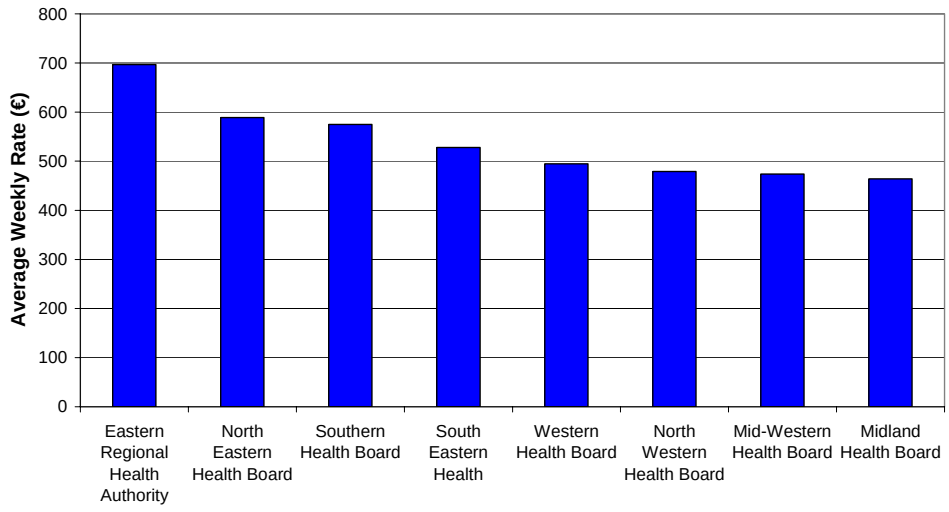
Table 7.5: Cost of Nursing Home Beds - Average Weekly Rate

Health Authority	Rate (€)
Eastern Regional Health Authority	697
Midland Health Board	464
Mid-Western Health Board	474
North Eastern Health Board	589
North Western Health Board	479
South Eastern Health	528
Southern Health Board	575
Western Health Board	495

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Figure 7.3 illustrates the fact that there are significant regional differences in the average rate paid for private nursing home beds.

Figure 7.3: Cost of Nursing Home Beds - Average Weekly Rate



Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Table 7.6 presents a regional break-down of the average turnover per registered bed. There is a cluster of regions around the €21,000 per year mark, with turnover lower in the North East, and higher in the South, the South East and the East. Average turnover in the Eastern Regional Health Authority is significantly higher than elsewhere at over €30,000 per annum.

Table 7.6: Average Turnover Per Registered Bed

Health Authority	Turnover (€)
Eastern Regional Health Authority	30,616
Midland Health Board	21,200
Mid-Western Health Board	20,317
North Eastern Health Board	21,146
North Western Health Board	17,937
South Eastern Health	25,301
Southern Health Board	26,492
Western Health Board	20,311

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Table 7.7 present data on the average weekly food bill in different regions. The average bill is significantly less in the North Western ad Western Health Board areas than elsewhere in the country, at €20 and €25 per week respectively. Weekly food costs are highest in the in the South East (€47) and the Mid-West (€46), with the average food bill in the remaining regions clustering between €34 and €40.

Table 7.7: Average Weekly Food Bill per Resident

Health Authority	Weekly Food Bill (€)
Eastern Regional Health Authority	39.67
Midland Health Board	38.50
Mid-Western Health Board	46.14
North Eastern Health Board	34.26
North Western Health Board	20.00
South Eastern Health	47.33
Southern Health Board	38.27
Western Health Board	25.62

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

Table 7.8 presents a regional breakdown of the average annual staff costs faced by nursing homes. Staff costs are highest in the Eastern North Eastern and South Eastern Health Authority areas and are lowest in the Western and Midlands areas.

Table 7.8: Average Annual Staff Cost Per Registered Bed

Health Authority	Annual Cost (€)
Eastern Regional Health Authority	16,910
Midland Health Board	10,975
Mid-Western Health Board	12,965
North Eastern Health Board	15,364
North Western Health Board	13,031
South Eastern Health	15,570
Southern Health Board	12,325
Western Health Board	10,938

Source: Irish Nursing Homes Organisation Annual Private Nursing Homes Survey 2004

7.3.4 Level of Incentive Utilisation

Table 7.9 presents a result from the Indecon Survey of Nursing Homes/Convalescent Facilities in Ireland. 41.5% of respondents had availed of the tax incentive in the last five years.

Table 7.9: Proportion of Nursing Home/Convalescent Facilities that have Utilised the Tax Incentive over the past 5 years

Impact	% of Survey Respondents
Nursing Home/Convalescent Facilities that have availed of the tax incentive scheme over the past 5 years	41.5%
Nursing Home/Convalescent Facilities that have not availed of the tax incentive scheme over the past 5 years	58.5%
Total	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.10 presents the result of the Indecon survey on the nature of nursing home facilities. The vast majority of facilities were described by respondents as either 'high dependence' or 'both high and low dependence'. Only 7.4% of homes that have availed of the tax incentive and 10.5% of those that have not suggested they were 'low dependence' facilities although it is clear that this is an issue which is subject to significant judgment.

Table 7.10: Survey Respondents - Nature of Facilities: High or Low Dependence, Nursing Home/Convalescent Facilities With and Without Tax Incentive

	% of Survey Respondents	
Impact	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Low Dependence	7.4%	10.5%
High Dependence	70.4%	76.3%
Both High and Low Dependence	22.2%	13.2%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.3.5 Level of Employment in the Sector

Table 7.11 presents information from the Indecon Survey of Nursing Homes in Ireland on the number of full time equivalent persons employed in the Nursing Home Sector who responded to the Indecon Survey. There has been a greater tendency for larger homes to avail of the tax incentive than smaller homes. The former category has an average of 36.2 full time equivalent persons employed while the latter has an average of 26.2 employed. However, there is greater variation in the size of establishments availing of the tax incentive, indicating that a number of smaller homes have chosen to avail of it.

Table 7.11: Summary Statistics on the Number of Full-Time Equivalent Persons Employed, by Respondents to Indecon Survey of Nursing Home/Convalescent Facilities

	Number of FTE Persons Employed	
Statistic	**Homes that availed of Tax Incentive**	**Homes that did not avail of Tax Incentive**
Total persons employed in the sector	904	839
Average per facility	36.2	26.2
Std. Dev. per facility	35.7	15.4
Maximum per facility	200	70
Minimum per facility	8	10

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.3.6 Level of Construction Activity

Table 7.12 gives the average number of years since the construction or last major refurbishment in homes that responded to the Indecon Survey. The average is 5 years in the case of those homes that have availed of the tax incentive and 19 years in the case of those that have not. The figures suggest that the tax incentives have played an important role in modernising nursing home facilities.

Table 7.12: Average Number of Years since Construction / Latest Refurbishment – Nursing Home/Convalescent Facilities With and Without Tax Incentive

Number of Nursing Home/Convalescent Facility Bedrooms	Average Number of Years since Construction / Latest Refurbishment
Nursing Home/Convalescent Facilities that have availed of the tax incentive scheme over the past 5 years	5
Nursing Home/Convalescent Facilities that have not availed of the tax incentive scheme over the past 5 years	19

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.13 presents information on the number of planning application submitted to Local Authorities for Nursing Homes over the last five years. The number of annual applications has been between 77 and 89 per year. With the exception of the 72 approvals in 2002, there have been between 50 and 56 application approved in each of the years between 2000 and 2004.

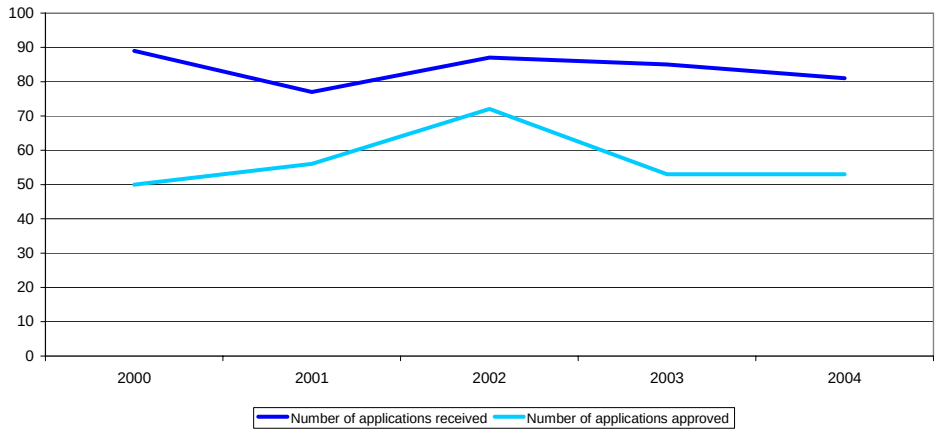
Table 7.13: Details of Planning Applications - Total Number of Applications: Nursing Homes, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	89	77	87	85	81
Number of applications approved	50	56	72	53	53
Number of applications awaiting decision	7	5	4	3	21

Source: Indecon Confidential Survey of Local Authorities.

These trends can also be seen in Figure 7.4.

Figure 7.4: Details of Planning Applications - Total Number of Applications: Nursing Homes, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

Table 7.14 presents the number of planning applications for Associated Residential Units. There has been a steady increase in applications from 4 in 2000 to 24 in 2004, with an associated increase in approvals from 2 to 12 over the same period. This increased supply is likely to have been stimulated by the tax incentives.

Table 7.14: Details of Planning Applications - Total Number of Applications: Associated Residential Units, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	4	7	11	14	24
Number of applications approved	2	7	9	9	12
Number of applications awaiting decision	0	0	1	1	7

Source: Indecon Confidential Survey of Local Authorities.

Table 7.15 gives the number of planning applications to local authorities for convalescence homes since 2000. There have been only two applications in the last five years, one in 2001 and one in 2002. The former application was approved while the latter was rejected.

Table 7.15: Details of Planning Applications - Total Number of Applications: Convalescence Homes, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	0	1	1	0	0
Number of applications approved	0	1	0	0	0
Number of applications awaiting decision	0	0	0	0	0

Source: Indecon Confidential Survey of Local Authorities.

7.4 Case Study

Before we examine the detailed impacts of the incentives, it is useful to consider a case study of a nursing home investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work. Nursing Homes may be understood as *de facto* investments in residential property. This observation informs the following analysis.

7.4.1 Investor Perspective

Despite the absence of publicly available data concerning nursing home yields, they may be compared with the yield from residential property. Assume an investor is choosing between an investment in residential property and an investment in a nursing home. A base case involves an investment of €1 million, a net yield from residential property of 5% and a net yield from nursing home properties of 4%. Rental income from both classes of property is assumed to grow at 4% per annum in nominal terms. The principal assumptions are summarized in Table 7.16.

Table 7.16: Key Assumptions

Item	Assumed Level
Investment	1000
Gross Yield	5.5%
Net Yield - Residential	5%
Net Yield - Nurse Home	4%
Tax Rate	42%
Assumed Revenue Growth	4%
10 Year Euro Bond Rate	3.3%

Source: Indecon.

Using these assumptions, in this case study example, the net loss associated with operating nursing homes is 6% of the construction cost, without capital allowances. The current capital allowances for nursing homes have a present value of 38%. In the presence of capital allowances, investors receive a present value of cumulative return of 32%.

Table 7.17: Return on Sports Clinics

Period	0	1	2	3	4	5	6	7	8	9	10
Ebitda - Residential		52	54	56	58	61	63	66	68	71	74
Ebitda - Nurse Home		42	43	45	47	49	51	53	55	57	59
Loss - Nurse Home		-10	-11	-11	-12	-12	-13	-13	-14	-14	-15
Taxes		4	5	5	5	5	5	6	6	6	6
After Tax Loss		-6	-6	-7	-7	-7	-7	-8	-8	-8	-9

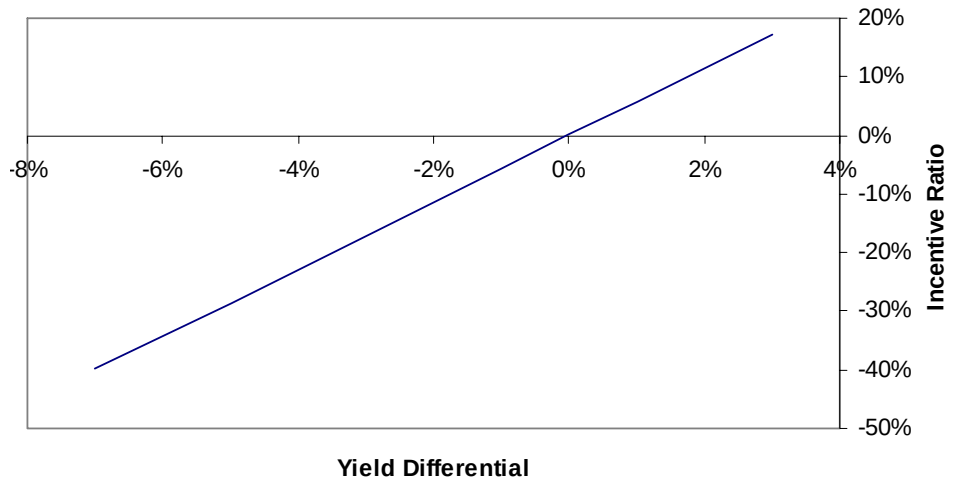
		% of Cost
Present Value of Losses	-60	-6%
PV (Capital Allowances)	381	38%
PV (Losses+ Allowance)	320	32%

Source: Indecon.

7.4.2 Sensitivity Analysis

The differential between rental yields on nursing homes and residential properties is the key driver of the Incentive Ratio. The impact of differential yields is summarized in Figure 7.5. For example, if the net yield on a nursing home is 1% and the net yield on residential property is 6%, then the yield differential is -5%. From Figure 7.5, it may be seen that a yield differential of -5% gives rise to an Incentive Ratio of -30%. Stated differently, an investor in this example would require capital allowances equal to 30% of the capital cost to consider an investment in a nursing home.

Figure 7.5: Incentive Ratio Vs. Yield Differential



Source: Indecon.

7.5 Impacts of Tax Incentive

7.5.1 Impact on the Supply of Nursing Home/ Convalescent Facility Places Available and Utilised

Table 7.18 presents results from the Indecon survey of Nursing Homes and Convalescent facilities on the growth of the supply of beds available between 2000 and 2005. The number of beds available in responding facilities that have availed of the tax incentive rose by 29.4% to 1,267 while the growth in beds in facilities not availing of the tax incentive increased only very marginally over the same period.

Table 7.18: Number of Nursing Home/Convalescent Facility Beds Available – Nursing Home/Convalescent Facilities With and Without Tax Incentive, 2000 and 2005

Number of Nursing Home/Convalescent Facility Places Available	2000	2005	Growth Rate (%)
Nursing Home/Convalescent Facilities that have availed of the tax incentive scheme over the past 5 years	979	1,267	29.4%
Nursing Home/Convalescent Facilities that have not availed of the tax incentive scheme over the past 5 years	1,142	1,172	2.6%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.19 presents information from Indecon's survey on the average number of beds utilised in 2000 and 2005. The number of beds utilised in facilities that have availed of the tax incentive rose by 23.9% from 858 in 2000 to 1,063, while the number fell slightly in the case of facilities that have not availed of the tax incentive.

Table 7.19: Number of Nursing Home/Convalescent Facility Beds Utilised – Nursing Home/Convalescent Facilities With and Without Tax Incentive, 2000 and 2005

Number of Nursing Home/Convalescent Facility Places Utilised	2000	2005	Growth Rate (%)
Nursing Home/Convalescent Facilities that have availed of the tax incentive scheme over the past 5 years	858	1,063	23.9%
Nursing Home/Convalescent Facilities that have not availed of the tax incentive scheme over the past 5 years	1,167	1,133	-2.9%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.5.2 Impact on the Cost of Nursing Home/Convalescent Facility Places

Table 7.20 gives results from the Indecon Survey on Nursing Homes and Convalescent Facilities on the average weekly cost of nursing home beds. There have been significant prices increases between 2000 and 2005. The increase is more substantial in the case of facilities that have not availed of the tax incentives, among which the average weekly rate has increased by 72.6%. The increase among those facilities that have availed of the tax incentive was less though still substantial at 47%.

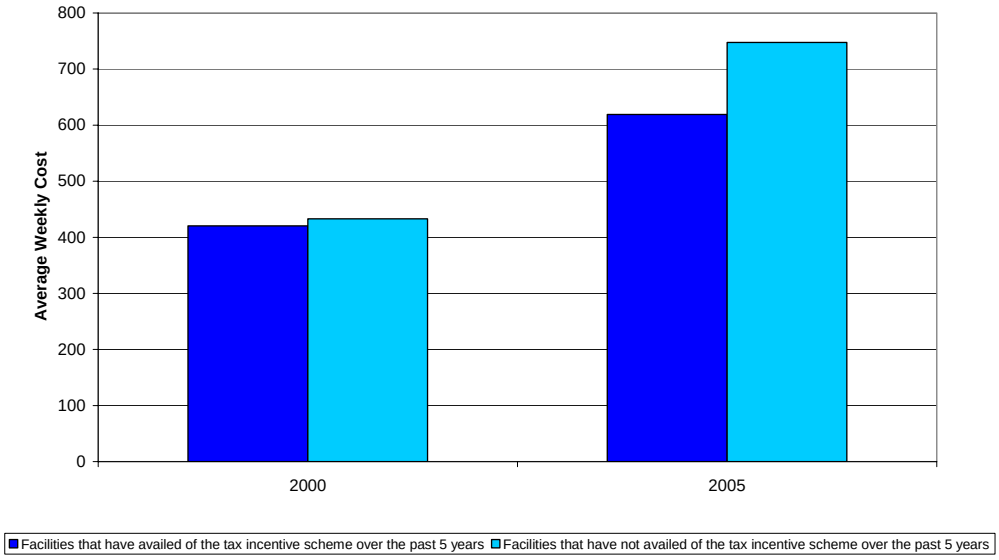
Table 7.20: Cost of Nursing Home/Convalescent Facility Places (€ per week) – Nursing Home/Convalescent Facilities With and Without Tax Incentive, 2000 and 2005

Cost of Nursing Home/Convalescent Facility Places (€ per week)	2000	2005	Growth Rate (%)
Nursing Home/Convalescent Facilities that have availed of the tax incentive scheme over the past 5 years	420.2	619.1	47.3%
Nursing Home/Convalescent Facilities that have not availed of the tax incentive scheme over the past 5 years	433.1	747.5	72.6%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

This pattern is also evident in Figure 7.6.

Figure 7.6: Cost of Nursing Home/Convalescent Facility Places (€ per week) – Nursing Home/Convalescent Facilities With and Without Tax Incentive, 2000 and 2005



Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.21 presents the views of the nursing home/convalescent facility sector on the impacts of the tax incentive scheme on the cost of nursing home places. Half of homes that have availed of the incentive and 70% of those that have not believe that it has had no impact on the cost of places. Most of the other respondents consider that it has resulted in either a marginal reduction in costs or has resulted in costs growing less rapidly than they would have in the absence of a tax incentive. Very few respondents considered that the scheme has had a 'significant' reduction in costs.

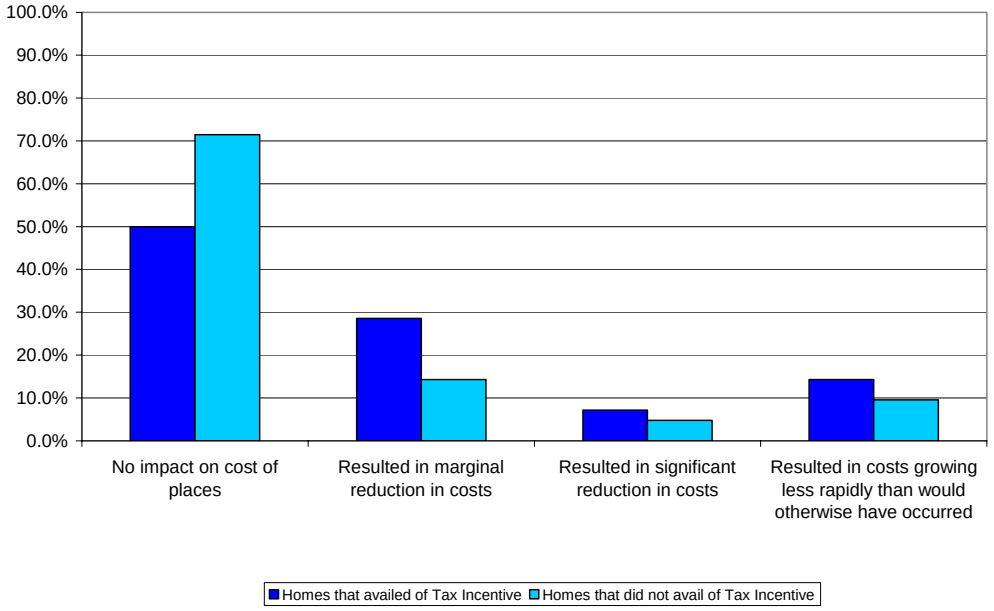
Table 7.21: Views of the Nursing Home/Convalescent Facility Sector on the Impacts of the Property-based Tax Incentive Scheme on the Cost of Nursing Home/Convalescent Facility Places, Nursing Home/Convalescent Facilities With and Without Tax Incentive

	% of Survey Respondents	
Impact	**Homes that availed of Tax Incentive**	**Homes that did not avail of Tax Incentive**
No impact on cost of places	50.0%	70.0%
Resulted in marginal reduction in costs	28.6%	15.0%
Resulted in significant reduction in costs	7.1%	5.0%
Resulted in costs growing less rapidly than would otherwise have occurred	14.3%	10.0%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

These results are also presented graphically in Figure 7.7.

Figure 7.7: Views of the Nursing Home/Convalescent Facility Sector on the Impacts of the Property-based Tax Incentive Scheme on the Cost of Nursing Home/Convalescent Facility Places, Nursing Home/Convalescent Facilities With and Without Tax Incentive



Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.5.3 Impact on Site Prices

Table 7.22 presents the views of the nursing home/convalescent facility on the impact of the tax incentive on site prices. Just over 70% of respondents felt that the scheme had increased site prices, with a slightly greater proportion of facilities that have availed of the tax incentive than have not availed of the tax incentive believing this to be the case.

Table 7.22: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Resulted in Higher Site Prices, Nursing Home/Convalescent Facilities With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Nursing Home/Convalescent Facilities	74.1%	70.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.5.4 Impact on Construction Costs

Table 7.23 presents the views of the nursing home/convalescent facility sector on the impact of the nursing home tax incentive scheme on construction costs. 56% of respondents felt that the incentive had raised construction costs, with no significant difference between the views of those who have availed of the incentive compared to those who have not.

Table 7.23: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Construction Costs, Nursing Home/Convalescent Facilities With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Nursing Home/Convalescent Facilities	56.0%	56.3%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.5.5 Impact on Level of Investment in Projects

Table 7.24 shows that there is little doubt among those involved in the nursing home/convalescent facility sector that the scheme has increased investment in the sector. All of the responding facilities that had availed of the incentive and 90% of those that had not believe it to have increased investment.

Table 7.24: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Investment, Nursing Home/Convalescent Facilities With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Nursing Home/Convalescent Facilities	100.0%	90.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.5.6 Impact on Financial Returns to Promoters

Table 7.25 presents the views of the nursing home/convalescent facility sector on the impact of the incentive on the financial returns to promoters. 62% of those surveyed believed that the scheme had increased returns, with little difference in the opinions of those that had availed and those that had not availed of the incentive.

Table 7.25: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Financial Return to Promoters, Nursing Home/Convalescent Facilities With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Nursing Home/Convalescent Facilities	62.5%	61.1%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.5.7 Impact on Property Prices

Table 7.26 presents the views of the nursing home / convalescent facility sector on the effect of the tax incentive on property prices. 76% of those in the sector that had not availed of the incentive and a smaller margin (61.5%) of those that had availed of it believe the scheme to have increased property prices.

Table 7.26: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has led to Higher Property Prices Compared to Non-Tax Incentive Properties, Nursing Home/Convalescent Facilities With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Nursing Home/Convalescent Facilities	61.5%	76.2%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.6 Evaluation of the Tax Incentive

7.6.1 Displacement, Deadweight and Opportunity Cost

Table 7.27 presents the views of the nursing home/convalescent facility sector on the likelihood of developments recently undertaken proceeding in the absence of the tax incentive. A significant proportion of both categories of operators believe that in the absence of the incentive projects would either not have proceeded or would have proceeded over a longer timeframe. Those who had availed of the incentive were more likely to consider this to consider this to be the case. Few operators believed that the all or most of the projects would have gone ahead in the absence of the tax incentive.

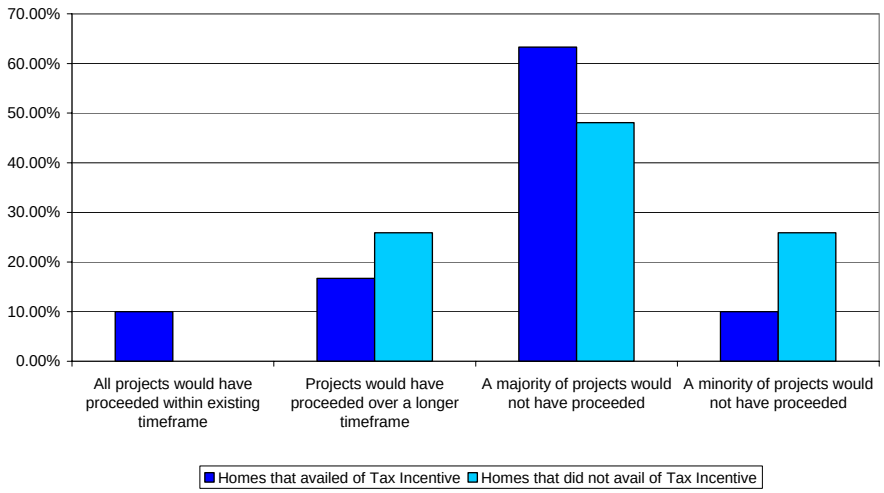
Table 7.27: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Investment in Nursing Home/ Convalescent Facilities) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
All projects would have proceeded within existing timeframe	10.0%	0.0%
Projects would have proceeded over a longer timeframe	16.7%	25.9%
A majority of projects would not have proceeded	63.3%	48.1%
A minority of projects would not have proceeded	10.0%	25.9%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

The views summarised in the above table are also expressed graphically in Figure 7.8.

Figure 7.8: Views of the Nursing Home/Convalescent Facility Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Investment in Nursing Home/Convalescent Facility Buildings) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.28 presents the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood of developments taking place in the absence of the tax incentive. A margin of 50% or greater of each category considers that in the absence of the scheme, a majority of projects would either not have proceeded or would have proceeded over a longer timeframe. However a minority of financial institutions (40%) and auctioneers (25.2%) believed that either all or a majority of projects would have gone ahead.

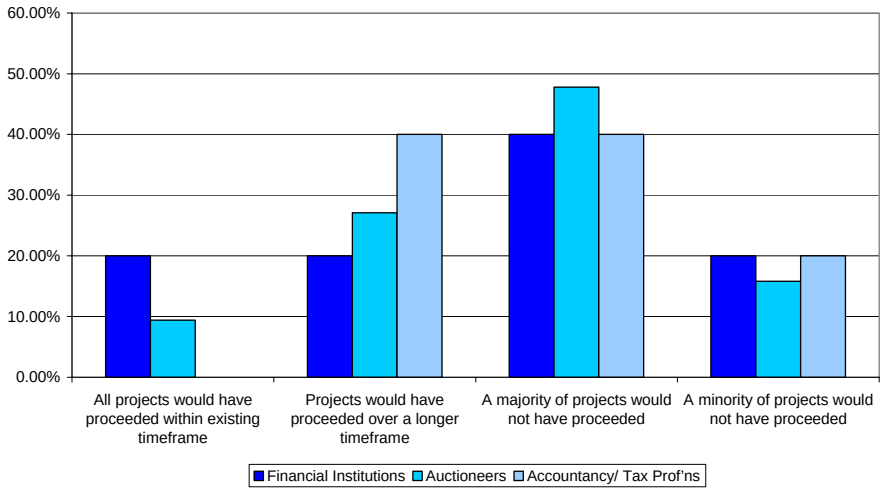
Table 7.28: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Investments in Nursing Homes) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	Auctioneers	Accountancy/ Tax Prof'ns
All projects would have proceeded within existing timeframe	20.0%	9.4%	0.0%
Projects would have proceeded over a longer timeframe	20.0%	27.1%	40.0%
A majority of projects would not have proceeded	40.0%	47.8%	40.0%
A minority of projects would not have proceeded	20.0%	15.8%	20.0%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 7.9 also presents the views of financial institutions.

Figure 7.9: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

7.6.2 Estimated Investment in the Sector

7.6.2.1 Capital Expenditure

Table 7.29 presents a result from the Indecon survey of nursing homes in Ireland. The total cumulative value of eligible capital expenditure undertaken by respondents came to just over €25m.

Table 7.29: Total Cumulative Value of Eligible Capital Expenditure incurred over the past 5 years, Nursing Home/Convalescent Facilities

With and Without Tax Incentive	Total Cumulative Value of Eligible Capital Expenditure (€'000s)
Nursing Home/Convalescent Facilities that have availed of the tax incentive scheme over the past 5 years	25,163

Note: * Respondents did not answer this question.

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.30 presents a breakdown of the total value of capital expenditure by type of facility undertaking the investment. A significant majority (over €19m) of the expenditure was undertaken on nursing homes with €3.5m spent on associated residential units and €2m on convalescent homes.

Table 7.30: Total Cumulative Value of Eligible Capital Expenditure incurred over the past 5 years, Nursing Home/Convalescent Facilities With and Without Tax Incentive, Split by Area of Expenditure

	Total Cumulative Value of Eligible Capital Expenditure (€'000s)	
Area of Expenditure	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Nursing homes	19,663	-
Associated residential units	3,500	-
Convalescent homes	2,000	-

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

7.6.2.2 *Lending Advanced by Financial Institutions*

Table 7.31 presents the result on lending to nursing home facilities from Indecon's Survey of Financial Institutions in Ireland. Lending increased from €61m in 2003 to €81m in 2004. The financial institutions estimate total capital expenditure, including promoter's equity, to have been €83m in 2003 and €103m in 2004.

Table 7.31: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimated Total Capital Expenditure on Nursing Homes including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	61,448	81,075
Total capital expenditure on projects including promoter's equity	83,298	103,100

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

7.6.3 Estimated Gross and Net Cost of Tax Incentive

7.6.3.1 *Capital Expenditure*

Indecon's estimate of investment in the nursing home sector is based on data from the Irish Nursing Home Organisation on average numbers of registered homes, as well Indecon research on average levels of investment in the sector[21]. This gives a figure on total capital expenditure over the period 2001-2005 of €171,091,000, or an annual average investment of €34,218,200. While this is less than suggested from the results from financial institutions we believe it is the most appropriate basis for our estimates.

[21] From the Indecon confidential survey of private nursing homes

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. As there is currently no time limit to the nursing home tax allowance scheme, it is difficult to estimate with certainty future investment under the scheme. Indecon have examined estimates on the level of planning applications. We estimate a possible scenario for total future investment of the order of €30,169,000 however this depends on whether the incentives continue whereby the level of investments could be significantly higher.

Table 7.32: Estimate of Total Eligible Capital Expenditure on Nursing Homes under the Tax Incentive Scheme

Detail	Value (€)
Total Cumulative Capital Expenditure	171,091
Forecast of Future Capital Expenditure	30,169

Source :Indecon Calculations

7.6.3.2 Impact of the Capital Expenditure

The increased levels of investment arising from the existence of the scheme will give rise to increased economic activity. In order to take this into account in our model we include a 'multiplier' effect, which estimates the increase in economic activity due to the increased level of investment. For the period 2001-2005, we have estimated that the level of investment outlined above will give rise to €214,719,000 of benefits to the Irish economy. However, this figure must be adjusted for the opportunity cost of the investment, reflecting the fact that had this money not been invested in the hotel sector it could have been invested in other sectors of the economy. We assume an opportunity cost of 95%. However, in the case of nursing homes, there is likely to be a wider benefit to the economy, arising from the role which these nursing homes play in reducing demands on the public health sector, equivalent to 15% to 20% of the total spend. We assume 20% in our estimate. The economic benefit is therefore estimated to be of the order of €42,943,000. While it is difficult to provide precise estimates of this we use an estimate of these benefits.

7.6.3.3 Impact on Exchequer Revenues

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the working of each tax incentive scheme. In the case of nursing homes, this is based on the method of calculating the capital allowance over 7 years, allowing for a 15% deduction during the first 6 years and a 10% deduction in the final year. The tax foregone for the years after 2005 is subject to a net present value (NPV) calculation, which reflects the current value of the future amount. Current corporate and income tax rates are used and the investor profile, which determines the tax rate applicable, is based on responses to Indecon's survey of private nursing homes.

Using this method, we have estimated a gross cost to the Exchequer of €54,952,000, €28,498,000 of which is to be claimed after 2005, at current prices. This gross figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €77,513,000. Adjusting this figure to reflect the opportunity cost of this tax revenue we calculate a net tax contribution of €19,378,000. Deducting this figure from the gross cost to the Exchequer, we calculate a net cost of €35,574,000.

The investor profile used in the above calculations is based on survey data gathered by Indecon. This assumption affects the results as different types of investors pay differing tax rates, i.e. the corporate tax rate or the PAYE rate. We have tested the sensitivity of our results to this assumption by calculating a weighted average of investors responding to the Indecon survey, as opposed to an arithmetic average. This increases the gross tax cost to €60,236,000 and the net tax cost to €40,858,000.

Table 7.33 gives a summary of Indecon's estimates for this scheme.

Table 7.33: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Private Nursing Homes

Estimate	€'000
Capital Expenditure to Date	171,091
Gross Tax Revenue Foregone	54,952
Tax Contribution allowing for Indirect Tax Revenues	19,378
Net Tax Revenue Foregone	35,574
Future Capital Expenditure	30,169

Source: Indecon Confidential Surveys of Private Nursing Homes and County Councils, Irish Nursing Home Organisation.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Based on Indecon's survey of nursing homes, auctioneers, financial institutions and the accountancy profession, we estimate deadweight under this tax incentive to be of the order of 15%. The 'Tax contribution allowing for opportunity cost factor' figure must be reduced to reflect this. We therefore get a tax contribution figure of €16,472,000, reflecting deadweight of around €3,000,000. This results in a net tax revenue foregone of €38,480,287.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we decrease this figure to 1.1 the net tax revenue foregone increases to €37,967,000, while adjusting it to 1.35 decreases net tax foregone to €34,107,000. This gives a range of €3.8M. In addition to this we have assumed a deadweight for the tax incentive equal to 15%, based on survey responses. Reducing this figure to 5% give a net tax foregone of €36,542,000, while increasing it to 25% gives a figure of €40,418,000. This corresponds to a range of around €4M.

7.6.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 7.34 presents the profile of respondents to the Indecon survey who have availed of the tax incentive. Over half described themselves as 'individuals in business', while just over a quarter were companies. 18.5% of those availing of the incentive were 'passive investors'.

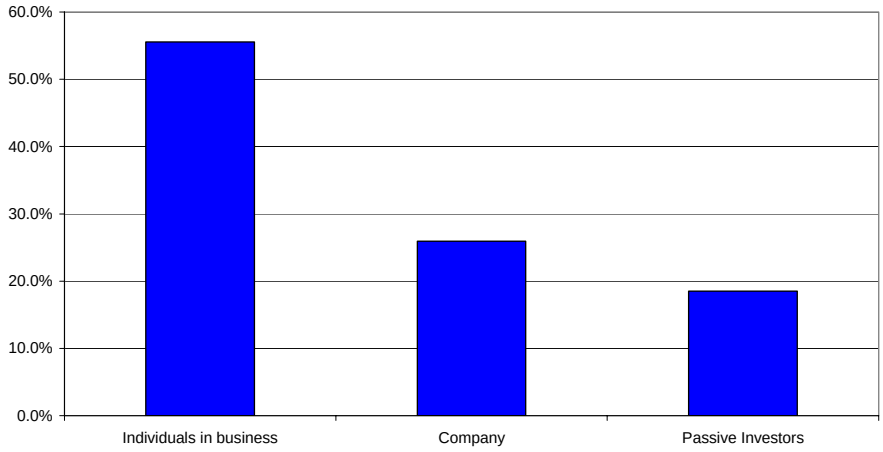
Table 7.34: Profile of Claimants of the Capital Allowances in the case of Nursing Home/Convalescent Facilities which have Utilised the Tax Incentive Scheme

Claimant	% of Respondents
Individuals in business	55.6%
Company	25.9%
Passive Investors	18.5%
Total	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Figure 7.10 illustrates the profile of respondents to the Indecon survey who have availed of the tax incentive.

Figure 7.10: Profile of Claimants of the Capital Allowances in the case of Nursing Home/Convalescent Facilities which have Utilised the Tax Incentive Scheme



Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.35 presents the views of accountancy/tax professionals on the likely income category of investors availing of the tax incentive. All felt that investors were likely to be earning over €100,000, with 16.7% of respondents considering it likely that investors would be earning over €200,000.

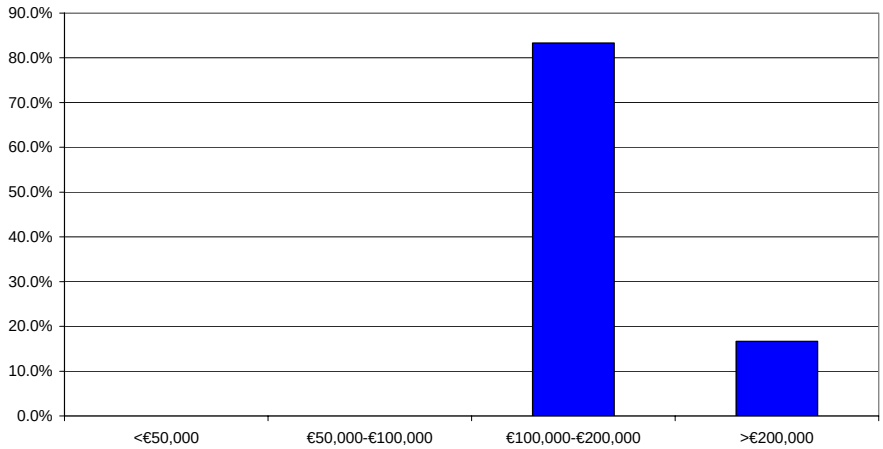
Table 7.35: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Nursing Home Tax Incentive

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	16.7%
Majority of investors were likely to be earning between €100,000 and €200,000	83.3%
Majority of investors were likely to be earning between €50,000 and €100,000	0.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 7.11 emphasises the fact that, in the opinion of accountancy/tax professionals, most investors are likely to be high-earners.

Figure 7.11: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Nursing Home Tax Incentive



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

7.6.5 Overall Effectiveness in Achieving Policy Objective

Table 7.36 presents the views of the nursing home/convalescent facility sector on the effectiveness of the tax incentive scheme in increasing the supply of places. A majority of both categories operators believed that the scheme has been effective in this regard.

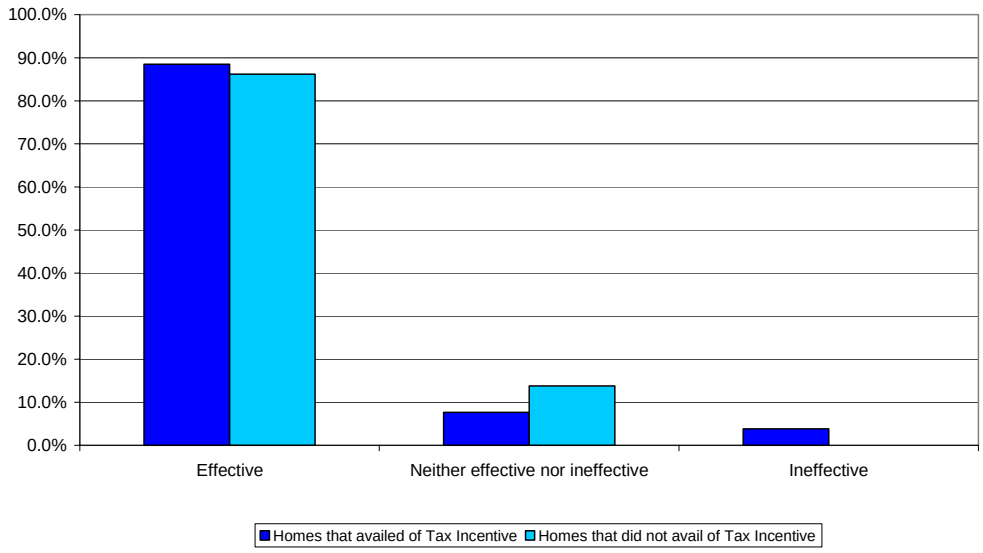
Table 7.36: Views of the Nursing Home/Convalescent Facility Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Nursing Home/Convalescent Facility Places, Nursing Home/Convalescent Facilities With and Without Tax Incentive

	% of Respondents	
Level of Effectiveness	**Homes that availed of Tax Incentive**	**Homes that did not avail of Tax Incentive**
Effective	88.5%	85.7%
Neither effective nor ineffective	7.7%	14.3%
Ineffective	3.8%	0.0%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

The extent of this belief is evident from Figure 7.12.

Figure 7.12: Views of the Nursing Home/Convalescent Facility Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Nursing Home/Convalescent Facility Places, Nursing Home/Convalescent Facilities With and Without Tax Incentive



Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Table 7.37 summarise the views of Local Authorities on the effectiveness of the tax incentive in increasing the supply of nursing home accommodation. Nearly two-thirds of local authorities consider the scheme to have been successful in this regard, with most of the remainder considering it to have been 'neither effective nor ineffective'.

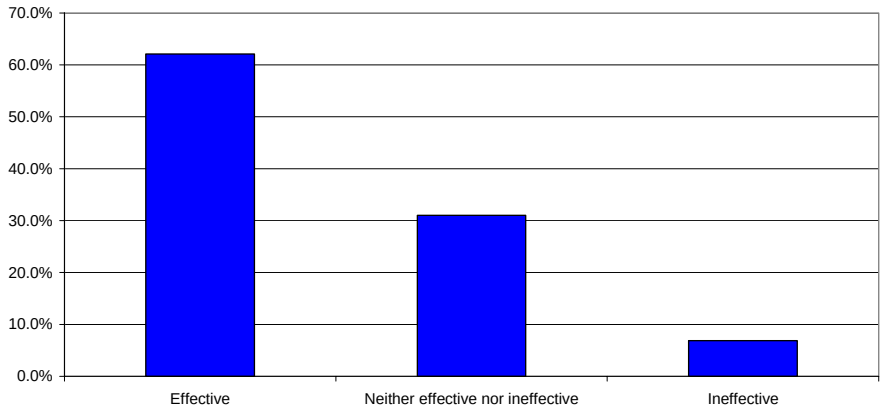
Table 7.37: Views of Local Authorities on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Nursing Homes/Convalescence Accommodation

Level of Effectiveness	% of Local Authorities
Effective	62.1%
Neither effective nor ineffective	31.0%
Ineffective	6.9%
Total	100.0%

Source: Indecon Confidential Survey of Local Authorities.

Figure 7.13 illustrates these views graphically.

Figure 7.13: Views of Local Authorities on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Nursing Homes/Convalescence Accommodation



Source: Indecon Confidential Survey of Local Authorities.

Table 7.38 details the fact that few operating in the nursing home/ convalescent facility sector consider that the tax incentive scheme has been successful in reducing the cost of places, with less than 4% of operators that have availed of the incentive and less than 11% of those that have not considering it to have been effective in this regard. Just over half of the former category and over 60% of latter consider it to have been ineffective, with the remainder not expressing an opinion. It is clear that while those in the sector are positive about the effect of the incentive on the supply of nursing home beds, they are less inclined to consider that it has had any significant effect on prices.

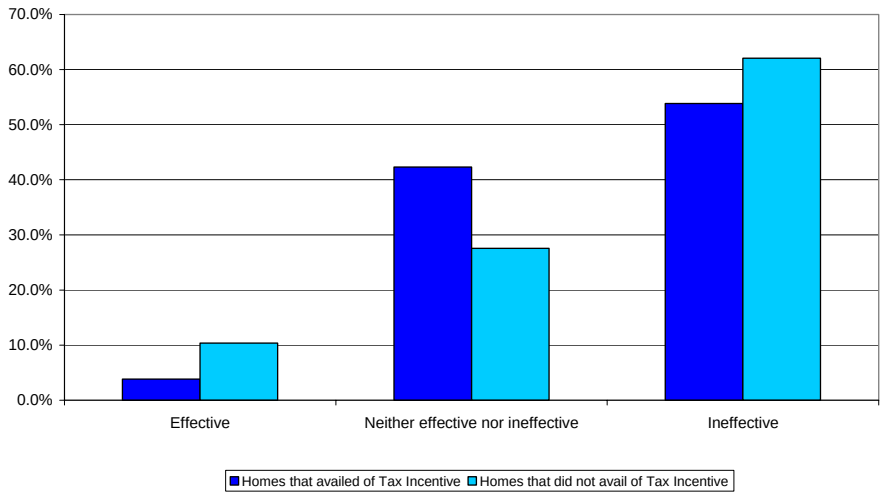
Table 7.38: Views of the Nursing Home/Convalescent Facility Sector on the Effectiveness of Property-based Tax Incentive Scheme in Reducing the Cost of Nursing Home/Convalescent Facility Places, Nursing Home/Convalescent Facilities With and Without Tax Incentive

Level of Effectiveness	% of Respondents	
	Homes that availed of Tax Incentive	Homes that did not avail of Tax Incentive
Effective	3.8%	10.7%
Neither effective nor ineffective	42.3%	28.6%
Ineffective	53.8%	60.7%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

Figure 7.14 illustrates the fact that few operating in the nursing home/ convalescent facility sector consider that the tax incentive scheme has been successful in reducing the cost of places

Figure 7.14: Views of the Nursing Home/Convalescent Facility Sector on the Effectiveness of Property-based Tax Incentive Scheme in Reducing the Cost of Nursing Home/Convalescent Facility Places, Nursing Home/Convalescent Facilities With and Without Tax Incentive



Source: Indecon Confidential Survey of Nursing Home/Convalescent Facilities in Ireland.

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7.7 Summary of Main Findings

In this we have reviewed the property-based tax incentive for nursing homes and outlined its effect both on the supply and cost of nursing home accommodation as well as its impact on Exchequer returns. The key findings from our analysis are as follows:

- There is regional heterogeneity in the current profile of nursing homes in Ireland. There is considerable variation across different regions in the number of nursing homes beds per capita, the costs to the operator per bed, the rate charged per bed, and the average occupancy rates.
- It is widely held, both among operators in the sector and in local authorities that the tax incentive has been effective in increasing the supply of nursing home places. It is also likely that many projects would either not have proceeded in the absence of the tax incentive or would have taken longer to come on-line.

- The weekly cost of places has risen over the last number of years. Indecon survey evidence suggests that the tax incentive scheme had been ineffective in reducing, the increase in the cost of nursing home accommodation. Indecon however believes that in the absence of investment in the sector cost increases would be likely to be greater.
- We have estimated the capital expenditure to date, and presented a forecast for expenditure on eligible projects in the future. After taking account of the beneficial effects of extra investment as a result of the scheme, allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive as €38.5m in terms of tax revenue foregone.
- Those availing of tax relief due to investment in nursing homes were likely to be earning in excess of €100,000 per year.

8 Capital Allowances for Third Level Educational Buildings

8.1 Introduction and Background

In this section, we present our examination of the tax incentive for third-level educational buildings, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability. As part of our research we received survey responses from 11 major third level institutions.

8.2 Description of Tax Incentive

This relief provides for the granting of capital allowances in respect of capital expenditure incurred on certain buildings used for the purposes of third level education. Such expenditure must be approved by the Minister for Education and Science and have the consent of the Minister for Finance. The measure covers both construction expenditure and expenditure on the provision of machinery or plant. Capital allowances are provided for in respect of qualifying expenditure at the rate of 15 per cent per annum for 6 years with the balance (10 per cent) being written off in year 7.

To be eligible for the allowances, the premises must be let to an approved institution. In addition, the approved institution must have raised a sum of money from private sources equivalent to at least 50 per cent of the total qualifying expenditure before construction begins. The Minister for Finance must certify that this is the case and that this sum is to be used solely for the purpose of paying interest, rent and eventually buying back the new premises at the end of the lease period. The section covers projects undertaken in the period from 1 July 1997 to 31 July 2006, provided a Ministerial certificate was received in the Department of Finance by 31 December 2004.

8.3 Measure of Overall Level of Activity in Sector

8.3.1 Level of Incentive Utilisation

Table 8.1 presents a result from Indecon's survey of Third Level Institutions in Ireland. 45.5% of respondents have availed of the tax incentive in the last five years.

Table 8.1: Proportion of Third Level Institutions that Utilised the Section 843 Scheme for Investment in Third Level Educational Buildings

Impact	% of Survey Respondents
Third Level Institutions that have availed of the Section 843 investment scheme	45.5%
Third Level Institutions that have not availed of the Section 843 investment scheme	54.5%
Total	100.0%

Source: Indecon Confidential Survey of Third Level Educational Institutions in Ireland.

8.4 Case Study

Before we examine the detailed impacts of the incentives, it is useful to consider a case study of a third level educational building investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

These incentives are very different from the other incentives since the State is likely to hold the residual (or equity) interest in the facilities[22]. In exchange for tax incentives, the Exchequer receives a real estate investment at the end of seven years. It is therefore appropriate to see the incentive as an alternative to public expenditure or to the institutions borrowing the funds.

[22] If private sector third level institutions avail of this scheme, then the analysis is similar to that of hospitals.

8.4.1 Investor Perspective

An investor plans to purchase a €50 million facility on behalf of a University. The investor pays taxes at 42% and will lease the facility back to the University. At the end of a 7 year lease term, the University has the right to purchase the facility for €0.01. The investor's cost of capital is equal to the 7 year Euro par rate. These assumptions are summarised in Table 8.2.

Table 8.2: Key Assumptions

Item	Assumed Level
Cost of Asset (€ million)	50
10 Year Bond Rate	3%
Lease Term (Years)	7
Tax Rate	42%

Source: Indecon.

Using these assumptions, the investor could charge the University annual lease payments of €8 million and break-even on this transaction. However, if the investor avails of capital allowances, the transaction becomes highly profitable. The capital allowances are €3.2 million in the first 6 years and €2.1 million in the seventh year (see Table 8.3). The present value of these allowances is €19 million (38% of the cost of the asset).

Table 8.3: Return on Third Level Education Buildings

Period	0	1	2	3	4	5	6	7
Interest Revenue		1.5	1.3	1.1	0.9	0.7	0.5	0.2
Principal Repaid		6.5	6.7	6.9	7.1	7.3	7.6	7.8
Cash Flow	-50	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Capital Allowance		3.2	3.2	3.2	3.2	3.2	3.2	2.1
CA As % of Cash Flow		39%	39%	39%	39%	39%	39%	26%

Source: Indecon.

In practice, some form of gain-sharing is likely to take place. Largely, this will depend upon the relative bargaining power of the investor and the University. For example, if there is a 50-50 effective sharing of the benefits allocation of the capital allowances, then the present value of the transaction to the investor is €9.5 million and the University will make lease payments of €6.4 million in each of the first 6 years and €7 million in the final year. From the perspective of the University, the transaction results in a saving of €9.5 million (19% of the cost of the asset). In practice, research undertaken by Indecon suggests that many third level institutions may benefit less than indicated in this case study.

8.5 Impacts of Tax Incentive

8.5.1 Impact on Cost of Educational Buildings

Table 8.4 gives a summary of the views of the Third Level Education sector on the impact of the tax incentive scheme on the cost of educational buildings. Two thirds of those respondents who had utilized the scheme felt that it enabled their institution to lease a building at a lower cost than financing, while a third felt that it enabled their institution to lease a building without having to borrow.

Table 8.4: Views of the Third Level Education Sector on the impact of the Section 843 Scheme on the Cost of Educational Buildings, in the case of Third Level Institutions which have Utilised the Scheme

Main Impact	% of Respondents
Enabled institution to lease a building at a lower cost than financing, i.e. directly through borrowings	66.7%
Facilitated institution to lease a building without recourse to borrowings	33.3%
Other	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

A number of third level institutions have also indicated to Indecon that the scheme involves what in their view is an onerous and complicated certification for each project.

In relation to the 50% private funding requirement before construction some third level institutions have indicated that they are experiencing smaller individual donations over a period and that they believe it would be preferable to proceed with projects prior to reaching the 50% funding provided they were confident that targets for the generation of private funds could be achieved. Permitting colleagues to proceed with prudent plans based on normal borrowing financing could reduce overall costs if delays to projects were avoided in periods of high cost inflation.

8.6 Evaluation of the Tax Incentive

8.6.1 Displacement, Deadweight and Opportunity Cost

Table 8.5 details the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood of realised capital expenditure proceeding in the absence of the tax incentive. Few respondents in any of the categories felt that all projects would have proceeded within the existing timeframe. Over a third of auctioneers, a third of accountancy/tax professionals and nearly 60% of respondents in financial institutions felt that projects would have proceeded over a longer timeframe, while over a third of auctioneers and a third of accountants felt that a majority of projects would not have proceeded at all. The third level institutions and other agencies of government are likely to be in a better position than these other groups to evaluate the likelihood of projects proceeding in the absence of the property based tax incentives. This is, however, more difficult to judge than might at first be thought. Third level institutions who we consulted were of the view that the buildings funded were of critical importance. However, whether they would have been able to proceed with the projects within the timescale would have depended on the willingness of the Exchequer to provide the funds or the feasibility of the institutions raising the funding through borrowings, donations or own resources. In many ways as these projects represent public goods this issue is less relevant than for some of the other schemes.

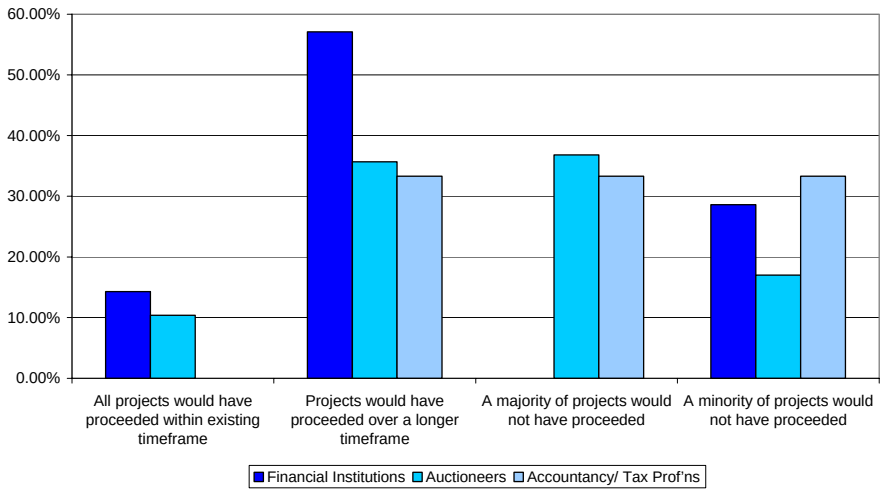
Table 8.5: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	Auctioneers	Accountancy / Tax Prof'ns
All projects would have proceeded within existing timeframe	14.3%	10.4%	0.0%
Projects would have proceeded over a longer timeframe	57.1%	35.7%	33.3%
A majority of projects would not have proceeded	0.0%	36.8%	33.3%
A minority of projects would not have proceeded	28.6%	17.0%	33.3%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 8.1 illustrates the views of financial institutions and auctioneers/ accountancy professionals.

Figure 8.1: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

8.6.2 Estimated Investment in the Sector

8.6.2.1 Capital Expenditure

Table 8.6 presents an overview of the project certified for funding under the first and second cycle of the Programme for Research in Third Level Institutions. For cycle 2 the figure was €43.147 and for non PRTLI the estimated capital spend was €147.508.

Table 8.6: Capital Spend on Section 843 Projects

		Section 843 Projects €m
PRTLI	Cycle 1	157.329
PRTLI	Cycle 2	43.147
Non PRTLI		147.508
		347.984

Source: Department of Education and Science

In addition to projects approved there are three more projects to be considered for approval and the value of these have been estimated to be €79m. We have not included these projects in our estimates.

Table 8.7 gives some indicative estimates of the timing of the projects approved as eligible to utilise the Section 843 scheme between 1997 and 2005 based on our survey responses.

Table 8.7: Total Number of Approved Projects (i.e. Third Level Educational Buildings) Utilising the Section 843 Scheme, 1997-2005

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Number of projects	0	1	1	2	2	2	1	0	1

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

Table 8.8 details results from Indecon's survey of Third Level Institutions in Ireland. The average percentage cost savings for institutions utilising the Section 843 scheme compared to borrowing funds was 6.8%. As illustrated in our case study, the NPV to investors of the capital allowances could be as high as 38% of the capital costs in cases where personal investment was used on non PRTLI projects. This indicates that the Exchequer is paying multiples to the investors of the benefits secured by the universities. The scheme therefore represents an extremely costly mechanism for the state to fund the much needed investment in our third level sector. The funds could be secured at a fraction of the cost of the tax incentives. Even in cases where corporate investment is used we believe the scheme is not cost-effective.

Table 8.8: Average percentage cost savings compared to borrowing funds secured in the case of Third Level Institutions which have Utilised the Section 843 Scheme

Item	%
Average percentage cost savings	6.8%

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

8.6.2.2 Sources of Funding for Capital Expenditure

Table 8.9 gives the breakdown in funding sources for capital investments in third level buildings. Nearly 40% came from direct sponsorship or gift, with 30% coming from the government and just under a quarter borrowed from banks.

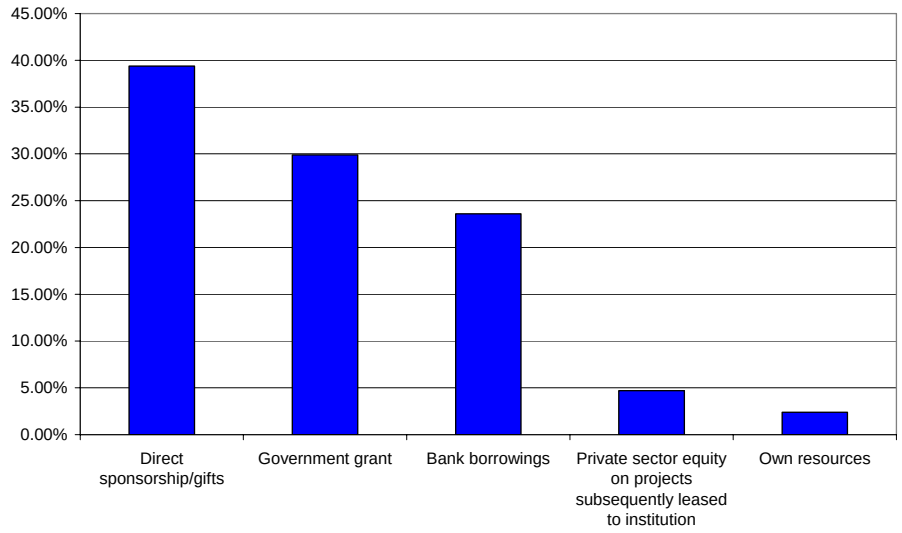
Table 8.9: Breakdown of Funding Sources, in the case of Third Level Institutions which have Utilised the Scheme

Source of funding	%
Bank borrowings	23.6%
Private sector equity on projects subsequently leased to institution	4.7%
Direct sponsorship/gifts	39.4%
Government grant	29.9%
Own resources	2.4%
Total	100.0%

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

Figure 8.2 graphically depicts these figures.

Figure 8.2: Breakdown of Funding Sources, in the case of Third Level Institutions which have Utilised the Scheme



Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

8.6.3 Estimated Gross and Net Cost of Tax Incentive

8.6.3.1 Capital Expenditure

Under the tax allowance scheme for third level educational buildings, all schemes must be certified by either the Higher Education Authority or the Department of Finance. As Indecon has had access to this data, we are able to estimate levels of investment under this scheme. Overall capital expenditure is estimated to be €348m.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. Based on information from the Department of Finance, we understand that there are 3 more schemes to be approved under this scheme with estimated value of €79m.

Table 8.10: Estimate of Total Eligible Capital Expenditure on Third Level Educational Buildings under the Tax Incentive Scheme

Detail	Value (€'000s)
Total Cumulative Capital Expenditure to date	347,984
Estimated Future Capital Expenditure	79,000

Source :Indecon Calculations

8.6.3.2 Impact of the Capital Expenditure

The impact of this investment will give rise to increased capital formation which in turn will give rise to increased economic activity. It is therefore important to estimate the knock-on macro-economic effect of the investment on the economy as a whole in order to calculate the net effect on the Exchequer. In order to do this, Indecon has applied a 'multiplier' to the capital investment, which effectively multiplies the investment by an integer calculated by past empirical research. For the Third Level Educational Sector, we have estimated that the initial investment will give rise to overall economic expenditure of the order of €436,720,000. However, this figure must be adjusted to reflect the opportunity cost of the investment, which is due to the fact that the money could have been invested in another part of the economy. We assume an opportunity cost of 95% suggesting a macro-economic benefit of €21,835,996. This however does not take account of the very important impact of investment in the third level sector on human capital. Indecon believes that continued investment in the third level sector is essential and we believe that based on previous evaluations that these projects can have a significant economic return. We have not attempted to evaluate these benefits as part of this assignment but would strongly support on-going investment in the sector.

8.6.3.3 Impact on Exchequer Revenues

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the working of each tax incentive scheme. In the case of third level educational buildings, this is based on the method of calculating the capital allowance over 7 years, allowing for a 15% deduction over the first 6 years and a final 10% deduction in the 7th year. The tax foregone relating to years after 2005 are subject to a net present value (NPV) calculation, which reflects the current value of the future tax foregone. Current corporate and income tax rates are applied.

The issue of what tax rate to utilise in our estimates is a difficult one to decide in the case of third level buildings and in general it can be assumed that investors will utilise the structure which maximise their net benefit. In this case this suggests the appropriateness of assuming the allowances have been claimed at the personal tax rates and we are aware of utilisation of this incentive by personal investors. This is the assumption used for non PRTLI projects. For PRTLI projects, investors are obliged to apply corporate tax rates and provide an estimate of their tax savings arising from the scheme. Indecon has had access to this information and our tax figures for PRTLI projects are based on the original estimates by financial institutions at the time of the tender for the PRTLI scheme. The total gross tax foregone under this scheme is of the order of €29,162,000. Adding this to our estimate for the gross tax cost of the non-PRTLI scheme, we estimate a total gross tax cost of €87,075,000.

This gross figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €157,656,000.

Adjusting this figure to reflect the opportunity cost of the tax revenues we calculate a net tax contribution of €39,414,000 as a result of the investment in new facilities. Deducting this figure from the gross cost to the Exchequer, we estimate a net cost of €47,661,000. Table 8.11 gives a summary of Indecon's estimates for this scheme.

Table 8.11: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Third Level Educational Buildings

Estimate	€m
Capital Expenditure	348
Gross Tax Revenue Foregone	87
Tax Contribution allowing for Indirect Tax Revenues	39
Net Tax Revenue Foregone	48

Source: Department of Finance, Higher Education Authority, Indecon survey of Universities.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Based on Indecon's survey of universities, auctioneers, financial institutions and the accountancy profession, we estimate deadweight under this tax incentive to be of the order of 15%. The 'Tax Contribution allowing for Opportunity Cost' figure must be reduced to reflect this. We therefore get a tax contribution figure of €33,502,000, reflecting deadweight of around €5.9m. This results in net tax revenue foregone of €53,573,000.

Indecon has undertaken a sensitivity analysis on the above figures, in relation to the multiplier and deadweight assumptions. The multiplier used for the above estimates is 1.255. Reducing this to 1.1 gives a net tax cost figure of €52,529,000, while increasing it to 1.35 gives a figure of €44,678,000; a range of around €8m. A deadweight figure of 15% was applied to the net tax contribution arising from the capital expenditure. Reducing this to 10% increases the net tax foregone figure to €51,602,000, while increasing it to 25% results in a figure of €57,515,000. Therefore, a 15% change in the deadweight assumption leads to a €6m change in the net tax foregone.

8.6.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 8.12 gives the opinion of accountancy/tax professionals on the income category of investors availing of the tax incentive. All respondents felt that investors were likely to be earning in excess of €200,000 per years.

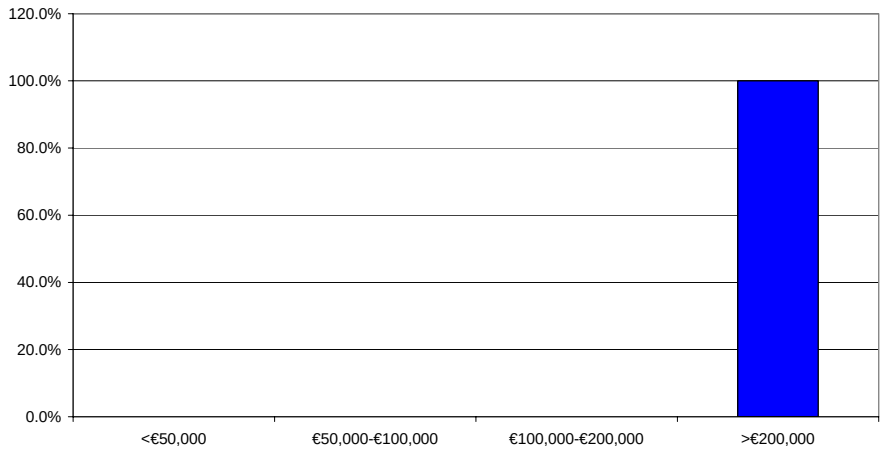
Table 8.12: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors utilising the Third Level Educational Buildings Tax Incentive.

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	100.0%
Majority of investors were likely to be earning between €100,000 and €200,000	0.0%
Majority of investors were likely to be earning between €50,000 and €100,000	0.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

This decisive result is illustrated in Figure 8.3, below.

Figure 8.3: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Estimates of Gross Annual Income Category accounting for the Majority of Investors utilising the Third Level Educational Buildings Tax Incentive.



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

8.6.5 Overall Effectiveness in Achieving Policy Objective

Table 8.13 presents the views of the Third Level Education sector on the effectiveness of the tax incentive in attracting additional investment in third level educational facilities. While 75% of those responding institutions which had availed of the tax incentive felt that the scheme had been successful in this regard, none of the respondents from institutions that had not availed the incentive felt this to be the case.

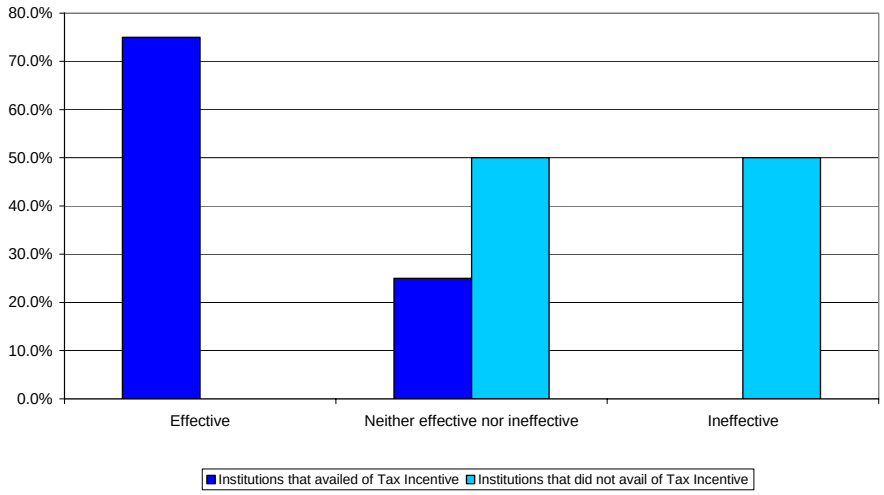
Table 8.13: Views of the Third Level Education Sector on the Effectiveness of the Section 843 Capital Allowance Scheme in Attracting Additional Investment In Third Level Educational Facilities , Third Level Institutions With and Without Tax Incentives

	% of Respondents	
Level of Effectiveness	**Institutions that availed of Tax Incentive**	**Institutions that did not avail of Tax Incentive**
Effective	75.0%	0.0%
Neither effective nor ineffective	25.0%	50.0%
Ineffective	0.0%	50.0%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Third Level Educational Institutions in Ireland.

The differences in the opinions of those institutions which availed of the tax incentive and those that did not is emphasised by Figure 8.4.

Figure 8.4: Views of the Third Level Education Sector on the Effectiveness of the Section 843 Capital Allowance Scheme in Attracting Additional Investment In Third Level Educational Facilities , Third Level Institutions With and Without Tax Incentives



Source: Indecon Confidential Survey of Third Level Educational Institutions in Ireland.

Table 8.14 displays the views of the third level education sector on the impacts of the Section 843 Capital Allowance Scheme. All respondents who had availed of the incentive felt it had facilitated the development of R&D activities, while 60% felt it had facilitated an expansion in student numbers, improved facilities for students and staff and made possible the provision of new facilities.

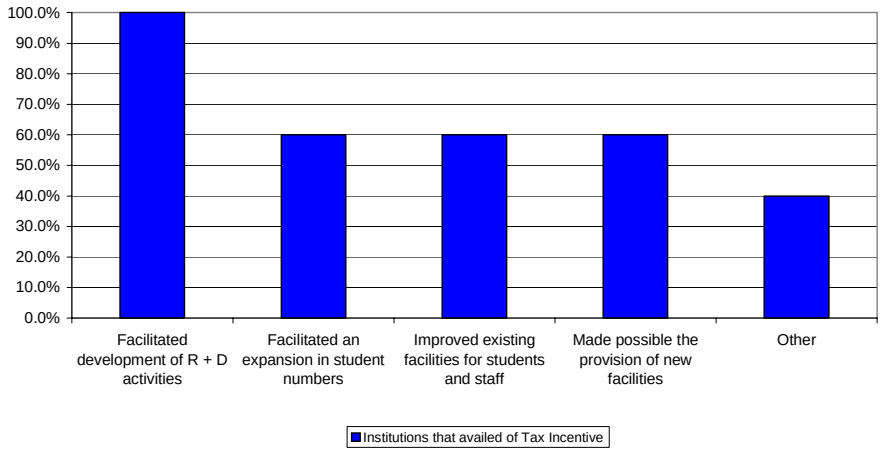
Table 8.14: Views of the Third Level Education Sector on the Impacts of the Section 843 Capital Allowance Scheme on Investment in Third Level Educational Facilities, Third Level Institutions With and Without Capital Allowances

Impact	% of Survey Respondents	
	Institutions that availed of Tax Incentive	Institutions that did not avail of Tax Incentive
Facilitated development of R & D activities	100.0%	-
Facilitated an expansion in student numbers	60.0%	-
Improved existing facilities for students and staff	60.0%	-
Made possible the provision of new facilities	60.0%	-
Other	40.0%	-

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

Figure 8.5 illustrates these responses.

Figure 8.5: Views of the Third Level Education Sector on the Impacts of the Section 843 Capital Allowance Scheme on Investment in Third Level Educational Facilities, Third Level Institutions With and Without Capital Allowances



Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

8.7 Summary of Main Findings

In this section we have described the property-based tax incentive for third level educational buildings and outlined its effect both on third level institutions and on Exchequer returns. The key findings from our analysis are as follows:

- Among those institutions that have availed of the incentive there is broad support for the contention that it has facilitated investment in research and led to the development of new R&D facilities as well as an improvement in existing ones. Among those institutions that have not availed of the incentive there is a tendency to consider that the scheme has been ineffective in this regard.
- We have estimated the total capital expenditure undertaken to date. After taking account of the beneficial effect of extra investment as a result of the scheme allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive as €53.6 million in terms of tax revenue foregone.
- The investments supported by the Section 843 incentives are likely to have had significant economic benefits and Indecon believes continued investment in this sector is needed.
- Our analysis however has indicated that the incentives resulted in very little cost savings for the institutions and that these were a fraction of the Exchequer costs. A much more cost effective way would be for the institutions to have borrowed the funds.
- The incentives which have been used primarily by high income earners represent a very costly way to fund the needed investment. Public expenditure could have achieved the same results at much lower Exchequer costs.

9 Section 23 Relief for Student Accommodation

9.1 Introduction and Background

In this section, we present our examination of the tax incentive for student accommodation properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability.

9.2 Description of Tax Incentive

This scheme was introduced in Finance Act 1999 with the intention of increasing the supply of suitable student accommodation in the vicinity of 3rd level institutions. The scheme applies to capital expenditure incurred in the period between 1 April 1999 and 31 July 2006 (Finance Act 2004) where an application for full planning permission has been received by the planning authority by 31 December 2004. The extension also applies, as in other schemes (hotels, holiday cottages) in relation to exempted development where the relevant conditions are satisfied by 31 December 2004. Expenditure on the construction, conversion or refurbishment of rented residential accommodation for third level students qualifies for "Section 23" type relief. The relief provides for a deduction of 100% of the construction, conversion or refurbishment expenditure, which may be off-set against all Irish rental income - whether derived from the premises in question or from other lettings. The development must conform with guidelines issued by the Minister for Education and Science. These guidelines deal with various features of the scheme, including the institutions which qualify, conditions relating to the standards and location of accommodation and the categories of students whose accommodation will be covered.

The accommodation must be provided within an 8km radius of the main campus and must be approved by the relevant third level institution. One of the provisions of the section was that the first letting must be to students of the certifying educational institution and this is an understandable provision. In cases, however, where a unit was first completed and available for letting outside of the academic year it had the potential to cause a loss of summer business and a vacant property.

9.3 Measure of Overall Level of Activity in Sector

9.3.1 Supply of Student Accommodation

Table 9.1 presents the views of the third level education sector on the current supply of student accommodation. Of institutions that have availed of the incentive, 44.4% consider there to be currently excess supply of student accommodation. Concerns over over-supply were also expressed to Indecon by a number of parties during our research. This supply problem will also be influenced by the significant pipeline of projects which have met the 2004 planning deadline. If all of these projects proceed there is likely to be a significant oversupply situation. Of those responding institutions that had not availed of he the tax incentive, 100% consider the current supply of student accommodation to be adequate.

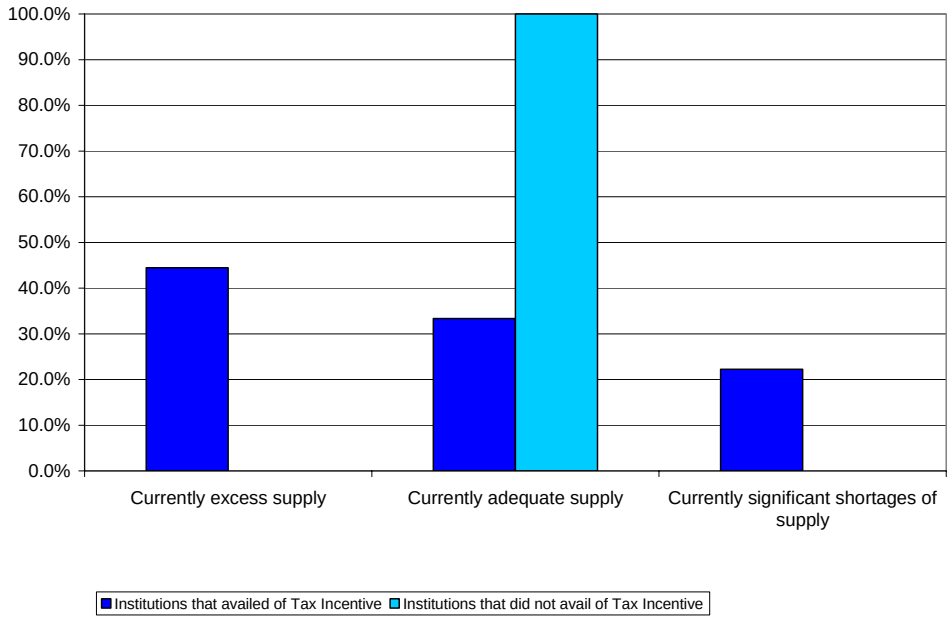
Table 9.1: Views of the Third Level Education Sector on the Current Supply of Student Accommodation, Third Level Institutions With and Without Tax Incentive

	% of Survey Respondents	
Impact	**Institutions that availed of Tax Incentive**	**Institutions that did not avail of Tax Incentive**
Currently excess supply of accommodation available on market	44.4%	0.0%
Currently adequate supply	33.3%	100.0%
Currently significant shortages of supply	22.2%	0.0%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

Figure 9.1 presents the above views graphically.

Figure 9.1: Views of the Third Level Education Sector on the Current Supply of Student Accommodation, Third Level Institutions With and Without Tax Incentive



Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

9.3.2 Level of Incentive Utilisation

Table 9.2 presents the proportion of respondents to the Indecon survey who have availed of the tax incentive (90%).

Table 9.2: Proportion of Third Level Education Institutions that have Certified Projects that qualify for Section 23 Type Relief Capital Allowances for Student Accommodation

	% of Survey Respondents
Institutions that have certified projects qualifying for Section 23 type relief capital allowances	90.0%
Institutions that have not certified projects qualifying for Section 23 type relief capital allowances	10.0%
Total	100.0%

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

Table 9.3 details the type of accommodation used by third level students in 2000 and in 2005. The proportion of students residing in student accommodation approved under the scheme rose by 16.6% percentage points. There has been an associated fall in the proportion of students living in other accommodation provided by the market (20.1 percentage points).

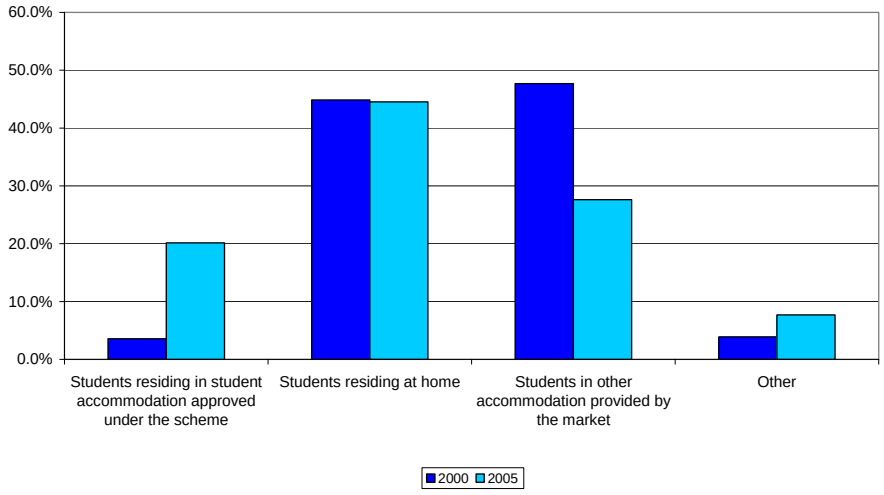
Table 9.3: Details of Student Accommodation, Percentage of Students Residing in Types of Accommodation: 2000-2005

Detail	2000 %	2005 %	Change 2000-2005 (%)
Students residing in student accommodation approved under the scheme	3.6%	20.1%	16.6%
Students residing at home	44.8%	44.5%	-0.3%
Students in other accommodation provided by the market	47.7%	27.6%	-20.1%
Other	3.9%	7.7%	3.8%
Total	100.0%	100.0%	-

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

The proportion of students residing at home has remained relatively constant as can be seen in Figure 9.2.

Figure 9.2: Details of Student Accommodation, Percentage of Students Residing in Types of Accommodation: 2000-2005



Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

9.3.3 Level of Construction Activity

The Department of the Environment and Local Government have to date issued Certificates of Reasonable Cost[23] or Certificates of Compliance[24] to 4,718 completed units[25] to be used as student accommodation. These units have been completed. Table 9.4 illustrates the locations of these units.

[23] A certificate of Reasonable Cost is issued by the Department of Environment and Local Government in cases where the builder does not sell the property on. It certifies that the cost of construction was reasonable, that the building regulations have been complied with and that the floor area is in line with that set out in the guidelines issued by the Department of Education and Science.

[24] A Certificate of Compliance is issued by the Department of Environment and Local Government where a property is sold on by a builder. It certifies that the building regulations have been complied with and that the floor area is in line with that set out in the guidelines issued by the Department of Education and Science.

[25] A unit in this instance refers to an apartment or house.

Table 9.4: Section 50 Units Approved - 01/04/1999 – 18/02/2005

Location	No. of units
Carlow	79
Castlebar	22
Cork	570
Letterkenny	112
Dublin	641
Galway	819
Tralee	264
Maynooth	183
Limerick	1061
Sligo	356
Waterford	512
Athlone	99
Total	4718

Source: The Department of Education and Science

Table 9.5 presents the number of bedspaces developed or under construction in each year between 1999 and 2004. There has been a steady increase with a total of 15,317 new bedspaces developed over the 6 year period.

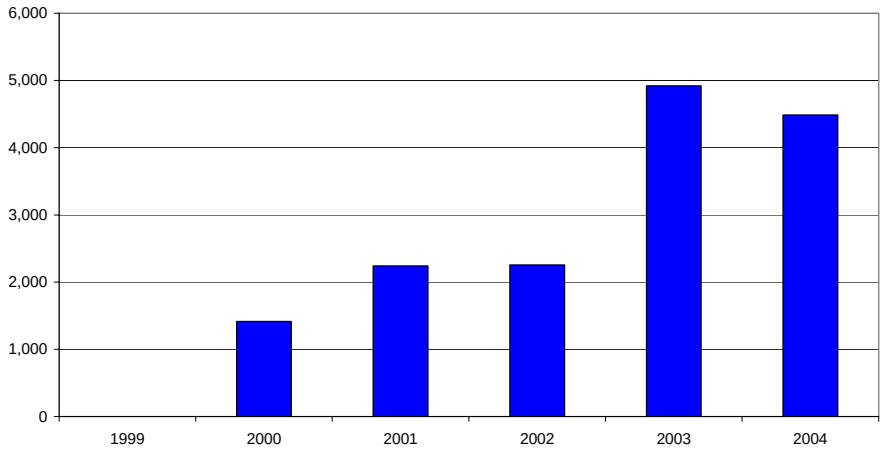
Table 9.5: Details of Student Accommodation Schemes Developed or Under Construction, in the case of Third Level Institutions availing of Tax-Relief- Number of Bed spaces.

Detail	1999	2000	2001	2002	2003	2004
Number of bedspaces in schemes	0	1,416	2,242	2,253	4,919	4,487

Source: The Department of the Environment and Local Government

This trend is illustrated in Figure 9.3.

Figure 9.3: Details of Student Accommodation Schemes Developed or Under Construction, in the case of Third Level Institutions availing of Tax-Relief- Number of Bed spaces.



Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

Table 9.6 gives details on the number of units in schemes developed or under construction in each year using the tax incentive. A total of 3,560 units were constructed between 1999 and 2004. (This differs from numbers approved).

Table 9.6: Details of Student Accommodation Schemes Developed or Under Construction, in the case of Third Level Institutions availing of the Tax-Relief- Number of Units in Schemes: 1999-2004

Detail	1999	2000	2001	2002	2003	2004
Number of units	0	356	413	538	1,215	1,038

Source: The Department of Education and Science.

9.4 Case Study

It is useful to consider a case study of a student accommodation investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

The analysis in this section assumes that a property will be purchased, operated as student accommodation for a 10 year period and subsequently resold as residential property. While this may be unlikely for accommodation located on college campuses it is the most likely outcome for accommodation outside of the campuses.

9.4.1 Investor Perspective

In our case study the investor makes an investment in a provincial student accommodation. Properties are available at a cost of €180,000. The student accommodation in our illustrative case study has a low yield due to lower occupancy rates in the summer months and additional security charges, resulting in a yield of €6,400 per annum[26]. Finally, a risk free interest rate is used to discount the differential cash flows as the differential is assumed to be known with certainty. These assumptions are summarised in Table 9.7[27].

Table 9.7: Key Assumptions

Item	Assumed Level
Investment (€'000)	180
Gross Yield	6%
Net Yield – Student Accomm.	3.6%
Tax Rate	42%
Assumed Revenue Growth	4%
Risk Free 10 Year Bond	3.3%

Source: Indecon.

[26] These yields are based on an examination of estate agents' web sites. A valuation formula is presented in Appendix A1.4 that may be used to examine alternative assumptions.

[27] Two simplifying assumptions have been made. First, fixtures and fittings are ignored since they will apply in both cases. Second, land costs are assumed to be immaterial.

In this case study it may be shown (Table 9.8) that the net loss associated with operating student accommodation in the absence of tax incentives is 9% of the construction cost. The current capital allowances for student accommodation have a present value of 41%[28]. Therefore an investor would be prepared to pay a premium of up to 32% (i.e. a selling price of €238,000 rather than €180,000) to acquire a residential property that is designated as student accommodation.

Table 9.8: Student Accommodation

Period	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Ebitda – Residential		9	10	10	11	11	11	12	12	13	13
Ebitda – Student Accom.		7	7	7	8	8	8	8	9	9	10
Loss - Student Accom		-3	-3	-3	-3	-3	-3	-3	-4	-4	-4
Taxes		1	1	1	1	1	1	1	1	2	2
After Tax Loss		-2	-2	-2	-2	-2	-2	-2	-2	-2	-2

		% of Cost
Present Value of Losses	-16	-9%
PV (Capital Allowances)	74	41%
PV (Losses+ Allowance)	58	32%

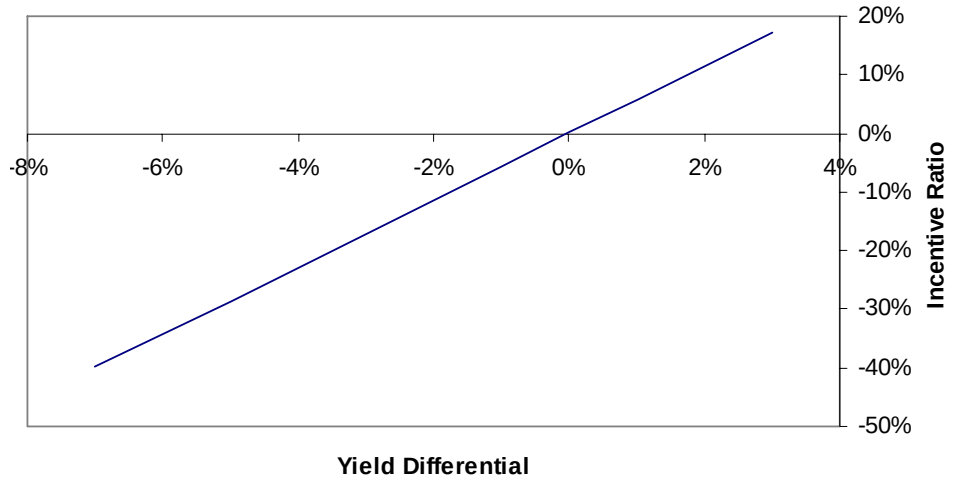
Source: Indecon.

[28] If the investor has sufficient rental income, 100% of the construction cost could be deducted in the first year. At a 42% tax rate, this has a present value of 41%.

9.4.2 Sensitivity Analysis

The differential between rental yields on student housing and residential properties is the key driver of the Incentive Ratio. The impact of differential yields is summarized in Figure 9.4. For example, if the net yield on student accommodation is 1% and the net yield on residential property is 6%, then the yield differential is -5%. From Figure 9.4, it may be seen that a yield differential of -5% gives rise to an Incentive Ratio of -30%. Stated differently, an investor in our case study would require capital allowances equal to 30% of the capital cost to consider an investment in student housing.

Figure 9.4: Incentive Ratio Vs. Yield Differential



Source: Indecon.

9.5 Evaluation of the Tax Incentive

9.5.1 Displacement, Deadweight and Opportunity Cost

Table 9.9 presents the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood of developments proceeding in the absence of the tax incentive. In the case of financial institutions and auctioneers, a substantial majority believed that a majority of projects would not have proceeded. There was less consensus among the accountancy/tax professionals. A third contended that a minority of projects would not have proceeded, a third contended that a majority of projects would not have gone ahead, with the remaining third believing that project would have proceeded over a longer timeframe.

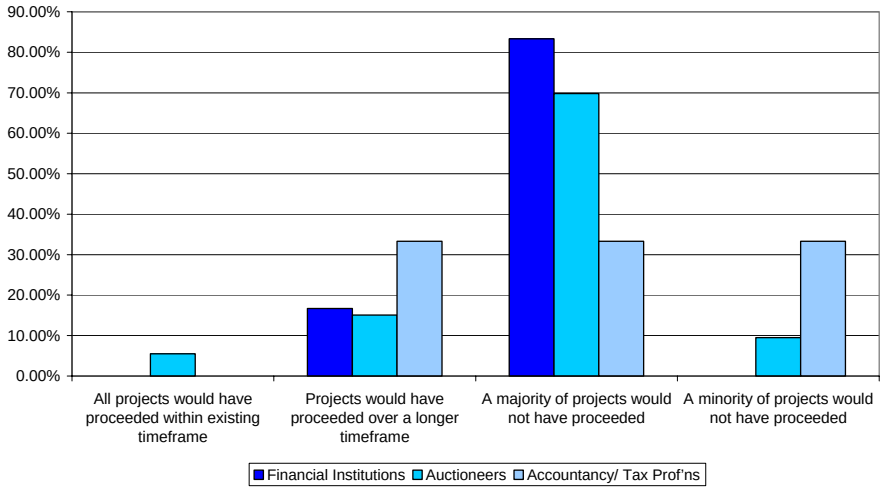
Table 9.9: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Student Accommodation Developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme.

	% of Survey Respondents		
View	**Financial Institutions**	**Auctioneers**	**Accountancy/ Tax Prof'ns**
All projects would have proceeded within existing timeframe	0.0%	5.5%	0.0%
Projects would have proceeded over a longer timeframe	16.7%	15.1%	33.3%
A majority of projects would not have proceeded	83.3%	69.8%	33.3%
A minority of projects would not have proceeded	0.0%	9.5%	33.3%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 9.5 emphasises the fact that while most of the financial institutions and auctioneers believe that most projects would not have proceeded without the tax incentive, the accountancy/tax professionals were less convinced as to the importance of the scheme.

Figure 9.5: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Student Accommodation Developments) would have proceeded in the Absence of the Property-based Tax Incentive Scheme.



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Table 9.10 presents the views of auctioneers on the current supply situation for third level institutions. Exactly one third believe that there is currently excess supply and just over one third believe that the market is in or near equilibrium.

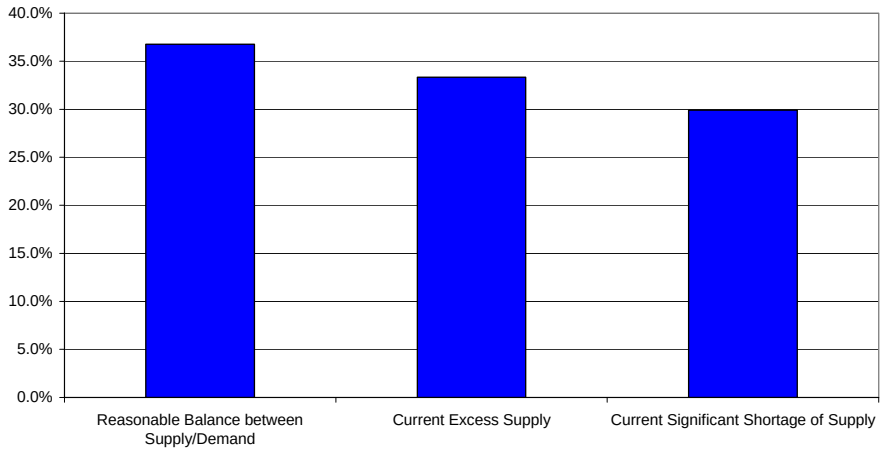
Table 9.10: Views of Auctioneers on Current Supply Position

View	% of Survey Respondents
Reasonable Balance between Supply/Demand	36.8%
Current Excess Supply	33.3%
Current Significant Shortage of Supply	29.9%
Total	100.0%

Source: Indecon Confidential Survey of Auctioneers in Ireland.

Figure 9.6 illustrates the views of auctioneers on the current supply situation for third level institutions.

Figure 9.6: Views of Auctioneers on Current Supply Position



Source: Indecon Confidential Survey of Auctioneers in Ireland.

9.5.2 Estimated Investment in the Sector

9.5.2.1 Capital Expenditure

Table 9.11 presents a result from Indecon's survey of Third Level Institutions in Ireland. It gives the level of capital expenditure by institutions availing of the tax incentive, on relevant projects.

Table 9.11: Details of Student Accommodation Schemes Developed or Under Construction, in the case of Third Level Institutions availing of the Tax-Relief-Level of Capital Expenditure: 1999-2004. €m

Detail	2000	2001	2002	2003	2004	2005
Level of capital expenditure €m	32.8	51.0	69.5	98.4	137.5	30.0

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

There was an upward trend between 2000 and 2005, with a total expenditure over the period of €419.1.

9.5.2.2 Lending Advanced by Financial Institutions

Table 9.12 details a result from Indecon's Survey of Financial Institutions in Ireland. The total value of lending to third level institutions by those who responded to the survey was €201m in 2003 and €366m in 2004. The responding institutions estimated total capital expenditure including promoter's equity to be €258m in 2003 and €440m in 2004.

Table 9.12: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimated Total Capital Expenditure on Student Accommodation including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	201,000	366,500
Total capital expenditure on projects including promoter's equity	258,000	440,700

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

9.5.3 Estimated Gross and Net Cost of Tax Incentive

9.5.3.1 Capital Expenditure

In order to qualify for relief under the tax incentive scheme for student accommodation, developers must be issued with a 'certificate of compliance' and certificates of reasonable cost by the Department of Environment, Heritage and Local Government. If developers plan to run these developments themselves (i.e. not sell them on the open market after construction) they must be issued with a 'certificate of reasonable cost' and their costs will be assessed. As records are kept on all applications under this scheme, and reports eligible capital expenditure for schemes issued with certificates of reasonable cost, Indecon has been able to estimate the total capital expenditure based on the actual number of schemes and a limited amount of actual cost data.

In order to calculate the total capital expenditure to date, Indecon applied average cost per apartment/house to all completed and approved schemes. Under this method, we calculate that total capital expenditure to date under this scheme is of the order of €510,474,000.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. For the schemes which have not yet been completed, Indecon applied the cost-per-apartment measure to come up with a total capital expenditure remaining under the scheme. This figure is of the order of €935,574,000. However, this assumes that all of the projects which have applied for the tax relief will proceed. To the extent that some do not proceed the level of capital spent will be reduced accordingly. For example, were only 80% of projects to proceed then the future capital spend would be equal to €748,459,000.

Table 9.13: Estimate of Total Eligible Capital Expenditure on Student Accommodation under the Tax Incentive Scheme

Detail	Value (€'000s)
Total Cumulative Capital Expenditure to date	510,474
Forecast of Future Capital Expenditure	935,574

Source :Indecon Calculations

9.5.3.2 Impact of the Capital Expenditure

Taking account of multiplier effects, we have estimated that the investment will give rise to overall economic expenditure of the order of €640,644,000. However, this figure must be adjusted to reflect the opportunity cost of the investment, which is due to the fact that the money could have been invested in another sector of the economy. We assume a 95% opportunity cost suggesting an economic benefit of the order of €32,032,000.

9.5.3.3 *Impact on Exchequer Revenues*

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the method of calculating allowances of each scheme. This is particularly simple in the case of student accommodation as 100% of the allowance is given in the year of completion. This also removes the issue of performing a net present value calculation on tax foregone after 2005, as there isn't any. Current corporate and income tax rates are used and applied

Using this method, we have estimated a gross cost to the Exchequer of €214,399,000. This gross figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €231,273,000. Adjusting this figure to reflect the opportunity cost of the investment (i.e. the fact that the money could have been invested in another sector of the economy) we calculate a net tax contribution of €57,818,000. Deducting this figure from the gross cost to the Exchequer, we estimate a net cost to the Exchequer of €156,581,000.

Table 9.14 gives a summary of Indecon's estimates for this scheme.

Table 9.14: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Student Accommodation

Estimate	€'000
Capital Expenditure to Date	510,474
Future Capital Expenditure	935,574
Gross Tax Revenue Foregone	214,399
Tax Contribution allowing for Indirect Tax Revenues	57,818
Net Tax Revenue Foregone	156,581

Source: Department of Education, Indecon survey of Universities.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Based on Indecon's survey of universities, auctioneers, financial institutions and the accountancy profession, we estimate deadweight under this tax incentive to be of the order of 5%. The 'Tax Contribution allowing for Opportunity Cost' figure must be reduced to reflect this. We therefore get a tax contribution figure of €54,927,000 reflecting deadweight or around €3,000,000. This results in a net tax revenue foregone figure of the order of €159,472,000.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we increase this figure to 1.35 the net tax revenue foregone decreases to €152,204,000, a fall of around €4.4m, and adjusting this figure for deadweight gives us a net figure of €15,314,000, representing a decrease of around €4.2m on the base case scenario. If we decrease the multiplier to 1.1, the net tax revenue foregone increases to €163,722,000, an increase of around €7.1m, and adjusting this figure for deadweight gives us a net figure of €166,225,000, representing an increase of around €6.8m on the base case scenario. Additionally, we have also assumed a deadweight figure of 5%. If we adjust this to 15%, holding the multiplier figure at 1.255, the net tax forgone figure increases to €165,253,000, an increase of around €5.8m.

9.5.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 9.15 presents views on the income category of investors in student accommodation. All respondents considered that investors were likely to be earning more than €50,000, 66.7% felt that they would be earning over €100,000 and 16.7% that the likely category was incomes of over €200,000.

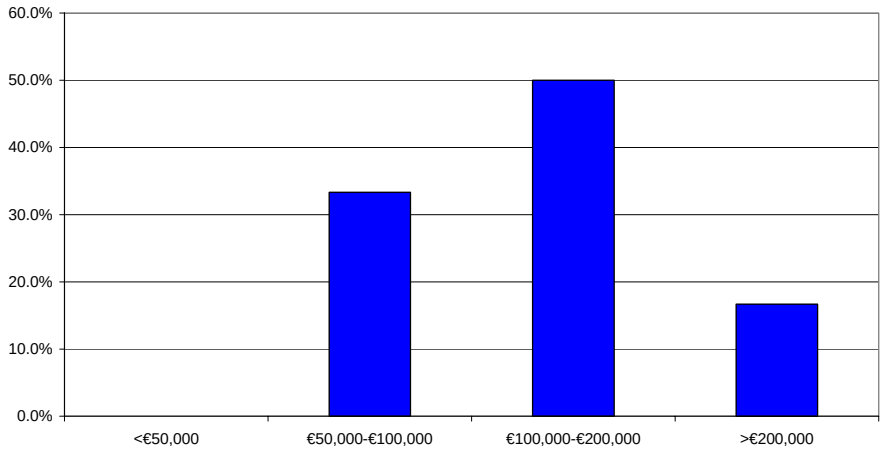
Table 9.15: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Student Accommodation Tax Incentive

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	16.7%
Majority of investors were likely to be earning between €100,000 and €200,000	50.0%
Majority of investors were likely to be earning between €50,000 and €100,000	33.3%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

The income distribution of investors is presented in and Figure 9.7.

Figure 9.7: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Student Accommodation Tax Incentive



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

9.5.5 Overall Effectiveness in Achieving Policy Objective

The policy objective of the student accommodation scheme as stated in the guidelines was the provision of additional rented accommodation to relieve the supply pressures on the private rented market. The underlying implicit objective involved improving the quality of student accommodation and potential positive impacts on the wider housing market. The increase in supply which occurred could also be expected to have helped bring down costs.

Table 9.16 summarises the opinion of the third level education sector on the effectiveness of the tax incentive scheme in reducing the cost of adequate student accommodation. Nearly 78% of respondents felt that it had had the effect of reducing costs, with over 22% considering the scheme did not have any impact on costs of adequate student accommodation.

Table 9.16: Views of the Third Level Education Sector on the Effectiveness of Property-based Tax Incentive Schemes in Reducing the Cost of Adequate Student Accommodation, Third Level Institutions

Impact	% of Respondents Institutions that availed of Tax Incentive
No impact	22.2%
Minor Impact in Reducing Costs	44.4%
Significant Impact in Reducing Costs	33.3%
Total	100.0%

Source: Indecon Confidential Survey of Third Level Institutions in Ireland.

9.6 Summary of Main Findings

In this section, we have reviewed the property-based tax incentive for student accommodation and outlined its effect both on the supply of accommodation and on Exchequer returns. The key findings from our analysis are as follows:

- Since the institution of this particular incentive in 1999, 15,000 new bedspaces have been created.

- The level of investment in student accommodation has been extraordinarily high reflecting the attractiveness of investing in what effectively represents residential property combined with a very generous tax incentive.
- The scheme has undoubtedly expanded the supply of high quality student accommodation but at a very high cost to the Exchequer.
- This has occurred at a time of a significant increase in the wider private rented property market.
- Concerns exist of potential over-supply of student accommodation and this will be significantly affected if pipeline projects proceed.
- We have estimated the total capital expenditure undertaken to date and have provided a forecast of expenditure on eligible projects yet to come on-line. After taking account of the beneficial effects of extra investment as a result of the scheme, and allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive to be approximately €159 million in terms of tax revenue forgone.
- The scheme has been used by high income earners to reduce their tax liabilities.

10 Capital Allowances for Childcare Facilities

10.1 Introduction and Background

In this section, we present our examination of the tax incentive for childcare facility properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability. As part of our research we received responses from 90 childcare operators.

10.2 Description of Tax Incentive

Capital allowances are available for expenditure incurred on or after 2 December 1998 on childcare facilities which meet the required standards for such facilities as provided in the Childcare Act, 1991. The allowances apply to expenditure incurred on the construction, extension and refurbishment of a building or part of a building used as a childcare facility as well as to expenditure on the conversion of an existing building or part of a building for use as a childcare facility. There will be a clawback of the allowances, in the form of a balancing charge, if the building ceases to be used as a childcare facility within 10 years. Relief is provided at 100 per cent in year one (with 100 per cent free depreciation for owner occupiers) or at 15% per annum for the first 6 years and 10% in year 7. There is no termination date for incurring qualifying expenditure in respect of this relief.

10.3 Measure of Overall Level of Activity in Sector

10.3.1 Supply of childcare places

Table 10.1 details the number of childcare places available in each county in the Border, Midland & West regions. In 2004, there were slightly over 20,000 places available. According to the 1999 census, there were 14,060 children attending childcare services in that year.

Table 10.1: Estimated Provision of Childcare Places: BMW Region

Region	1999 Census	2004 Census	2004 Health Boards Survey
	Number of children attending childcare services	No. of places at any one time:	Number of Places for Age Group 0-6
Cavan	709	1,481	1,108
Donegal	2,224	2,204	1,960
Galway City and County	2,387	3,951	5,325
Laois	663	1,266	1,278
Leitrim	441	847	559
Longford	714	718	637
Louth	1,175	2,312	2,564
Mayo	1,283	1,800	2,056
Monaghan	1,295	1,133	632
Offaly	819	1,055	1,319
Roscommon	579	737	795
Sligo	857	1,003	1,037
Westmeath	914	1,775	1,831
BMW Region	14,060	20,282	21,101

Source: Childcare Directorate, Department of Justice Equality and Law Reform

Table 10.2 overleaf details the number of childcare places available in each county in the South & East regions. According to the 2004 Health Boards Survey, there were 55,900 places available for children aged 0-6 in that year. According to the 2004 census, there were 57,760 paces available. The corresponding figures for the national total are 77,001 and 78,042 respectively. According to the 1999 census, there were 42,743 children attending childcare services in the South & East regions, with 56,803 attending nationally.

Table 10.2: Estimated Provision of Childcare Places: SE Region

Region	1999 Census	2004 Census	2004 Health Boards Survey
	Number of children attending childcare services	No. of places at any one time:	Number of Places for Age Group 0-6
Carlow	868	1,144	920
Clare	1,290	2,230	2,114
Cork City	2,243	1,668	
Cork County	4,753	2,936	
Cork City and County	**6,996**	**4,604**	**7,548**
Dublin City	7,864	10,354	
*Dublin Fingal**	3,292	9,280	
Dublin South	2,503	4,605	
D. L.-Rathdown	3,256	3,099	
Dublin City and County	**16,915**	**27,338**	**22,933**
Kerry	1,682	1,896	1,909
Kildare	2,028	4,559	2,251
Kilkenny	806	1,831	1,685
Limerick City	1,014	1,236	
Limerick County	1,202	1,684	
Meath	1,457	2,434	3,676
Tipperary North	1,074	1,151	
Tipperary South	1,370	537	
Waterford City	1,007	1,233	
Waterford County	725	981	
Wexford	1,877	2,360	2,396
Wicklow	2,432	2,542	2,382
SE Region	**42,743**	**57,760**	**55,900**
National Total	**56,803**	**78,042**	**77,001**

Source: Childcare Directorate, Department of Justice Equality and Law Reform

Table 10.3 gives the number of childcare facilities by age group and type in 2004. Over 45% of the total number of facilities were sessional-type, with nearly 33% providing full day-care. Nearly 65% of the former category catered for children between the ages of 3 and 5, with the bulk of the remainder catering for toddlers (1 to 2 years). After school and drop-in facilities make up a relatively small proportion of the total.

Table 10.3: Number of Available Facilities by Age Group and Service Type

Age Group	Full Day Care	Full Day Care %	Sess-ional	Sess-ional %	Drop in	Drop in %	After School	After School %
Babies (up to 1 year)	247	26.7%	98	7.6%	22	19.5%	-	
Toddlers (1 and 2 years)	334	36.1%	259	20.1%	39	34.5%	-	
Preschool children (3 to 5 years)	343	37.1%	835	64.7%	29	25.7%	60	12.1%
After school (6 to 9 years)	-		68	5.3%	12	10.6%	292	58.9%
After school (10 to 14 years)	-		31	2.4%	11	9.7%	144	29.0%
Total	924	100.0%	1291	100.0%	113	100.0%	496	100.0%

Source: EOCP Beneficiaries Survey 2004

Table 10.4 details the total number of childcare providers operating in Health Board areas according to respondents to Indecon's survey of Health Service Executives. There has been a steady upward trend in the number of providers operating since 1999, with the level in 2005 nearly 50% higher than the level in 1999. Growth was most impressive in the East where the number of providers more than doubled, however this is likely to reflect the dramatic increase in demand for childcare.

Table 10.4: Total Number of Childcare Providers Operating in Health Board areas, 1999-2005

	1999	2000	2001	2002	2003	2004	2005
Western	314	343	385	418	462	493	
Midlands	160	190	200	213	222	233	237
South Eastern	285	295	340	414	433	436	451
Southern		527	544	522	543	555	556
North Eastern	272	309	296	317	353	399	404
North Western	200	209	199	223	227	228	240
Mid-Western			346	348	371	438	548
South-western	362	457	511	539	557	584	595
Northern	335	404	437	450	478	501	515
East	163	286	279	307	327	339	334
Total[29]	2964	3366	3537	3751	3973	4206	4373

Source: Indecon Confidential Survey of HSE

Table 10.5 details the progress towards targets for childcare places set in the National Development Plan. By 2004 new childcare places accounted for nearly 75% of the EOCP II target in the S&E region and over 85% of the target in the BMW region. There has been more progress made in the creation of part time places than full time place. This is particularly the case in the SE region, where the actual increase in the provision of part-time childcare place has exceeded the target.

[29] To avoid including an artificial trend due to gaps in the data, in calculating the totals, the total for the Western Health Board in 2005 was assumed to be equal to its value in 2004. The total for the Southern Area in 1999 was assumed to be equal to its value in 2000 and the values for the Mid-Western area in 1999 and 2000 were assumed to be equal to the value in 2000.

Table 10.5: EOCP II Targets for New and Existing Childcare Places and Actual Impact of the Programme to End December 2004

Targets	Childcare Places SE			Childcare Places BMW		
	Part Time	Full Time	Total	Part Time	Full Time	Total
ACTUAL Number of Childcare Places	10,682	19,943	30,625	3,790	12,099	15,889
Increase in childcare places	+7,470	+8,499	+15,969	+2,883	+5,784	+8,667
NDP target increase	+7,036	+14,336	+21,372	+3,292	+6,708	+10,000
	New	**Up-graded**	**Total**	**New**	**Up-graded**	**Total**
Childcare Facilities	349	675	1,024	178	420	598

Source: Report for Regional Operational Programme, Spring 2005.

10.3.2 Demand for Childcare Places

This analysis of demand can be presented alternatively by examining total estimated childcare hours as set out Table 10.6. Focusing on the number of families paying for childcare, the data indicate that the majority (36,500) require more than 21 hours, with 8,300 requiring 1-10 hours and 15,000 requiring 10-20 hours. Classifying the hours by pre-school and primary only, a higher percentage of families with pre-school children utilise more hours of childcare.

Table 10.6: Families Mainly Dependent on Non-parental Childcare (distinguishing those using unpaid childcare), Classified by Number of Hours of Childcare Required Weekly, and September- November 2002.

	Pre-school only		Primary Only		Both		Total	
	Non-parental	Paid	Non-parental	Paid	Non-parental	Paid	Non-parental	Paid
All children	38.0	24.0	38.8	17.1	28.5	18.6	105.4	59.8
Total childcare hours required								
1-10	2.6	1.5	14.9	5.2	3.0	1.6	20.6	8.3
11-20	8.3	4.3	14.0	6.7	5.8	4.0	28.1	15.0
21-30	9.8	6.2	5.5	2.9	4.8	3.0	20.1	12.1
31-40	11.2	7.5	2.8	1.4	4.6	3.0	18.7	11.9
41+	6.0	4.6	1.6	0.9	10.3	7.1	17.9	12.5

Source: Quarterly National Household Survey, Quarter 4, 2002

Table 10.7 gives a breakdown of the type of facility attended by those children using childcare facilities. Nearly 60% of the total number of children availing of childcare service attended a sessional facility. The proportion of children aged 3 to 5, (making up over 60% of the total of children attending childcare facilities) attending sessional facilities is even higher at over 80%. In the case of children younger than 3 years, more attend full day-care than attend sessional facilities.

Table 10.7: Number of Children Attending All Facilities by Age Group and Service Type

Age Group	Full Day Care	Full Day Care %	Sess-ional	Sess-ional %	Drop in	Drop in %	After School	After School %
Babies (up to 1 year)	1,080	12.6%	412	2.0%	89	12.0%	-	-
Toddlers (1 and 2 years)	3251	38.0%	2,350	11.4%	262	35.4%	-	-
Preschool children (3 to 5 years)	4235	49.4%	16,552	80.4%	244	32.9%	400	7.2%
After school (6 to 9 years)	-	-	870	4.2%	86	11.6%	3,534	63.9%
After school (10 to 14 years)	-	-	408	2.0%	60	8.1%	1,594	28.8%
Total	8,566	100.0%	20,592	100.0%	741	100.0%	5,528	100.0%

Source: EOCP Beneficiaries Survey 2004

Table 10.8 examines in detail the different childcare options that are used. Examining the pre-school families initially, the data indicate that the vast majority of families are paying for childminding. The main options are paid carer (21,500) and crèche/Montessori (19,800) with 8,000 families paying a relative. Interestingly, out of the 73,100 pre-school families, 31,000 have both pre-school and older children.

Table 10.8 : Families Classified by use of Non-Parental Care for Pre-School or Primary School-going Children ('000), September – November 2002.

	Unpaid Relative		Paid Relative		Paid Carer		Crèche/Montessori		Other		Total	
	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary
All Families	**22.8**	**31.1**	**8.8**	**9.5**	**21.5**	**21.5**	**19.8**	**4.1**	**5.4**	**2.9**	**73.1**	**67.5**
Number of Children-Total												
1	11.5	14.6	4.2	3.0	7.7	6.3	8.0	1.3	1.5	1.0	31.0	25.7
2	7.4	12.0	3.1	4.4	8.6	9.3	7.8	2.0	2.2	0.9	26.9	27.8
3	3.1	3.8	1.0	1.8	4.4	5.1	3.3	0.7	1.3	0.8	12.3	11.9
4+	0.7	0.7	0.5	0.4	0.8	0.9	0.8	*	0.5	*	2.8	2.1
Family Structure												
Pre-school children only	14.4	_	5.2	_	11.4	_	11.5	_	2.7	_	42.1	_
Primary school-going children only.	_	22.7	_	6.0	_	12.6	_	1.8	_	2.1	_	44.2
Both	8.4	8.4	3.5	3.5	10.2	9.0	8.3	2.3	2.8	0.8	31.0	23.3

Source: Quarterly National Household Survey, Quarter 4, 2002.

Table 10.9 shows that over half of all pre-school children are minded by a parent. The number is estimated to be 106,900 out of a total number of families with pre-school children of 172,200. This includes situations where the mother is on maternity leave or has left the labour force for a longer period. Regarding families with primary school children, they are purchasing a very modest amount of childcare relative to families with pre-school children and the survey indicates that parents are the principal minders.

Table 10.9 : Families Classified by Main Type of Childcare Arrangement Used for Pre-school or Primary School

	Parent		Unpaid Relative		Paid Relative		Paid Carer		Crèche/Montessori		Other		Total	
	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary	Pre-school	Primary
All Families	**106.9**	**207.4**	**19.1**	**25.1**	**7.9**	**8.5**	**19.8**	**19.7**	**15.8**	**3.7**	**2.7**	**2.2**	172.2	266.6
No. of Children														
1	33.5	75.1	9.7	11.9	3.9	2.7	7.4	5.8	6.8	1.3	0.6	1.0	61.8	98.0
2	39.0	79.7	6.3	9.5	2.7	3.9	7.8	8.4	6.0	1.6	1.1	0.7	62.9	103.9
3	22.8	37.9	2.6	3.2	1.0	1.6	4.0	4.7	2.5	0.6	0.6	0.3	33.5	48.4
4+	11.6	14.7	0.5	0.4	0.3	0.3	0.6	0.8	0.5	*	0.3	*	13.9	16.4
Pre-school children only	48.1	_	12.2	_	4.9	_	10.7	_	9.2	_	1.1	_	86.1	_
Primary school-going children only.	_	141.7	_	18.4	_	5.6	_	11.5	_	1.8	_	1.7	_	180.6
Both	58.8	65.8	6.9	6.7	3.0	3.0	9.2	8.2	6.5	1.9	1.6	0.5	86.1	86.1

Source: Quarterly National Household Survey, Quarter 4, 2002.

10.3.3 Cost of Childcare

Table 10.10 gives a regional breakdown of the average cost of childcare. The average weekly cost is more substantial in the case of families with pre-school children only than in the case of families with just primary school children. It is more expensive again for families with both pre-school and primary school children. As would be expected childcare is most expensive in Dublin and the Mid-East with an average weekly cost of €118.96 and €107.16 respectively. Childcare is cheapest in the Border and South-East regions with a weekly cost of €79.42 and €80.83 respectively.

Table 10.10 : Average cost of paid childcare per household per week for pre-school and primary-school going children, September – November 2002.

	Pre-school only		Primary Only		Both		Total	
	No. Families ('000)	Average (€)	No. Families ('000)	Average (€)	No. Families ('000)	Average (€)	No. Families ('000)	Average (€)
All families	**24.0**	**105.36**	**17.1**	**75.54**	**18.6**	**107.37**	**59.8**	**97.47**
Region								
Border	2.2	80.78	1.6	68.32	1.5	89.19	5.3	79.42
Midlands	1.2	94.74	1.1	68.05	1.1	96.47	3.4	87.02
West	3.0	89.62	1.6	63.03	1.9	93.14	6.5	84.21
Dublin	6.9	131.12	4.8	91.33	5.5	127.97	17.3	118.96
Mid-East	3.2	118.93	2.7	74.63	2.2	129.15	8.1	107.16
Mid-West	2.0	95.21	1.3	67.19	1.5	84.89	4.8	84.33
South-East	2.2	85.87	1.8	65.27	2.1	88.98	6.0	80.83
South-West	3.4	92.07	2.2	73.10	2.7	99.02	8.3	89.30

Source: Quarterly National Household Survey, Quarter 4, 2002

Table 10.11 gives the proportion of the 352,800 families relying on childcare who use paid childcare. It also shows the average weekly cost of childcare which is significantly higher in the case of families requiring pre-school children minded than in the case of families whose only childcare requirements concern primary school children.

Table 10.11 : Number of Families Relying on Paid Childcare and Average Weekly Cost

	Pre-school Only	Primary only	Both	Total
Total no. of families ('000)	86.1	180.6	86.1	352.8
No. families using paid childcare ('000)	24.0	17.1	18.6	59.8
Average cost of paid childcare (€)	€105.36	€75.54	€107.37	€97.47

Source: Quarterly National Household Survey, Quarter 4, 2002.

10.3.4 Level of Incentive Utilisation

Table 10.12 illustrates the fact that just under 35% of childcare providers that responded to Indecon's survey had utilised the tax incentive over the past 5 years.

Table 10.12: Proportion of Childcare Providers that have Utilised the Tax Incentive over the past 5 years

Impact	% of Survey Respondents
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	34.8%
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	65.2%
Total	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.3.5 Level of Government Grants

Table 10.13 presents the result from Indecon's survey of childcare providers in Ireland. 60% of childcare providers responding to the Indecon survey were in receipt of grants from the government.

Table 10.13: Proportion of Childcare Providers that have Received any Government Grants

Impact	% of Survey Respondents
Childcare Providers that have received any Government Grants	58.6%
Childcare Providers that have not received any Government Grants	41.4%
Total	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.3.6 Level of Construction Activity

Table 10.14 gives the average number of years since the construction or last major refurbishment of Irish childcare facilities. The average is 4 years in the case of facilities that have utilised the incentive in the last 5 years and 6 in the case of those who have not. This suggests a significant level of modernisation in the sector.

Table 10.14: Average Number of Years since Construction / Latest Refurbishment – Childcare Providers With and Without Tax Incentive

Number of Childcare Provider Bedrooms	Average Number of Years since Construction / Latest Refurbishment
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	4
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	6

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.15 summarises the data from the Local Authorities on the planning applications for childcare facilities between 2000 and 2004. There has been a steady increase in both applications and approvals with the former doubling and the latter increasing by over a half of the period under consideration.

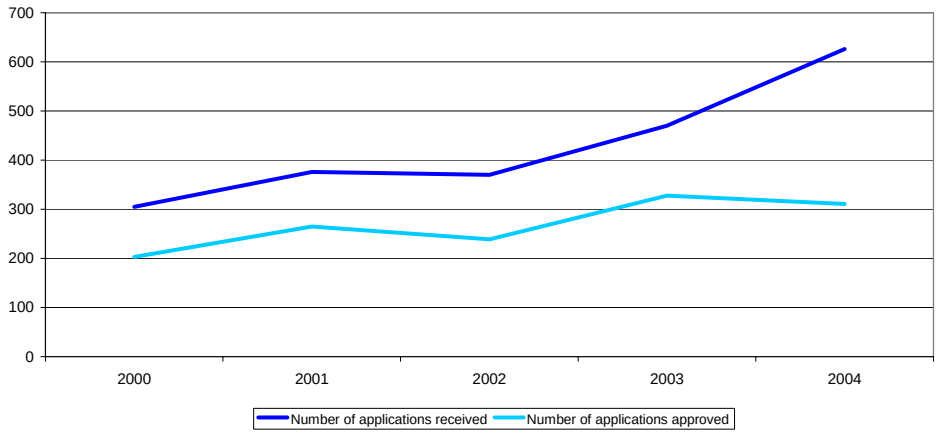
Table 10.15: Details of Planning Applications for Childcare Facilities- Total Number of Applications, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	305	376	370	470	626
Number of applications approved	203	265	239	328	311
Number of applications awaiting decision	50	30	30	24	118

Source: Indecon Confidential Survey of Local Authorities.

The trends in applications and approvals are illustrated in Figure 10.1.

Figure 10.1: Details of Planning Applications for Childcare Facilities- Total Number of Applications, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

10.4 Case Study

Before we examine the detailed impacts of the incentives, it is useful to consider a case study of a childcare facility investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

The analysis in this section assumes that a property will be purchased, operated as a childcare facility for a 10 year period and subsequently resold as residential property.

10.4.1 Investor Perspective

An Investor makes an investment in a childcare facility. The property in this case study involves investment costs of €300,000. It is assumed that net rental rates for childcare facilities are 3% per annum. The 10 year par yield rate is used to discount the differential cash flows as the differential is assumed to be known with certainty. These assumptions are summarised in Table 10.16.

Table 10.16: Key Assumptions

Item	Assumed Level
Investment (€'000)	300
Gross Yield	5.5%
Net Yield – Residential	5%
Net Yield – Childcare	3%
Tax Rate	42%
Assumed Revenue Growth	4%
10 Year Par Yield Rate	3.3%

Source: Indecon.

Using these assumptions, it may be shown (Table 10.17) that the net loss associated with operating childcare facilities is 12% of the construction cost. The current capital allowances for these facilities have a present value of 41%, if the investor can use the relief immediately.

Table 10.17: Return on Childcare Facilities

Period	0	1	2	3	4	5	6	7	8	9	10
Ebitda - Residential		16	16	17	18	18	19	20	21	21	22
Ebitda – Childcare		9	10	10	11	11	11	12	12	13	13
Loss – Childcare		-6	-6	-7	-7	-7	-8	-8	-8	-9	-9
Taxes		3	3	3	3	3	3	3	3	4	4
After Tax Loss		-4	-4	-4	-4	-4	-4	-5	-5	-5	-5

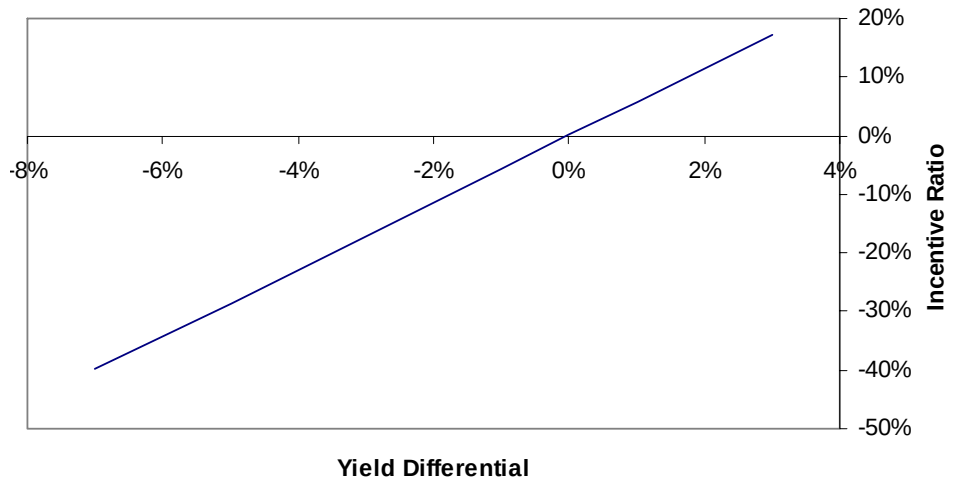
		% of Cost
Present Value of Losses	-36	-12%
PV (Capital Allowances)	114	41%
PV (Losses+ Allowance)	78	29%

Source: Indecon.

10.4.2 Sensitivity Analysis

The differential between rental yields on childcare facilities and residential properties is the key driver of the Incentive Ratio. The impact of differential yields is summarized in Figure 10.2. For example, if the net yield on childcare facilities is 1% and the net yield on residential property is 6%, then the yield differential is -5%. From Figure 10.2, it may be seen that a yield differential of -5% gives rise to an Incentive Ratio of -30%. Stated differently, an investor in our case study would require capital allowances equal to 30% of the capital cost to consider an investment in childcare facilities. If, however, revenues from the provision of childcare facilities increased the returns above the 3% implicit rental levels assumed, the required investment would be less. The case study also assumes the investor has not secured a capital grant under the EOCP programme.

Figure 10.2: Incentive Ratio Vs. Yield Differential



Source: Indecon.

10.5 Impacts of Tax Incentive

10.5.1 Impact on the Supply of Childcare Provider Places Available and Utilised

Table 10.18 displays the number of childcare places available in 2000 and 2005 by institutions responding to Indecon's survey. There was considerable growth in places by providers that have and those that have not availed of the incentive. In the former category, there was a growth of 170% between 2000 and 2005, whereas in the latter category, the growth rate was a more modest, but still considerable, 81.4%.

Table 10.18: Number of Childcare Provider Places Available – Childcare Providers With and Without Tax Incentive, 2000 and 2005

Number of Childcare Provider Places Available	2000	2005	Growth Rate (%)
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	801	2,164	170.2%
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	1,639	2,973	81.4%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.19 indicates that in the case of childcare providers the growth rate in the utilised childcare places has been very rapid.

Table 10.19: Number of Childcare Provider Places Utilised – Childcare Providers With and Without Tax Incentive, 2000 and 2005

Number of Childcare Provider Places Utilised	2000	2005	Growth Rate (%)
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	705	1,878	166.4%
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	1,406	2,653	88.7%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.20 details the opinions of auctioneers on the current supply situation with regard to childcare facilities. Nearly 57% of those responding to Indecon's survey believe that the market is characterised by significant shortages of supply with the bulk of the remainder considering the market to be in or near equilibrium.

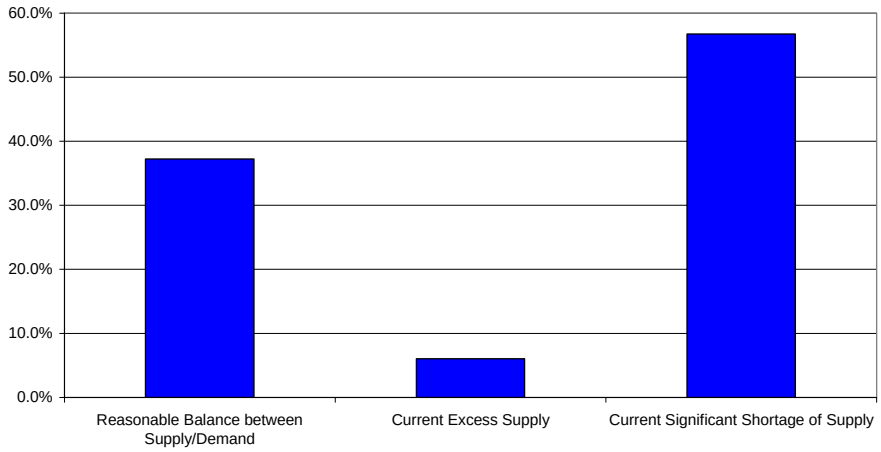
Table 10.20: Views of Auctioneers on Current Supply Position

View	% of Survey Respondents
Reasonable Balance between Supply/Demand	37.2%
Current Excess Supply	6.0%
Current Significant Shortage of Supply	56.7%
Total	100.0%

Source: Indecon Confidential Survey of Auctioneers in Ireland.

Figure 10.3 illustrates the views of auctioneers on the current supply position with regard to childcare facilities.

Figure 10.3: Views of Auctioneers on Current Supply Position



Source: Indecon Confidential Survey of Auctioneers in Ireland.

10.5.1.1 Number of Children Accommodated

Table 10.21 gives details on the average number of children accommodated in 2000 and 2005. There has been significant growth. The number of children accommodated in facilities that have used the incentive over the past five years has risen by 220% since 2000. The growth rate was a less spectacular, but still considerable 82% in the case of those facilities that did not use the tax incentive.

Table 10.21: Number of Children Accommodated – Childcare Providers With and Without Tax Incentive, 2000 and 2005

Number of Children Accommodated	2000	2005	Growth Rate (%)
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	550	1,762	220.4%
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	1,635	2,972	81.8%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.5.2 Impact on the Cost of Childcare Places

Table 10.22 details the fact that there has been a very significant increase in the cost of childcare since 2000. The rate of increase has been similar for providers who received the incentive and for other providers.

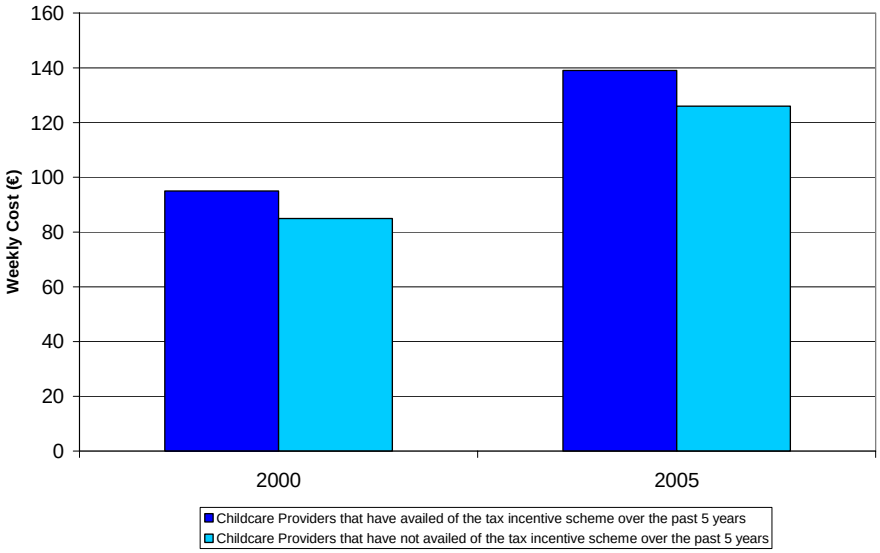
Table 10.22: Cost of Childcare Places (€ per week) – Childcare Providers With and Without Tax Incentive, 2000 and 2005

Cost of Childcare Places (€ per week)	2000	2005	Growth Rate (%)
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	95	139	47.5%
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	85	126	47.9%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Figure 10.4 illustrates the increased cost of childcare places in 2005 compared to those rates in 2000.

Figure 10.4: Cost of Childcare Places (€ per week) – Childcare Providers With and Without Tax Incentive, 2000 and 2005



Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.23 gives the views of childcare providers on the impact of the incentive on the cost of childcare places. A substantial majority fell that it has had no effect on the cost. Nearly 34% of those who utilised the incentive however feel it had some impact on costs.

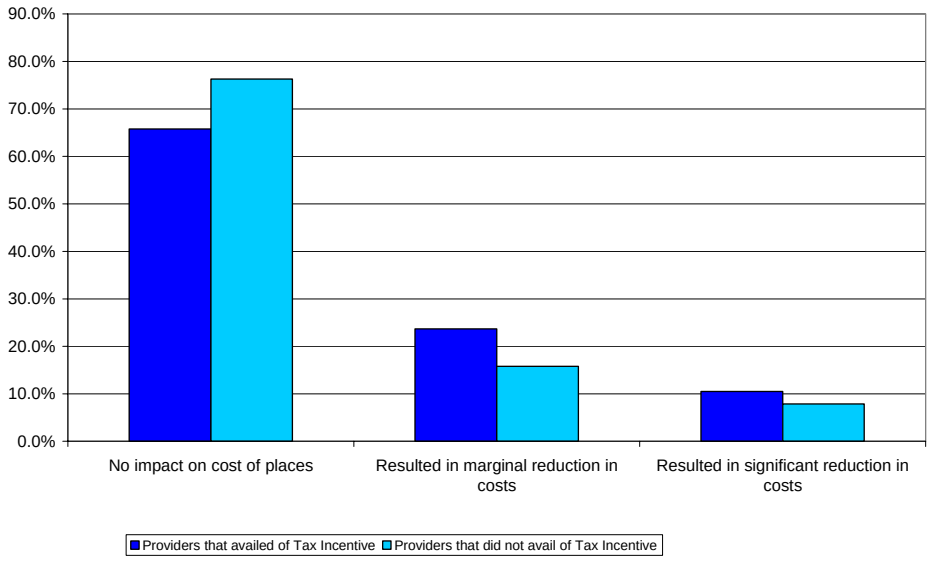
Table 10.23: Views of the Childcare Provider Sector on the Impacts of the Property-based Tax Incentive Scheme on the Cost of Childcare Places, Childcare Providers With and Without Tax Incentive

Impact	% of Survey Respondents	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
No impact on cost of places	65.8%	76.3%
Resulted in marginal reduction in costs	23.7%	15.8%
Resulted in significant reduction in costs	10.5%	7.9%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

The views of childcare providers on the impact of the tax incentives on costs are presented in Figure 10.5.

Figure 10.5: Views of the Childcare Provider Sector on the Impacts of the Property-based Tax Incentive Scheme on the Cost of Childcare Places, Childcare Providers With and Without Tax Incentive



Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.5.3 Impact on Site Prices

Table 10.24 gives the opinion of the childcare provider sector on the effect of the incentive on site prices. A majority would contend that it has led to an increase in site prices.

Table 10.24: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Resulted in Higher Site Prices, Childcare Providers With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Childcare Providers	54.8%	64.3%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.5.4 Impact on Construction Costs

Table 10.25 gives the opinion of the childcare provider sector on the effect of the property-based tax incentive scheme on construction costs. Over half of those who have not availed of the incentive and 40% those who have, consider it to have led to an increase in construction costs

Table 10.25: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Construction Costs, Childcare Providers With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Childcare Providers	40.7%	53.7%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.5.5 Impact on Level of Investment in Projects

Table 10.26 illustrates that there is considerable support among both categories of childcare provider for the view that the property-based tax incentive has increased investment in relevant projects. This is also consistent with the data analysed by Indecon indicating a very significant expansion in the sector.

Table 10.26: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Investment in Projects, Childcare Providers With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Childcare Providers	90.3%	78.6%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.5.6 Impact on Financial Returns to Promoters

Table 10.27 illustrates the fact that half of childcare providers who have not availed of the tax incentive and nearly 45% of those who have, consider the one of its effects to have been increased financial returns to promoters.

Table 10.27: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has Increased Financial Return to Promoters, Childcare Providers With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Childcare Providers	44.4%	50.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.5.7 Impact on Property Prices

Table 10.28 displays the fact that a majority of childcare providers believe that the scheme has led to higher property prices compared to non-tax incentive properties. In the case of those who have not availed of the incentive the proportion who believe this is over three quarters.

Table 10.28: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Proportion of Respondents believing that the Scheme has led to Higher Property Prices Compared to Non-Tax Incentive Properties, Childcare Providers With and Without Tax Incentive

Respondent Group	% of Survey Respondents Believing Impact to be a Result of the Tax Incentive	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Childcare Providers	50.0%	78.6%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.6 Evaluation of the Tax Incentive

10.6.1 Displacement, Deadweight and Opportunity Cost

Table 10.29 gives the views of childcare providers on the likelihood that projects would have proceeded in the absence of the tax incentive. Very few believe that all of the projects would have proceeded within the existing timeframe.

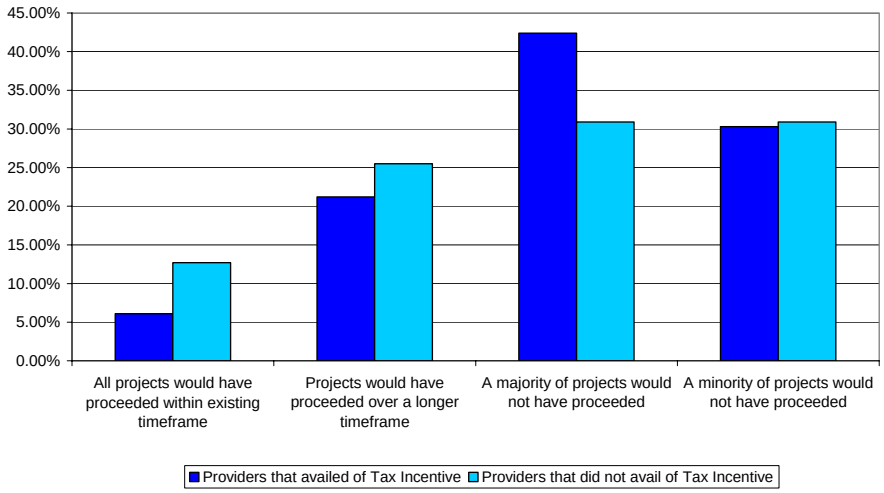
Table 10.29: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Investment in Childcare Buildings) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents	
	Providers that availed of Tax Incentive	**Providers that did not avail of Tax Incentive**
All projects would have proceeded within existing timeframe	6.1%	12.7%
Projects would have proceeded over a longer timeframe	21.2%	25.5%
A majority of projects would not have proceeded	42.4%	30.9%
A minority of projects would not have proceeded	30.3%	30.9%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Figure 10.6 illustrates the views of the childcare providers on the likelihood of projects proceeding in the absence of the tax incentive.

Figure 10.6: Views of the Childcare Provider Sector on the Impact of the Property-based Tax Incentive Scheme – Views on the likelihood that Projects (i.e. Capital Investment in Childcare Buildings) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.30 gives the opinions of the financial institutions, auctioneers and accountancy/tax professionals on the likelihood of projects proceeding in the absence of the tax incentive scheme. The prevailing opinion among the accountants is that a majority of projects would not have proceeded. Among financial institutions responding to Indecon's survey, half believed that projects would have proceeded over a longer time frame. Few respondents in any category believed that all projects would have gone ahead within the existing timeframe.

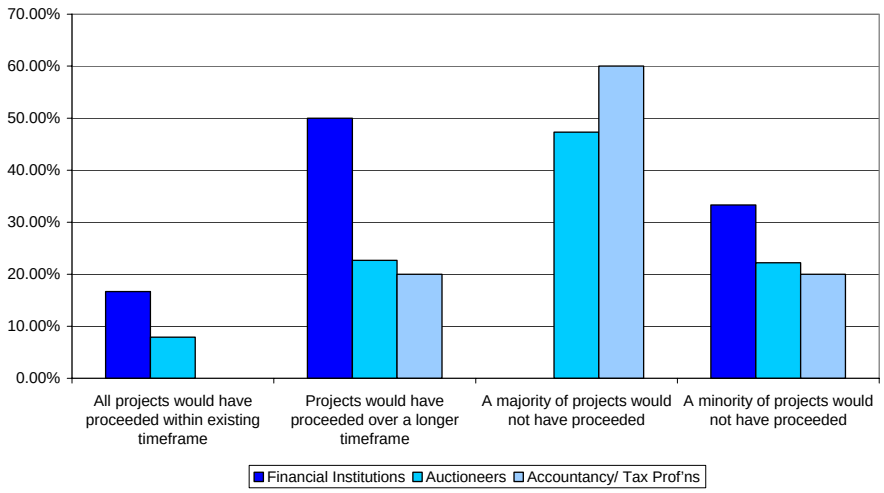
Table 10.30: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	**Auctioneers**	**Accountancy/ Tax Prof'ns**
All projects would have proceeded within existing timeframe	16.7%	7.9%	0.0%
Projects would have proceeded over a longer timeframe	50.0%	22.7%	20.0%
A majority of projects would not have proceeded	0.0%	47.3%	60.0%
A minority of projects would not have proceeded	33.3%	22.2%	20.0%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 10.7 presents the views of financial institutions, auctioneers, and accountancy/tax professionals on the likelihood of projects proceeding in the absence of the tax incentive.

Figure 10.7: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

10.6.2 Estimated Investment in the Sector

10.6.2.1 Capital Expenditure

Table 10.31 gives the total cumulative value of capital expenditure eligible for tax relief by childcare facilities responding to Indecon's survey. The total was nearly €5.7m in the case of childcare providers who had availed of the incentive.

Table 10.31: Total Cumulative Value of Eligible Capital Expenditure on Childcare Facilities incurred over the past 5 years

Total Cumulative Value of Eligible Capital Expenditure	Childcare Providers (€'000s)
Childcare Providers that have availed of the tax incentive scheme over the past 5 years	5,687
Childcare Providers that have not availed of the tax incentive scheme over the past 5 years	20

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

10.6.2.2 Lending Advanced by Financial Institutions

Table 10.32 presents the total value of new lending for childcare facilities by the Financial Institutions responding to Indecon's survey. The institutions also estimated total capital expenditure on childcare facilities (including promoter's equity) to have been over €61m in 2003 and just under €50m in 2004. Some of the lending will have been an investment in existing buildings and not all of the investment in new projects or refurbishment will be eligible due to expenditure on site costs, etc.

Table 10.32: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimated Total Capital Expenditure on Childcare Facilities including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	47,650	43,100
Total capital expenditure on projects including promoter's equity	61,560	49,600

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

10.6.3 Estimated Gross and Net Cost of Tax Incentive

10.6.3.1 Capital Expenditure

Indecon has based its estimate of total capital expenditure under the tax incentive scheme for childcare facilities on data from our survey of private childcare facilities as well as census data on the total number of childcare places in the economy. Under this method, we have estimated a total capital expenditure over the period 2001-2005 of €30,710,000.

While the results from financial institutions would suggest a higher level of capital investment we believe that some of this investment may not represent eligible expenditure.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. However, given that there is currently no time limit on approvals under this scheme, it is difficult to estimate future investment accurately. Indecon has therefore estimated likely investment based on current planning applications for childcare facilities. Indecon has estimated illustrative investment levels for existing planning applications of between €12,597,000 and €21,211,000, while there is significant uncertainty regarding future investment levels.

Table 10.33: Estimate of Total Eligible Capital Expenditure on Childcare Facilities under the Tax Incentive Scheme

Detail	Value (€'000s)
Total Cumulative Capital Expenditure to Date	30,710
Forecast for Future Expenditure	12,597 – 21,211

Source :Indecon Calculations

10.6.3.2 Impact of the Capital Expenditure

The increased levels of investment will give rise to increased capital formation which in turn will give rise to increased economic activity. Indecon has applied a 'multiplier' to the capital investment, which effectively multiplies the investment and for the childcare sector, we have estimated that the initial investment will give rise to overall expenditures of the order of €38,541,000. However, this figure must be adjusted to reflect the opportunity cost of the investment, which is due to the fact that the money could have been invested in another part of the economy, assuming an opportunity cost of 95%, reflecting the full employment status of the Irish economy. However, childcare facilities are likely to lead to very significant externalities in terms of assisting in the development of children and in facilitating labour force participation. We believe that these are likely to be fairly high and while precise estimates of such benefits are not feasible, we estimate these as equivalent to 15% of the total expenditure. The economic benefit of investment in projects to date is therefore estimated to be of the order of €7,708,000.

10.6.3.3 Impact on Exchequer Revenues

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the workings of each scheme. In the case of childcare facilities, this is based on the method of calculating the capital allowance over 7 years, allowing for a 15% deduction during the first 6 years and a 10% deduction in the final year. The tax foregone relating to the years after 2005 are subject to a net present value (NPV) calculation, which calculates the current value of the future amounts. Current corporate and income tax rates are used and the investor profile, which determines the tax rate applicable, is based on responses to Indecon's survey of private childcare facilities.

Using this method, we have estimated a gross cost to the Exchequer of €8,610,000, €4,465,000 of which will be claimed after 2005, though this figure has been deflated by a net present value (NPV) calculation. This gross figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €13,913,000. Adjusting this figure to reflect the opportunity cost of the investment (i.e. the fact that the money could have been invested in another sector of the economy), we calculate a net tax contribution of €3,478,000. Deducting this figure from the gross cost to the Exchequer, we calculate a net cost of €5,131,000.

Table 10.34 below gives a summary of Indecon's estimates for this scheme.

Table 10.34: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Private Childcare Facilities

Estimate	€'000
Capital Expenditure to Date	30,710
Gross Tax Revenue Foregone	8,610
Tax Contribution Adjusted for Indirect Tax Revenues	3,478
Net Tax Revenue Foregone	5,132
Future Capital Expenditure	12,597 – 21,211

Source: Indecon Confidential Surveys of Private Childcare Facilities and County Councils, Census 1999 and 2004.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Based on Indecon's survey of private childcare facilities, auctioneers, financial institutions and the accountancy profession, we estimate deadweight under this tax incentive to be of the order of 15%. The 'Tax contribution' figure must be reduced to reflect this. We therefore get a tax contribution figure of €2,957,000, reflecting deadweight or around €522,000. This results in net tax revenue foregone of €5,654,000.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. One of the assumptions used in the calculation of the central estimate above concerns the split of the profile of investors On the basis of the Indecon survey, we have used a 59% to 41% split between corporate and personal investors. If we change the proportion of investment sourced from corporate investors to 20%, the result is that the net tax revenue foregone is increased to €7,407,000, an increase of about €1.7m. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we increase this figure to 1.35 the net tax revenue foregone decreases to €4,868,000, a fall of around €0.26m, and adjusting this figure for deadweight gives us a net figure of €5,430,000. If we decrease the multiplier to 1.1, the net tax revenue foregone increases to €5,562,000, an increase of around €0.43m, and adjusting this figure for deadweight gives us a net figure of €6,019,000, representing an increase of around €0.37m on the base case scenario. Additionally, we have also assumed a deadweight figure of 15%. If we reduce this to 5%, holding the multiplier figure at 1.255, the net tax forgone figure decreases to €5,306,000, an decrease of around €0.35m. If the deadweight is increased to 25%, the net tax foregone increases to €6,002,000, an increase of around €0.35m.

10.6.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 10.35 indicates that while there is likely to be substantial company investment in childcare facilities, most investors are individuals involved in the business or 'passive investors'. Nearly half of claimants were individuals in business, while over 40% described themselves as 'companies'. The lower level of passive investors in this sector may reflect the small scale nature of many childcare businesses.

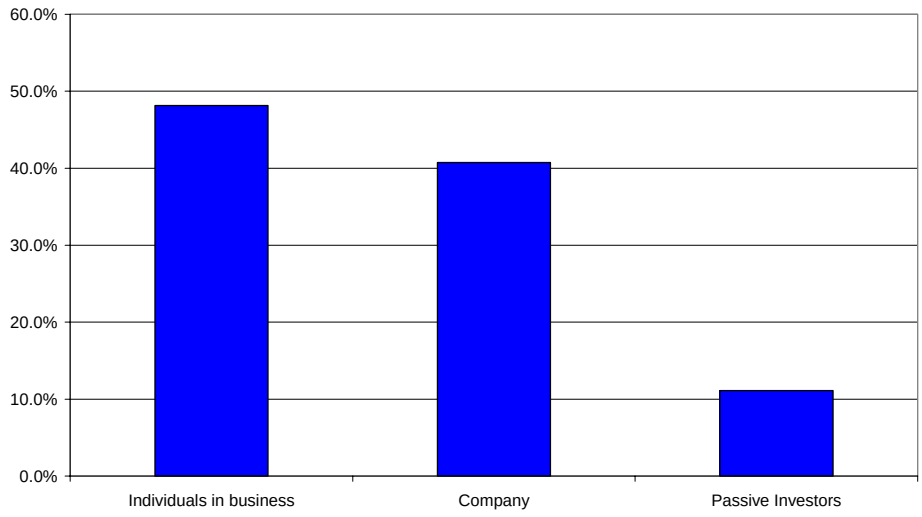
Table 10.35: Profile of Claimants of the Capital Allowances in the case of Childcare Providers which have Utilised the Tax Incentive Scheme

Claimant	% of Respondents
Individuals in business	48.1%
Company	40.7%
Passive Investors	11.1%
Total	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Figure 10.8 illustrates the profile of those that have availed of the tax incentive.

Figure 10.8: Profile of Claimants of the Capital Allowances in the case of Childcare Providers which have Utilised the Tax Incentive Scheme



Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.36 details the views of the accountancy/tax professionals on the likely income category into which most of those availing of the childcare tax incentive. Most believed that investors were likely to be earning between €50,000 and €100,000 per year. Interestingly, none believed that investors were likely to be earning in excess of €200,000.

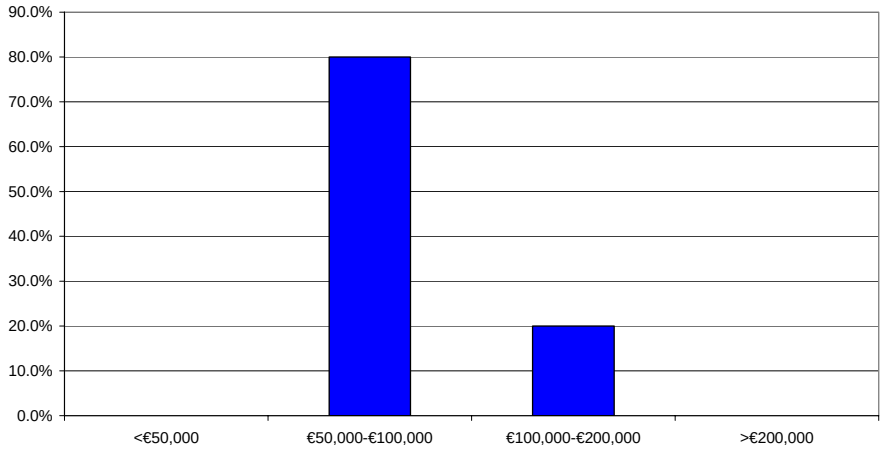
Table 10.36: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Childcare Facilities Tax Incentive

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	0.0%
Majority of investors were likely to be earning between €100,000 and €200,000	20.0%
Majority of investors were likely to be earning between €50,000 and €100,000	80.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 10.9 illustrates the views of accountancy/tax professionals as to likely incomes of those availing of the childcare tax incentive.

Figure 10.9: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Average Estimates of which Gross Annual Income Category accounted for the Majority of Investors Utilising the Childcare Facilities Tax Incentive



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

10.6.5 Overall Effectiveness in Achieving Policy Objective

Table 10.37 gives the views of the childcare sector on the effectiveness of the incentive in increasing the supply of childcare places. A substantial majority of respondents considered the scheme to have been effective in this regard.

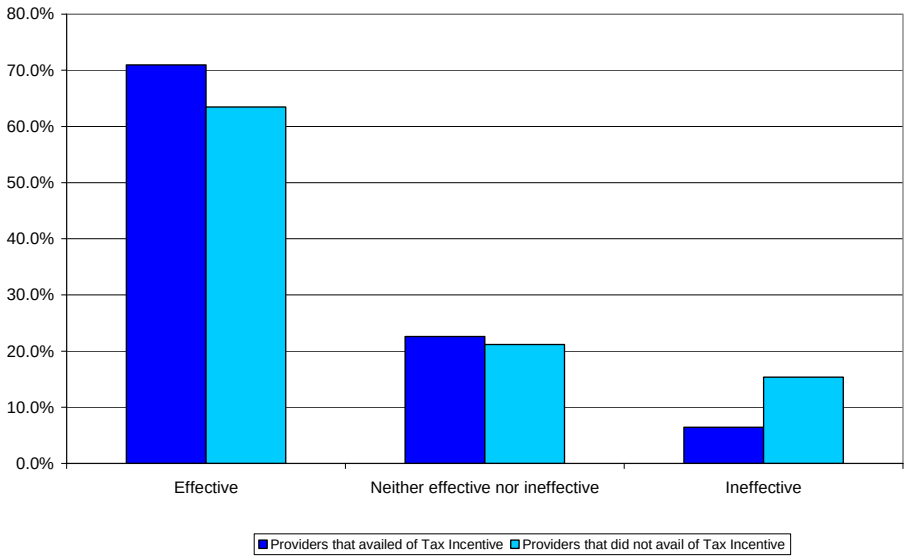
Table 10.37: Views of the Childcare Provider Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Childcare Places, Childcare Providers With and Without Tax Incentive

Level of Effectiveness	% of Respondents	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Effective	71.0%	63.5%
Neither effective nor ineffective	22.6%	21.2%
Ineffective	6.5%	15.4%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

These patterns in the opinions of those operating in the childcare sector can be seen in Figure 10.10.

Figure 10.10: Views of the Childcare Provider Sector on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Childcare Places, Childcare Providers With and Without Tax Incentive



Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.38 illustrates the fact that 50% of the regional areas within the Health Service Executive consider that the scheme was effective in increasing the supply of childcare facility places, but the remainder did not share this view.

Table 10.38: Views of the Health Services Executive on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Childcare Facility Places

Level of Effectiveness	% of Respondents
Effective	50.0%
Neither effective nor ineffective	0.0%
Ineffective	50.0%
Total	100.0%

Source: Indecon Confidential Survey of HSEs.

Table 10.39 gives the views of the Local Authorities on the effectiveness of the Tax Incentive Scheme in increasing the supply of childcare places. Nearly two thirds consider it to have been effective.

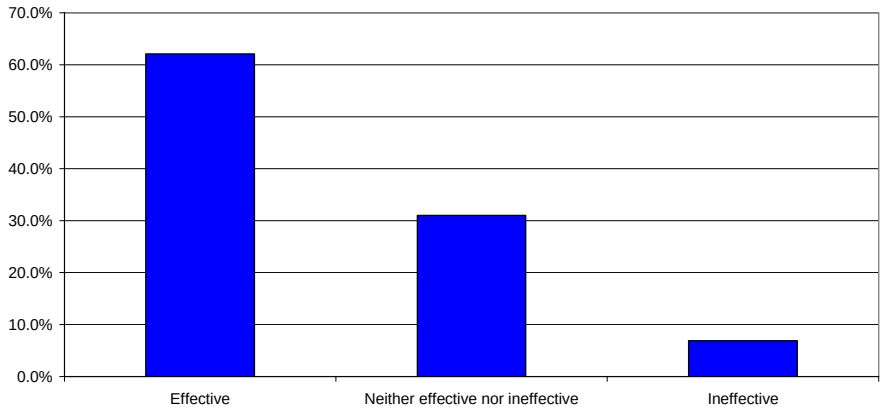
Table 10.39: Views of Local Authorities on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Childcare Places

Level of Effectiveness	% of Local Authorities
Effective	62.1%
Neither effective nor ineffective	31.0%
Ineffective	6.9%
Total	100.0%

Source: Indecon Confidential Survey of Local Authorities.

Figure 10.11 illustrates these results.

Figure 10.11: Views of Local Authorities on the Effectiveness of Property-based Tax Incentive Scheme in Increasing the Supply of Childcare Places



Source: Indecon Confidential Survey of Local Authorities.

Table 10.40 presents the views of the childcare providers on the effectiveness of the property-based tax incentive in reducing the cost of childcare places. Very few respondents considered it to have been effective in this regard. A comparison of these figures with those in Table 10.37 indicate that, in the opinion of those operating in the childcare sector, the tax incentives have been much more effective in increasing the supply than they have been in reducing the cost of places.

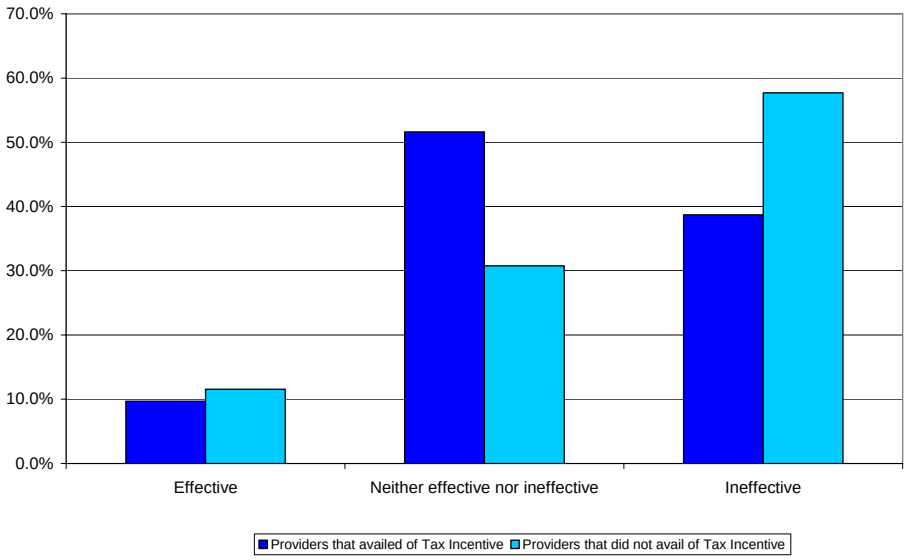
Table 10.40: Views of the Childcare Provider Sector on the Effectiveness of Property-based Tax Incentive Scheme in Reducing the Cost of Childcare Places, Childcare Providers With and Without Tax Incentive

Level of Effectiveness	% of Respondents	
	Providers that availed of Tax Incentive	Providers that did not avail of Tax Incentive
Effective	9.7%	11.5%
Neither effective nor ineffective	51.6%	30.8%
Ineffective	38.7%	57.7%
Total	100.0%	100.0%

Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Figure 10.12 illustrates these findings regarding the effectiveness of the tax incentive in reducing the cost of childcare facilities.

Figure 10.12: Views of the Childcare Provider Sector on the Effectiveness of Property-based Tax Incentive Scheme in Reducing the Cost of Childcare Places, Childcare Providers With and Without Tax Incentive



Source: Indecon Confidential Survey of Childcare Providers in Ireland.

Table 10.41 illustrates the fact that the Health Service Executive consider that the scheme was ineffective in reducing the cost of childcare places. This is consistent with the very significant increase in childcare costs evident in recent years. Indecon, however, believes that in the absence of the investment, which contributed to increased supply to meet demand, costs would have accelerated faster.

Table 10.41: Views of the Health Services Executive on the Effectiveness of Property-based Tax Incentive Scheme in Reducing the Cost of Childcare Facility Places

Level of Effectiveness	% of Respondents
Effective	0.0%
Neither effective nor ineffective	0.0%
Ineffective	100.0%
Total	100.0%

Source: Indecon Confidential Survey of HSEs.

10.7 Summary of Main Findings

In this section, we have reviewed the property-based tax incentive for childcare facilities and have outlined its effect both on the supply and cost of facilities, as well as its impact on Exchequer returns. We have presented data on the number of children requiring a place in such facilities, the profile of families demanding childcare as well as the number of childcare places currently available. The key findings from our analysis are as follows:

- Data from the Health Service Executive, as well as responses from Indecon's survey of childcare operators indicate that there has been a considerable increase in the number of childcare places available in recent years. In spite of this increase in the places available, Indecon believes that the sector is currently characterised by significant shortages of supply.
- It was felt by those operating within the sector as well as by those experts consulted by Indecon that most of the recent investment in childcare facilities either would not have proceeded in the absence of the tax incentive or would have taken longer to come on-line.

- The scheme had been successful in increasing the supply of childcare facilities, although this has not been sufficient to reduce the costs of childcare. Indeed, an analysis of Indecon's survey of childcare providers indicates significant increases in costs over the last number of years. Indecon, however, believes that increasing supply is very important in this sector due to the dramatic increase in demand. In the absence of means to enhance supply, Indecon believes that cost increases would have been much faster.
- We have estimated the total capital expenditure undertaken to date, and have provided a forecast of future eligible capital expenditure. After taking account of the beneficial effects of the extra investment as a result of the scheme, allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive to the Irish Exchequer as around €5.7 million.
- Indecon's surveys of accountancy/tax professionals indicated that most of those availing of the tax incentive are likely to be earning between €50,000 and €100,000 per year.

11 Capital Allowances and Other Reliefs for Park & Ride Facilities

11.1 Introduction and Background

In this section, we present our examination of the tax incentive for park & ride facilities, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability.

11.2 Description of Tax Incentive

Various allowances are available in respect of qualifying expenditure incurred on park and ride facilities in the larger urban areas. In the case of capital allowances for park and ride facilities and associated commercial premises, relief is denied to property developers where the property developer or a person connected with the property developer constructed or refurbished the building or structure involved. Park and ride facilities are defined as a building or structure served by a bus or train service with the purpose of providing, for members of the public intending to continue a journey by bus or rail and on payment of an appropriate charge, parking space for vehicles.

The scheme is subject to guidelines issued by the Minister for the Environment and Local Government. The local authorities empowered to certify areas for park and ride facilities are, Cork, Dublin, Galway, Limerick and Waterford Corporations, Dun Laoghaire/Rathdown, Fingal, Kildare, South Dublin and Wicklow County Councils and the Urban District Councils in Kildare, Meath and Wicklow. The scheme commenced on 1 July 1999 and is due to terminate on 31 July 2006.

The scheme was due to terminate on 31 December 2004 but this deadline was extended until 31 July 2006 by Section 26 of the 2004 Finance Act. The extension to 31 July 2006 will apply where an application for full planning permission is received by a relevant planning authority by 31 December 2004. The extension also applies, as in other schemes (hotels, holiday cottages) in relation to exempted development where the relevant conditions are satisfied by 31 December 2004. The allowances available are detailed overleaf.

11.2.1.1 (a) Park & Ride Facilities

Expenditure incurred on the construction or refurbishment of qualifying park and ride facilities, qualifies for the following allowances

- Owner Occupier:
  - 100% Free Depreciation or
  - 50% Initial Allowance;
  - 4% Annual Allowance;
  - Maximum 100%.
- Lessor:
  - 50% Initial Allowance;
  - 4% Annual Allowance;
  - Maximum 100%.

In the case of refurbishment expenditure, the allowances are available only if the expenditure is not less than 10% of the value of the premises before refurbishment.

Where the local authority is unable to give the required certification for a qualifying park and ride facility due to a delay in the provision of the public transport element, then the availability of the capital allowances may be suspended until the public transport element is in place and the development is certified.

11.2.1.2 (b) Commercial Premises

Expenditure incurred on the construction or refurbishment of certain commercial premises located on the site of a park and ride facility qualifies for the same allowances as shown above for park and ride facilities. The definition of commercial premises is restricted to premises in use for the purposes of retailing of goods or the provision of services only within the State. Specifically excluded are buildings or structures in use as offices or for the provision of mail order or financial services. However the total amount of capital expenditure which qualifies for allowances is restricted, so that, only expenditure which, when combined with expenditure on any residential accommodation at a park and ride facility, does not exceed 50% of the total allowable expenditure at the facility, will qualify for relief.

11.2.1.3 (c) Rented Residential Accommodation

Expenditure incurred on the construction of certain rented residential accommodation located on the site of a park and ride facility qualifies for "Section 23" type relief. The relief is a deduction of 100% of the construction expenditures against all Irish rental income whether it arises from the premises in question or from other lettings. There is an overall limit on the amount of expenditure which will qualify for this relief, so that, only expenditure which, when combined with any expenditure on owner-occupier accommodation at a park and ride facility, does not exceed 25% of total allowable expenditure at the facility, will qualify for relief.

11.2.1.4 (d) Owner-occupied Residential Premises

Relief is available for expenditure incurred on the construction of owner-occupied residential accommodation located on the site of a park and ride facility. An annual deduction of 5% of the expenditure incurred may be claimed by the owner occupier as a deduction from total income for 10 years provided the dwelling is the sole or main residence of the individual. There is an overall limit on the amount of expenditure which will qualify for this relief, so that, only expenditure which, when combined with any expenditure on "Section 23" accommodation at a park and ride facility, does not exceed 25% of the total allowable expenditure at the facility, will qualify for relief.

11.3 Measure of Overall Level of Activity in Sector

11.3.1.1 Number of Schemes Certified by Local Authorities

Table 11.1 details the number of schemes certified by local authorities as eligible for tax relief. Two schemes were certified, one in 1999 and one in 2005.

Table 11.1: Total Number of Schemes Certified by Local Authorities, 1999-2005

Detail	1999	2000	2001	2002	2003	2004	2005
No. of schemes certified by local authorities and developed or under construction	1	0	0	0	0	0	1

Source: Indecon Confidential Survey of Local Authorities.

11.3.1.2 Level of Construction Activity

Table 11.2 details the trend in planning applications for Park & Ride facilities between 2000 and 2005. There has been an average of just over 4 applications per year, with an average of 1.6 approvals, though as indicated above most of these have not to date secured certification.

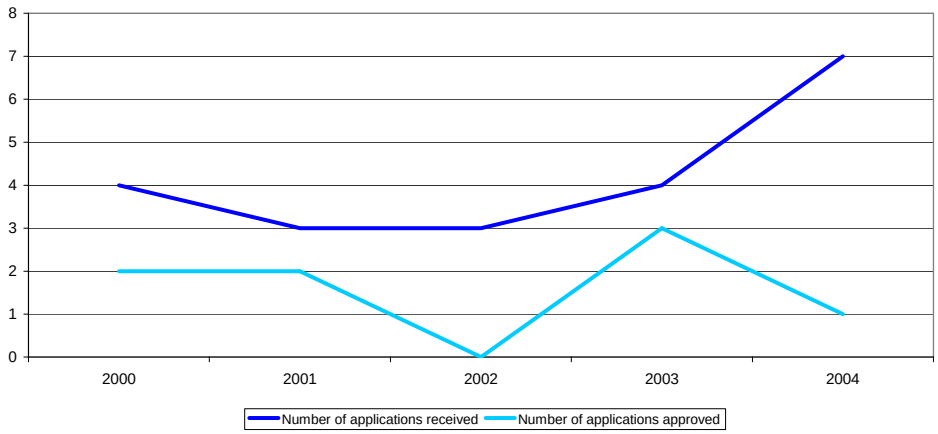
Table 11.2: Details of Planning Applications - Total Number of Applications for Park & Ride Facilities, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	4	3	3	4	7
Number of applications approved	2	2	0	3	1
Number of applications awaiting decision	0	0	0	2	3

Source: Indecon Confidential Survey of Local Authorities.

Figure 11.1 overleaf presents this data in graphical form.

Figure 11.1: Details of Planning Applications - Total Number of Applications for Park & Ride Facilities, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

11.4 Case Study

It is useful to consider a case study of a park and ride investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

Park and ride facilities are likely to be large scale investments and a realistic case study is likely to be readily identifiable. The following case study attempts to identify the principal characteristics of these schemes.

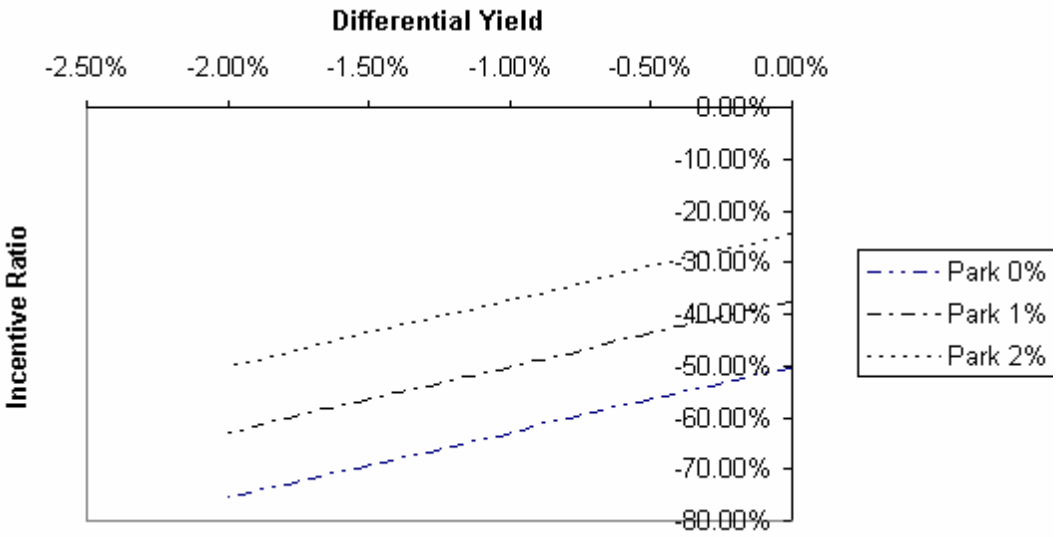
1.1.1 Investor Perspective

An investor is considering a €200 million investment in a commercial/residential development. The development consists of 50% commercial property and 50% residential property. Alternatively, the investor could choose a location that may be designated as a Park and Ride. This will entail an additional investment of €200 million and will result in capital allowances for the entire facility of €153 million (i.e. 38% of the original €400 million investment). However, these additional capital allowances must be weighed against:

- Park and Ride facilities are likely to have relatively low yields;
- The commercial and residential yields are likely to be lower than centre city locations.

To evaluate the impact of these factors, the proposed investment was considered over a 50 year horizon. Yield differentials are discounted using the Euro par yield curve and the value of the parking facility was computed for a number of scenarios. The results are presented in Figure 11.2.

Figure 11.2: Incentive Ratio Vs. Differential Yield



Source: Indecon.

Figure 11.2 contains estimates of the Incentive Ratio (expressed as a percentage of the total cost - €400 million in this case study). The relationship between the Incentive Ratio and the differential yield on the commercial/residential portion is estimated for three levels of EBITDA/Cost for the parking facility - 0%, 1% and 2%. It may be seen from Figure 11.2 that the Incentive Ratio is highly sensitive to the differential yield associated with the commercial/residential property and the yield on car parks. Two observations:

- If the commercial/residential yield is similar to other properties and the parking facility generates zero EBITDA, then the Incentive Ratio is -50%. If the parking facility generates 1% EBITDA (i.e. €2 million per annum in this case study), then the Incentive Ratio is -37%. Therefore, an investment in Park and Ride facilities will be marginal unless the EBITDA rate on the parking facility exceeds 1%.
- If the differential yield on the commercial/residential portion is negative, then park and ride facilities will become less attractive. In the presence of a capital allowances with a present value of 38% of the cost, the investment will be rejected unless the yield differential is -0.5% (-1%) when the EBITDA/Cost ratio for the parking facility is 1.5% (2%).

11.5 Evaluation of the Tax Incentive

11.5.1 Displacement, Deadweight and Opportunity Cost

Table 11.3 presents the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood that projects would have proceeded had the tax incentive not been instituted. Half of respondents from financial institutions, nearly 60% of auctioneers and 60% of accountancy/tax professionals felt that a majority of projects would not have proceeded in the absence of the tax incentive. Most other respondents felt either that projects would have proceeded over a longer timeframe or that a minority of them would not have proceeded at all. In discussion with some respondents it was clear that these views related to the park and ride element and not to the associated commercial or residential developments.

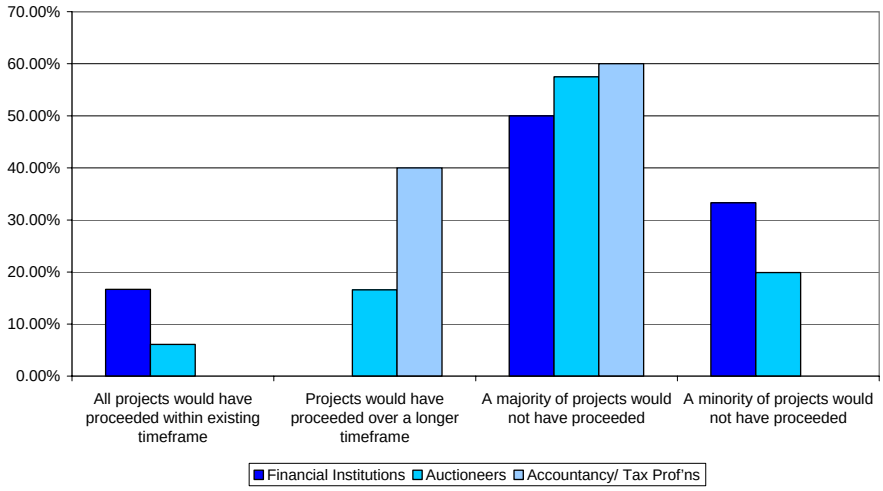
Table 11.3: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Park & Ride Facilities) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

View	% of Survey Respondents		
	Financial Institutions	**Auctioneers**	**Accountancy/ Tax Prof'ns**
All projects would have proceeded within existing timeframe	16.7%	6.1%	0.0%
Projects would have proceeded over a longer timeframe	0.0%	16.6%	40.0%
A majority of projects would not have proceeded	50.0%	57.5%	60.0%
A minority of projects would not have proceeded	33.3%	19.9%	0.0%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

This data is shown in graphical form in Figure 11.3 below. This clearly shows that the majority of nearly all respondents believed that the projects would not have gone ahead without the tax incentive.

Figure 11.3: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Park & Ride Facilities) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

There is a very significant shortage of Park & Ride facilities in Ireland, according to Indecon's survey of auctioneers. Table 11.4 shows that nearly three quarters of those surveyed believed such facilities to be in short supply with most of the remainder considering the market to be in or near equilibrium. Very few respondents felt that there is currently an excess supply of Park & Ride facilities. This is consistent with Indecon's own analysis which suggests a shortage of park and ride facilities in selected suburban and outer suburban areas in some major urban centres.

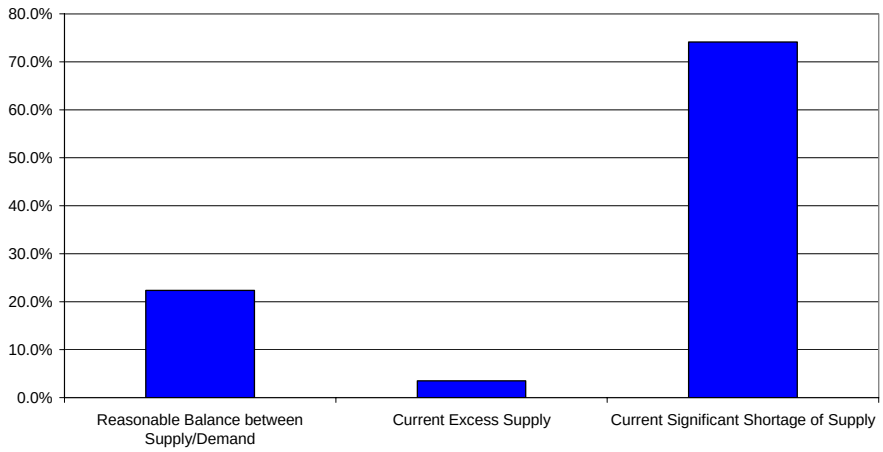
Table 11.4: Views of Auctioneers on Current Supply Position

View	% of Survey Respondents
Reasonable Balance between Supply/Demand	22.4%
Current Excess Supply	3.5%
Current Significant Shortage of Supply	74.1%
Total	100.0%

Source: Indecon Confidential Survey of Auctioneers in Ireland.

The extent of the feeling among auctioneers that there are significant supply shortages is evident from Figure 11.4.

Figure 11.4: Views of Auctioneers on Current Supply Position



Source: Indecon Confidential Survey of Auctioneers in Ireland.

11.5.2 Estimated Investment in the Sector

11.5.2.1 Capital Expenditure

Table 11.5 details the value of the capital expenditure certified by local authorities as eligible for tax relief. Just under €1 million was spent on a park & ride facility in 1999. In 2005, €15 million of eligible expenditure was undertaken on a commercial premises associated with a park & ride facility. While the figures appear to suggest that the commercial investments breach the 50% rule this is due to a complex structure whereby a much larger sum was spent on the park and ride facility but this was subsequently sold as part of an overall contractual arrangement and tax allowance was not claimed on the balance of the park and ride element of the investment.

Table 11.5: Average Certified Capital Expenditure per Local Authority, 1999-2005 (€)

Detail	1999	2000	2001	2002	2003	2004	2005
Capital expenditure	900,000	0	0	0	0	0	15,000,000
of which:							
Expenditure on park & ride facilities	900,000	0	0	0	0	0	0
Expenditure on commercial premises	0	0	0	0	0	0	15,000,000
Expenditure on residential accommodation on site	0	0	0	0	0	0	0

Source: Indecon Confidential Survey of Local Authorities.

11.5.3 Estimated Gross and Net Cost of Tax Incentive

11.5.3.1 Capital Expenditure

Available evidence on capital expenditure under the tax incentive scheme for park and ride facilities shows that there has been a limited uptake of the scheme and correspondingly limited private investment. Based on survey responses from county councils, Indecon estimates that eligible expenditure under the tax incentive scheme totals around €15,900,000.

Indecon believes that in general the economics of stand alone park and ride facilities, which are characterised by low levels of fees and revenues, high site costs and low levels of capital expenditure, are in general not amenable to incentivisation via the tax incentives and we are therefore not surprised at the low level of take up. Unless an accommodation element is included the returns are likely to be very low and including eligibility for tax incentives for private accommodation in suburban and outer suburban areas is extremely costly from an Exchequer position.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. Based on existing planning approvals and Indecon survey responses on average construction costs for park and ride facilities and eligible related investments, we estimate that future investment under this scheme could be in the region of €25,000,000, though it must be noted that this figure probably represents a maximum potential investment and we would not be surprised if no investment occurred unless subsidised by tax relief on associated investment. Table 11.6 below summarises these figures.

Table 11.6: Estimate of Total Eligible Capital Expenditure on Park & Ride Facilities under the Tax Incentive Scheme

Detail	Value (€'000s)
Total Eligible Capital Expenditure to date	15,900
Forecast for Future Capital Expenditure	25,000

Source :Indecon Calculations

11.5.3.2 Impact of Capital Expenditure

The investment in park and ride schemes will have an economic impact on the economy as a whole. The increased levels of investment will lead to a higher level of economic activity in general. By applying a 'multiplier' to the capital investment, Indecon estimates that the overall economic spend of this scheme is of the order of €19,954,000. However, this figure must be adjusted for the opportunity costs of the investment, which reflects the fact that had this money not been invested in Park and Ride facilities it could have been invested in other sectors of the economy, assuming an opportunity cost of 95%, reflecting the full employment status of the Irish economy. However, in the case of Park and Ride, there is likely to be a wider benefit to the economy, arising from reduction in congestion costs, and this is estimated to be equivalent to 5% of the total capital spend. The net economic benefit is therefore estimated to be of the order of €1,996,000.

11.5.3.3 Impact on Exchequer Revenues

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the workings of each scheme. In the case of park and ride facilities, this is based on assuming that €15m of the expenditure qualified for relief under the rented residential accommodation scheme and that this did not exceed 25% of the total expenditure.

Using this method, we have estimated a gross cost to the Exchequer of €5,775,000. This figure does not include the tax costs of the original €900,000 project although we take account of this in estimating tax revenue from indirect expenditure. This slightly underestimates the overall tax cost. However, we believe that our estimates represent a measured upper limit as it assumes that all of the €15m is eligible for an allowance in year 1 against rental income on rented residential accommodation. To the extent that this is not the case tax costs reduce accordingly. This gross figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €7,204,000. Adjusting this figure to reflect the opportunity cost of the investment (i.e. the fact that the money could have been invested in another sector of the economy), we calculate a net tax contribution of €1,801,000. Deducting this figure from the gross cost to the Exchequer, we calculate a net cost of €3,974,000.

Table 11.7 below gives a summary of Indecon's estimates for this scheme.

Table 11.7: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Park and Ride Facilities

Estimate	€'000
Capital Expenditure to Date	15,900
Gross Tax Revenue Foregone	5,775
Tax Contribution Allowing for Indirect Tax Revenues	1,801
Net Tax Revenue Foregone	3,974
Future Capital Expenditure	25,000

Source: Indecon Confidential Surveys of County Councils.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Indecon believes deadweight under this tax incentive to be extremely high on the accommodation element. However, the indirect tax contribution may be higher than estimated as it did not take account of the fact that the €15m was assumed to only equate to a maximum of 25% of total investment. We are assuming these two factors cancel out. Unlike other incentives where there have been a large number of projects the results here should be seen as indicative, as for confidentiality reasons we have utilised some illustrative assumptions to highlight the potential costs of these incentives where accommodation investment is incentivised.

Indecon has also undertaken a sensitivity analysis on these figures, in relation to our assumptions for the multiplier and deadweight. We have assumed a multiplier of 1.255 for the capital expenditure under this tax incentive. If we were to reduce this figure to 1.1 the net tax cost of the scheme would be €4,196,000, while were we to increase it to 1.35 the corresponding figure would be €3,837,000. This represents a range of around €360,000. In relation to the deadweight assumption, we have assumed that the deadweight of the incentive will be offset by the extra tax revenues generated. Disregarding these revenues, if we take a deadweight of 10% the corresponding net tax foregone will equal €4,154,000, while a deadweight of 20% gives a figure of €4,334,000. In other words, a variation of 10% in the deadweight assumption causes a €180,000 variation in the net cost of the tax incentive to the Exchequer.

11.5.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 11.8 presents the views of accountancy/tax professionals on the income bracket into which likely investors in Park & Ride facilities are likely to fall. 80% of respondents to Indecon's survey felt that investors were likely to be earning in excess of €200,000 per year.

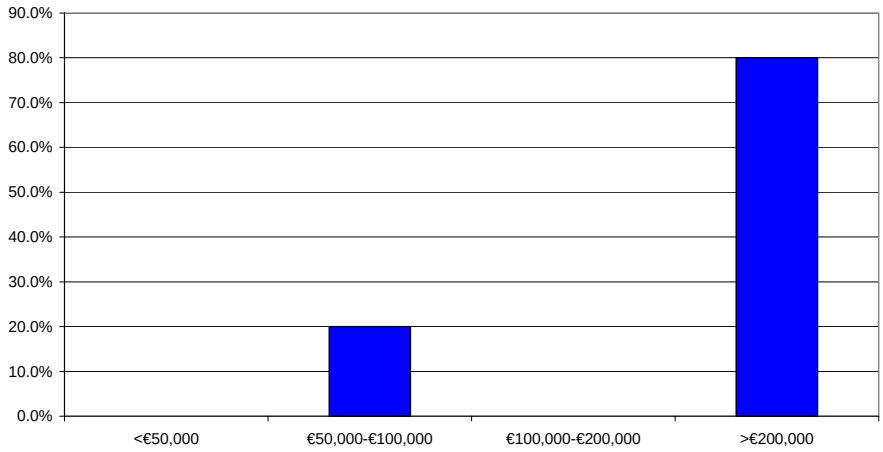
Table 11.8: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Park & Ride Tax Incentive.

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	80.0%
Majority of investors were likely to be earning between €100,000 and €200,000	0.0%
Majority of investors were likely to be earning between €50,000 and €100,000	20.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 11.5 presents the above data in graphical form.

Figure 11.5: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland: Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Park & Ride Tax Incentive.



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

11.5.5 Overall Effectiveness in Achieving Policy Objective

Table 11.9 details the results from Indecon's survey of Local Authorities on the question of the effectiveness of the tax incentive. Almost half of respondents felt that the tax incentive for Park & Ride facilities was 'neither effective nor ineffective'. Of those that expressed a definite opinion, more considered the scheme to have been ineffective than considered it to have been effective. It is clear that the scheme is potentially very costly from an Exchequer perspective but there has been limited take up. Indecon however strongly supports measures to increase the supply of adequate park and ride facilities as they have significant benefits in reducing the costs of congestion and encouraging use of public transport. We however believe that public expenditure may be a more effective and lower cost mechanism to achieve this objective.

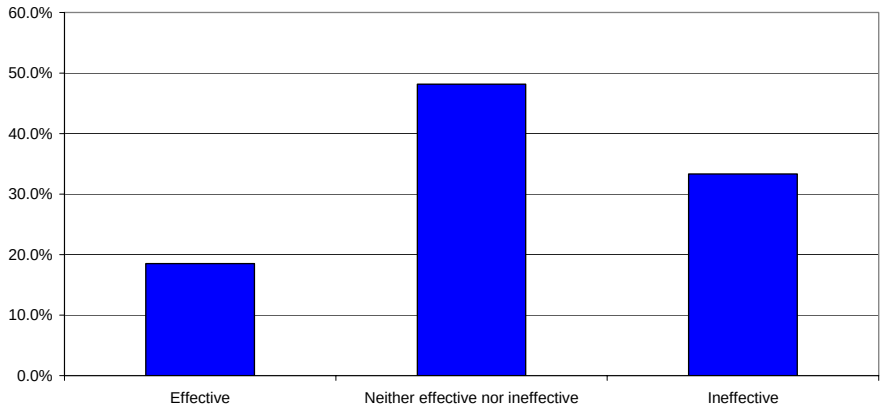
Table 11.9: Views of Local Authorities on the Effectiveness of Park & Ride Tax Incentive

Level of Effectiveness	% of Local Authorities
Effective	18.5%
Neither effective nor ineffective	48.1%
Ineffective	33.3%
Total	100.0%

Source: Indecon Confidential Survey of Local Authorities.

Figure 11.6 illustrates the above data in a bar chart.

Figure 11.6: Views of Local Authorities on the Effectiveness of Park & Ride Tax Incentive.



Source: Indecon Confidential Survey of Local Authorities.

11.6 Summary of Main Findings

In this section, we have reviewed the property-based tax incentives for park & ride facilities as well as commercial and residential premises associated with such areas. We have outlined the effect of the tax incentive on the supply of park & ride facilitates as well as its impact on Exchequer returns. The key findings from our analysis are as follows:

- Although there has been a number of planning approvals granted by local authorities, only 2 certified projects have proceeded since 1999.
- Indecon believes there is currently a significant shortage of park & ride facilities.
- We have estimated the total capital expenditure undertaken to date, and have provided a forecast of eligible capital expenditure in the future. Indicative estimates suggest the scheme could have cost the Exchequer of the order of €4m.
- This scheme provides a means for high earners to reduce their tax liability.
- Park and Ride facilities have very beneficial economic benefits in terms of reducing congestion costs and encouraging use of public transport.
- The tax incentives, if associated private accommodation is not eligible, are unlikely to be effective. If a tax incentive is provided for private accommodation the cost to the Exchequer is likely to be very significant and public expenditure could be a more cost effective mechanism to achieve the objectives.

12 Capital Allowances for Investment in Multi-storey Car Parks

12.1 Introduction and Background

In this section, we present our examination of the tax incentive for multi-storey car park properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability.

12.2 Description of Tax Incentive

The 1995 Finance Act provided for a scheme of capital allowances in respect of capital expenditure incurred in the qualifying period on the construction or refurbishment of certain multi-storey car parks in certain urban areas. To qualify, a multi-storey car park must be certified by the relevant local authority as having been developed in accordance with criteria laid down by the Minister for the Environment, Heritage and Local Government following consultation with the Minister for Finance.

The scheme was to originally run for the period 1 July, 1995 to 30 June, 1998 and has been extended on a number of occasions for projects outside the Dublin and Cork City Council areas. The latest extension which was provided for in Finance Act 2004 extended the scheme from 31 December 2004 until 31 July 2006 for projects where at least 15 per cent of total costs were incurred by 30 September, 2003. The scheme provides for relief as set out in Table 12.1.

Table 12.1: Rates of Capital Allowances

Capital Allowances (Section 344)	Owner-Occupier (Trader)	Lessor
Qualifying Multi-Storey Car Parks	Construction or Refurbishment Total of 100%	Construction or Refurbishment Total of 100%
Year One Allowance	50%	50%
OR		
Free Depreciation	100%	None
Annual Allowance	4%	4%
Balancing Charge	none after 13 years	

Source: Department of Finance.

12.3 Measure of Overall Level of Activity in Sector

12.3.1 Number of Schemes Certified by Local Authorities

Table 12.2 gives details of the number of Multi-Storey Car Parks certified by Local Authorities as eligible for tax relief. A total of 21 projects were certified over the period 1999-2005.

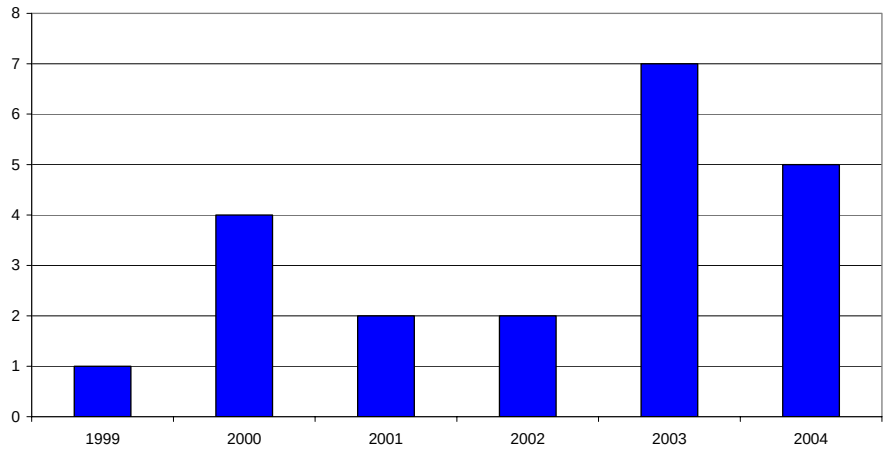
Table 12.2: Total Number of Schemes Certified by Local Authorities, 1999-2004

Detail	1999	2000	2001	2002	2003	2004
No. of schemes certified by local authorities and developed or under construction	1	4	2	2	7	5

Source: Indecon Confidential Survey of Local Authorities.

Figure 12.1 shows the trend in schemes certified.

Figure 12.1: Total Number of Schemes Certified by Local Authorities, 1999-2005



Source: Indecon Confidential Survey of Local Authorities.

12.3.2 Level of Construction Activity

Table 12.3 presents data on the number of planning applications for multi-storey car-parks received and approved over the period 2000 to 2004. A total of 44 applications (an average of 8.8 per year) was received and of those, a total of 33 were approved (an average of 6.6 per year).

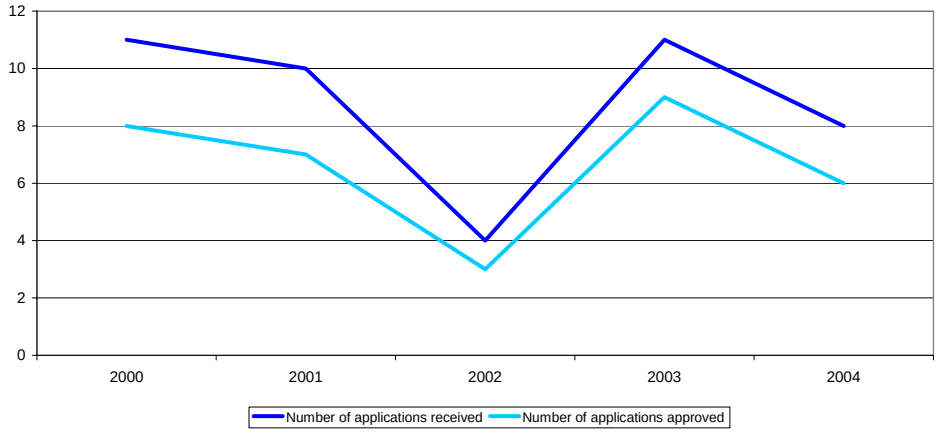
Table 12.3: Details of Planning Applications - Total Number of Applications for Multi-Storey Car Parks, 2000-2004

Detail	2000	2001	2002	2003	2004
Number of applications received	11	10	4	11	8
Number of applications approved	8	7	3	9	6
Number of applications awaiting decision	0	2	0	0	1

Source: Indecon Confidential Survey of Local Authorities.

The trends in applications and approvals are illustrated in Figure 12.2.

Figure 12.2: Details of Planning Applications - Total Number of Applications for Multi-Storey Car Parks, 2000-2004



Source: Indecon Confidential Survey of Local Authorities.

12.4 Case Study

It is useful to consider a case study of a multi-storey car park investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

For the car parking case study, yields were estimated using the published financial data for Central Parking Corporation.

12.4.1 Investor Perspective

An investor makes an investment in the construction of a parking facility at a cost of €10 million. The cost of equity is 49% (Annex 1) and the facility is 75% debt financed at 300 basis points above the Euro par yield curve. The investment will yield 8%. Both revenues and the cost of the asset are assumed to grow at 3% per annum. These assumptions are summarised in Table 12.4.

Table 12.4: Key Assumptions

Item	Assumed Level
Investment ('000)	10,000
Investment Term (years)	13
Cost of Equity	49%
Borrowing/Investment	75%
Cost of Debt	6%
Term of Loan (years)	25
Tax Rate	42%
Assumed Yield	8%
Assumed Asset Growth	3%
Assumed Revenue Growth	3%
Capital Gains Tax (CGT)	20%

Source: Indecon.

The Incentive Ratio is computed in Table 12.5 and it may be seen that an investor in this example would require an incentive equal to 22% of the construction cost. The current level of incentive is 37% and this exceeds the Incentive Ratio. However, unlike many other classes of real estate investment, land costs are likely to be high relative to the construction cost of the facility. The incentive will be sufficient to encourage investment if the land costs are less than or equal to 80% of the construction cost. If, however, yields are greater than indicated, or if asset growth is faster, the returns to investors will increase accordingly. The value of the tax incentive will also be influenced by whether the investor is an owner-occupier or lessor and whether they claim 50% allowance in year one or free depreciation of 100%.

Table 12.5: Multi Storey Car Parks

Period	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**
Asset Cost	-10000													
Sale of Asset (net of CGT)														14685
EBITDA		824	849	874	900	927	955	984	1013	1044	1075	1107	1141	1175
Interest Expense		-450	-442	-433	-424	-414	-404	-393	-381	-369	-356	-342	-327	-312
Taxes		-157	-171	-185	-200	-216	-232	-248	-266	-283	-302	-322	-342	-363
Net Cash Flow		217	236	256	276	298	320	343	367	391	417	444	472	15186
Debt Service – Principal	7500	-137	-145	-154	-163	-173	-183	-194	-206	-218	-231	-245	-259	-5194
Cash Flow to Equity (CFE)	-2500	80	91	102	114	125	137	149	161	174	186	199	212	9992

		% Cost	% Cost 20% Land	% Cost 80% Land
Present Value of CFE	-2237	-22%	-21%	-20%
Capital Allowance	3719	37%	31%	+20%
PV Project + Allow	1482	15%	10%	0%

Source: Indecon.

12.5 Evaluation of the Tax Incentive

12.5.1 Displacement, Deadweight and Opportunity Cost

Table 12.6 presents the views of financial institutions, auctioneers and accountancy/tax professionals on the likelihood that capital expenditure on multi-storey car parks would have gone ahead in the absence of the tax incentive. Two thirds of respondents from financial institutions, two-thirds of accountancy/tax professionals and over 70% of auctioneers believed that without the tax incentive either a majority of projects would not have gone ahead or projects would have proceeded over a longer timeframe. The remainder (not more than a third for any of the three categories) believed either that all or all but a minority of projects would have proceeded without the existence of the incentive.

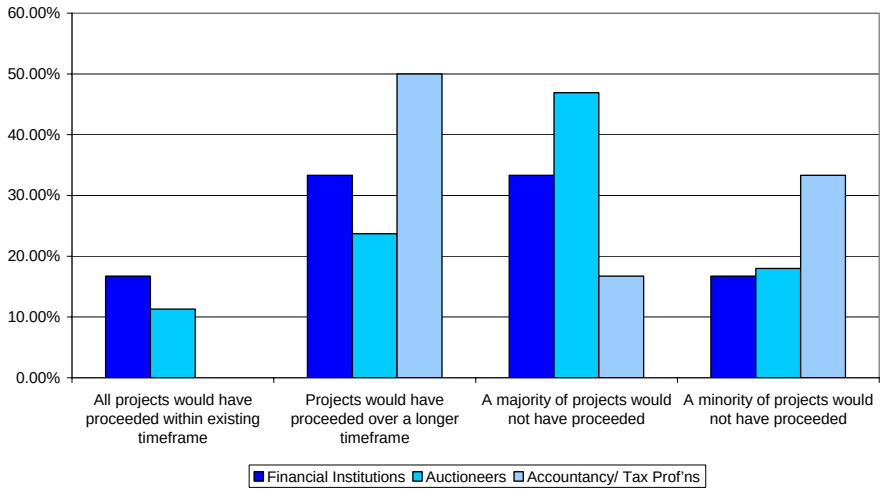
Table 12.6: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Multi-Storey Car Parks) would have proceeded in the Absence of the Property-based Tax Incentive Scheme

	% of Survey Respondents		
View	**Financial Institutions**	**Auctioneers**	**Accountancy/ Tax Prof'ns**
All projects would have proceeded within existing timeframe	16.7%	11.3%	0.0%
Projects would have proceeded over a longer timeframe	33.3%	23.7%	50.0%
A majority of projects would not have proceeded	33.3%	46.9%	16.7%
A minority of projects would not have proceeded	16.7%	18.0%	33.3%
Total	100.0%	100.0%	100.0%

Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

Figure 12.3 presents these views graphically.

Figure 12.3: Views of Financial Institutions, Auctioneers and Accountancy/Tax Professionals on the Impact of the Property-based Tax Incentive Scheme –Views on the likelihood that Projects (i.e. Capital Expenditure on Multi-Storey Car Parks) would have proceeded in the Absence of the Property-based Tax Incentive Scheme



Source: Indecon Confidential Surveys of Financial Institutions, Auctioneers and Accountancy/Tax Professionals in Ireland.

12.5.2 Estimated Investment in the Sector

12.5.2.1 Capital Expenditure

Table 12.7 presents a summary of the total capital expenditure on multi-storey car parks certified by local authorities between 2000 and 2004. Total expenditure over the period equalled over €61m. Average expenditure was over €14.5m per year. Certified capital expenditure peaked in 2003 when the 7 projects cost a total of approximately €21.1m.

Table 12.7: Total Capital Expenditure Certified by Local Authorities, 1999-2004 (€)

Detail	2000	2001	2002	2003	2004
Capital expenditure	3,000,000	11,604,322	13,500,000	21,131,000	11,810,000

Source: Indecon Confidential Survey of Local Authorities.

12.5.2.2 Lending Advanced by Financial Institutions

Table 12.8 presents a result from Indecon's survey of financial institutions in Ireland. Respondents to the Indecon survey estimated the total capital expenditure including promoter's equity at €38m in 2003 and €43m in 2004.

Table 12.8: Indecon Confidential Survey of Financial Institutions in Ireland: Total Value of Annual New Lending Advanced and Estimated Total Capital Expenditure on Multi-Storey Car Parks including Promoter's Equity, 2003-2004

Detail	2003 (€'000)	2004 (€'000)
Total value of annual new lending advanced	20,000	35,000
Total capital expenditure on projects including promoter's equity	38,000	43,000

Source: Indecon Confidential Survey of Financial Institutions in Ireland.

12.5.3 Estimated Gross and Net Cost of Tax Incentive

12.5.3.1 Capital Expenditure

Figures on investment in multi-storey car parks come directly from the county councils, who have to certify each scheme[30]. These figures show that the cumulative investment in these facilities, as well as related investment eligible for the allowances, totalled €61,045,000 for the period 2000-2004.

While there is likely to be variance in annual investment levels we believe this figure of €61m to be the best estimate of expenditure over the period. While the results from financial institutions would suggest a higher level of capital investment we believe that some of this investment may occur in future years and some may relate to expenditure outside of Ireland.

It is, however, important to also take account of future investment for projects which have qualified under this scheme but for which the investment has not yet been completed. Under the extension of the scheme approved under the Finance Act 2004, a development must have had incurred at least 15% of its total costs before 30/09/2003. In order to calculate the remaining capital expenditure under this scheme, Indecon has examined the planning approvals up until 2003 and determined how many have not yet gone ahead. This figure is given in Table 12.9 below.

Table 12.9: Estimate of Total Eligible Capital Expenditure on Multi-Storey Car Parks under the Tax Incentive Scheme

Detail	Value (€'000s)
Total Cumulative Capital Expenditure to date	61,045
Forecast for Future Capital Expenditure	12,792

Source :Indecon Calculations

[30] Indecon's confidential survey of county councils

12.5.3.2 Impact of the Capital Expenditure

In relation to capital expenditure on multi-storey car parks, we have estimated that the initial investment will give rise to overall economic expenditure of the order of €76,612,000. However, this figure must be adjusted to reflect the opportunity cost of the investment, which arises from the fact that the money could have been invested in another part of the economy. We assume a 95% opportunity cost suggesting a net economic benefit of the order of €3,831,000.

12.5.3.3 Impact on Exchequer Revenues

In order to calculate the gross and net impacts of the tax allowances schemes on Exchequer revenues, Indecon has developed a model based on the method of calculating tax allowances under each scheme. In the case of multi-storey car parks, this is based on the method of calculating the capital allowance over 14 years, allowing for an initial 50% deduction, a subsequent deduction of 4% for the next 12 years and a final deduction of 2% in the 14th year. The tax foregone relating to years after 2005 are subject to a net present value (NPV) calculation, which gives the current value of the future amounts. Current corporate and income tax rates are applied.

Using this method, we have estimated a gross cost to the Exchequer of €22,878,000, €8,464,000 of which will be claimed after 2005, though the figure has been deflated by a net present value (NPV) calculation. This gross figure must be adjusted to reflect the fact that the increased level of investment will lead to increased economic activity, as outlined above, giving rise to increased Exchequer revenues. Indecon has estimated the gross tax revenues arising from the increased economic activity to be of the order of €27,657,000. Adjusting this figure to reflect the opportunity cost of the investment (i.e. the fact that the money could have been invested in another sector of the economy) we calculate a net tax contribution of €6,914,000. This means that the net cost to the Exchequer from this tax incentive is of the order of €15,964,000. Table 12.10 below gives a summary of Indecon's estimates for this scheme.

Table 12.10: Estimates of Capital Expenditure and Tax Revenue Foregone under the Tax Incentive Scheme for Multi-storey Car Parks

Estimate	€'000
Capital Expenditure to Date	61,045
Future Capital Expenditure	12,792
Gross Tax Revenue Foregone	22,878
Tax Contribution allowing for Opportunity Cost	6,914
Net Tax Revenue Foregone	15,964

Source: Indecon Confidential Survey of County Councils.

The above figures must be further adjusted to take account of deadweight. This arises from the fact that some of the projects built under the tax incentive would have gone ahead anyway, in the absence of the tax incentive. Based on Indecon's survey of multi-storey car park operators, auctioneers, financial institutions and the accountancy profession, we use a deadweight assumption under this tax incentive of the order of 20%. The 'Tax contribution allowing for opportunity cost factor' figure must be reduced to reflect this. We therefore estimate a tax contribution figure of €5,531,000 reflecting deadweight or around €1.4m. This results in a net tax revenue foregone figure of €17,347,000.

Indecon has also undertaken a sensitivity analysis on the assumptions underlying the above figures. In order to calculate the gross economic benefits of the capital expenditure we have assumed a multiplier of 1.255. If we increase this figure to 1.35 the net tax revenue foregone decreases to €15,441,000, a fall of around €0.5m, and adjusting this figure for deadweight gives us a net figure of €16,928,000, representing a decrease of around €0.4m on the base case scenario. If we decrease the multiplier to 1.1, the net tax revenue foregone increases to €16,818,000, an increase of around €0.85m, and adjusting this figure for deadweight gives us a net figure of €18,030,000, representing an increase of around €0.68m on the base case scenario. Additionally, we have also assumed a deadweight figure of 20%. If we adjust this to 10%, holding the multiplier figure at 1.255, the net tax forgone figure decreases to €16,656,000, an decrease of around €0.7m. If the deadweight is increased to 30%, the net tax foregone figure increases to €18,039,000, an increase of around €0.7m.

12.5.4 Scope for High-Income Individuals to Reduce Tax Liabilities

Table 12.11 presents a result from Indecon's survey of Accountancy/Tax Professionals. All respondents felt that investors availing of the multi-storey car park tax incentive were likely to have an income of over €100,000. 83.3% of respondents felt that such investors were likely to be earning more than €200,000.

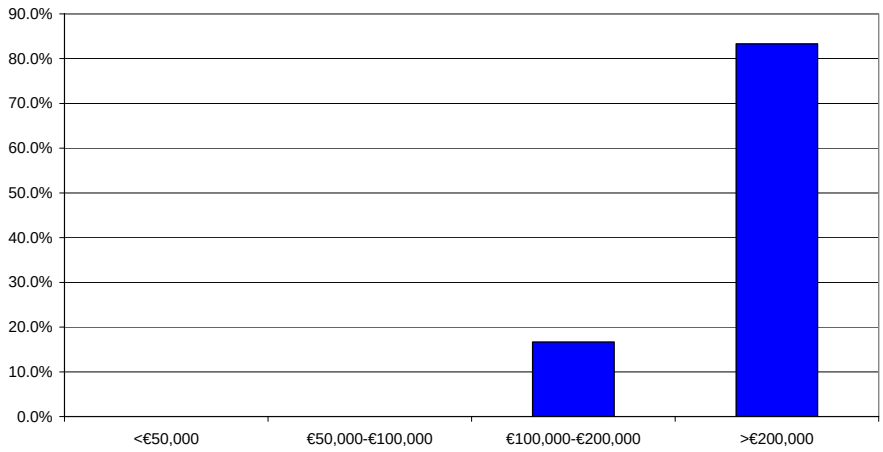
Table 12.11: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Multi-Storey Car Park Tax Incentive.

Gross Annual Income Category of Investors	% of Survey Respondents
Majority of investors were likely to be earning in excess of €200,000	83.3%
Majority of investors were likely to be earning between €100,000 and €200,000	16.7%
Majority of investors were likely to be earning between €50,000 and €100,000	0.0%
Majority of investors were likely to be earning less than €50,000	0.0%
Total	100.0%

Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

Figure 12.4 presents the investor profile graphically.

Figure 12.4: Views of Accountancy/Tax Professionals - Estimates of Gross Annual Income Category accounting for the Majority of Investors Utilising the Multi-Storey Car Park Tax Incentive.



Source: Indecon Confidential Survey of Accountancy/Tax Professions in Ireland.

12.5.5 Overall Effectiveness in Achieving Policy Objective

Table 12.12 presents results from Indecon's survey of Local Authorities. 80% of respondents felt that the multi-storey car park tax incentive was an effective way of providing car park spaces.

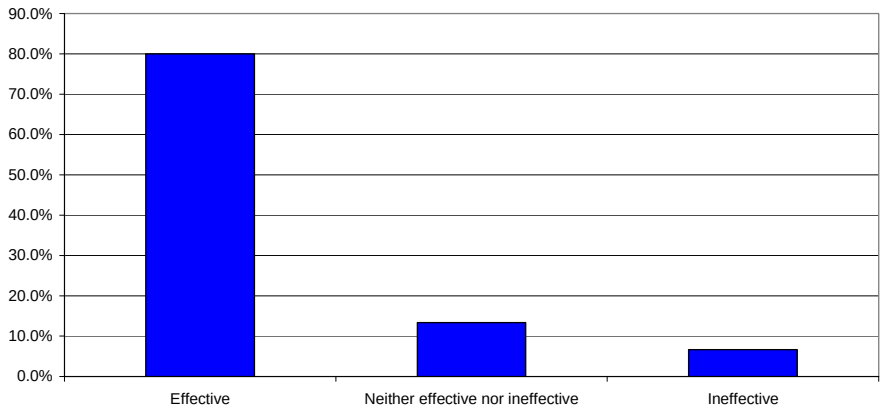
Table 12.12: Views of Local Authorities on the Effectiveness of the Multi-Storey Car Park Tax Incentive

Level of Effectiveness	% of Local Authorities
Effective	80.0%
Neither effective nor ineffective	13.3%
Ineffective	6.7%
Total	100.0%

Source: Indecon Confidential Survey of Local Authorities.

The positive feeling in relation to the tax incentive for Multi-Storey Car Parks on the part of the Local Authorities is evident from Figure 12.5.

Figure 12.5: Views of Local Authorities on the Effectiveness of Multi-Storey Car Park Tax Incentive



Source: Indecon Confidential Survey of Local Authorities.

12.6 Summary of Main Findings

In this section we reviewed the property-based tax incentive for multi-storey car parks, and outlined its effect both on the supply of such facilities and on returns to the Exchequer. The key findings from our analysis are as follows:

- There has been considerable uptake of the incentive, and a very considerable majority of local authorities consider that the incentive has been successful in increasing the supply of multi-storey car-parks.
- We see no cause of market failure which would justify government subsidies for multi-storey car parks. Pricing of parking meters, parking fines and compliance measures should be sufficient to encourage appropriate level of investment in multi-storey car parks without any government subsidies.
- We have provided data from the local authorities on the value of certified capital expenditure to date and have provided a forecast of future capital expenditure under the scheme. After taking account of the beneficial effects of extra investment as a result of the scheme, and allowing for opportunity cost and deadweight, Indecon estimates the net cost of the tax incentive to the Irish Exchequer at just over €17.3m in terms of tax revenue foregone.
- Most of those investing in multi-storey car parks are likely to earning in excess of €200,000 per year.

13 Relief for the Refurbishment of Certain Rented Residential Properties

13.1 Introduction and Background

In this section, we present our examination of the tax incentive for the refurbishment of certain rented residential properties, including our assessment of the extent to which the scheme has justified its introduction and the contribution that the relief has made and can make to the wider policy objectives of the sector. We also examine the extent to which high income individuals use the relief to reduce their tax liability.

13.2 Description of Tax Incentive

Under this scheme tax relief is available to lessors in respect of the expenditure incurred on the refurbishment of certain rented residential accommodation throughout the country. The relief is available in respect of all existing rented residential properties that meet the required criteria. These include compliance with any guidelines issued by the Minister for the Environment and Local Government. Also the lesser of the premises must comply with various regulations in relation to Standards of Rental Houses, Rent Books, and Registration of Rented Houses. Premises which qualified or which would qualify for tax relief under any other tax incentive scheme do not qualify for relief under this scheme.

Expenditure incurred on a building which, before and after the refurbishment, contains one or more residential units, is allowable against rental income receivable by the lesser of the qualifying residential units - in so far as the expenditure incurred is attributable to such qualifying units.

Relief for expenditure incurred is available for set off against all rental income arising in the State but, unlike other schemes, such relief must be drawn down over a 7 year period, i.e. 15% per annum in years 1 to 6 and 10% in year 7.

No relief is available to owner-occupiers under this scheme.

13.3 Measure of Overall Level of Activity in Sector

13.3.1 Level of Awareness and Utilisation of the Scheme

Table 13.1 presents the views of the local authorities on the level of awareness in their area concerning tax relief available on the refurbishment of certain types of residential accommodation. 87.1% of local authorities felt that there was 'little or no' awareness of the scheme in there area. Indecon's own research suggests that this scheme has not been widely publicised or marketed by tax practices and we were not able to identify any investment which qualified under the scheme. The recent changes in the Revenue Commissioners' requirements to notify use of capital allowances does not include this scheme. While we do not see this as significant, we believe an amendment to the Revenue requirements should be included to capture any potential investment under this scheme.

Table 13.1: Views of Local Authorities on the Level of Awareness and Utilisation of the Scheme of the Property-based Tax Incentive Scheme

Response	% of Local Authorities
Little or no awareness of any utilisation of this scheme in our local authority area	87.1%

Source: Indecon Confidential Survey of Local Authorities.

13.4 Case Study

It is useful to consider a case study of a Countrywide Refurbishment Scheme investment benefiting from the tax incentive. This case study is focused on illustrating how the tax incentives work.

13.4.1 Investor Perspective

From an investor perspective, the refurbishment scheme results in a capital allowance equal to 38% of the expenditure.

For the case study, consider a refurbishment that costs €100,000. Assume a 15% cost of equity and 75% debt finance at 100 basis points above the Euro par yield curve. The rental yield is assumed to be zero, but it is assumed that the investor will enjoy a 6% p.a. increase in the market value of the refurbishment. These assumptions are summarised in Table 13.2.

Table 13.2: Key Assumptions

Item	Assumed Level
Investment ('000)	100
Investment Term (years)	10
Cost of Equity	15%
Borrowing/Investment	75%
Cost of Debt	4%
Term of Loan (years)	25
Tax Rate	42%
Assumed Yield	0%
Assumed Asset Growth	6%
Assumed Revenue Growth	0%
Capital Gains Tax (CGT)	20%

Source: Indecon.

Using these assumptions, the incentive that the investor will require is 17% of the refurbishment cost. However, in practice we believe that the increased rental income and the enhanced capital appreciation will be more than sufficient to incentivise investment in refurbishment without tax incentives.

Table 13.3: Return on Countrywide Refurbishment Scheme investment

Period	0	1	2	3	4	5	6	7	8	9	10
Asset Cost	-100										
Sale of Asset (net of CGT)											163
EBITDA		0	0	0	0	0	0	0	0	0	0
Interest Expense		-3	-3	-3	-3	-3	-3	-3	-3	-3	-2
Taxes		1	1	1	1	1	1	1	1	1	1
Net Cash Flow		-2	-2	-2	-2	-2	-2	-2	-2	-1	162
Debt Service – Principal	75	-2	-2	-2	-2	-2	-2	-2	-2	-2	-57
Cash Flow to Equity (CFE)	-25	-4	-4	-4	-4	-4	-4	-4	-4	-4	105

		% Cost
Present Value of CFE	-17	-17%
PV Capital Allowance	38	38%
PV of Project + CA	21	21%

Source: Indecon.

13.5 Deficiencies in Residential Properties

Indecon accepts that there remains a significant amount of sub-standard private rented accommodation. Local authority returns show a high proportion of dwellings inspected not meeting regulatory standards e.g. in Dublin City Council 4,354 inspections were reported in 2004 with 1,467 recorded as not meeting regulatory requirements. This represents around one in three – in fact the proportion is probably higher as the inspection figure is likely to include some repeat inspections of the same dwelling. Also of relevance is the fact that the Irish National Survey of Housing Quality published by DEHLG in association with ESRI in November 2003 indicated that 17% of all private rented households experienced problems with the general condition of the dwelling and 11% experienced problems with space. A similar picture emerges from a survey published by the independent housing organisation Threshold on rent supplement tenants in Cork which indicated that the accommodation of half the rent supplement recipients surveyed failed to comply with the minimum standard requirements and that 1,090 complaints received in 2004 (almost 20% of the total) related to accommodation standards.

There is also evidence that vulnerable individuals and families are living in unsatisfactory rented accommodation. Indecon believes that a range of programmes and measures are needed to address this but we do not believe this specific tax incentive measure is an appropriate policy response. A significant percentage of tenants in the private rented sector are in receipt of rent supplements and there is a need for the state to ensure adequate protection for both this group and for others renting private accommodation. It has, for example, been suggested in a recent newspaper article by Sr. Stanislaus Kennedy that "Government firstly needs to ensure that standards in the private rental sector are adequate by enforcing registration and undertaking regular inspections to ensure compliance with legal regulations". Indecon agree with this and with other appropriate measures.

13.6 Summary of Main Findings

In this section we reviewed the property-based tax incentive on certain types of rental accommodation. The details of the scheme's operation were presented. Indecon's survey of local authorities revealed that there is very little awareness regarding the availability of these incentives.

Indecon believes that there has been little or no investment under this scheme but also that there is no justification for this incentive. In a period of rapidly rising property prices, property owners are investing in refurbishment to ensure quality lettings and to capture escalating capital appreciation. We see no cause of market failure which would justify this incentive.

14 Conclusions and Recommendations

14.1 Introduction

In previous sections, we have examined the operation of each of the property-based tax incentives and assessed the effectiveness of the incentive in achieving policy aims. Having examined each of the incentives in detail and their economic costs and benefits, in this section we outline our recommendations for the future of the property-based tax incentive schemes.

14.2 General Recommendations on Property-based Tax Incentive Schemes

In Table 14.1 we present our general recommendations, applicable across all of the tax incentive schemes, which are discussed in subsequent paragraphs. The general recommendations are designed to improve the appraisal and monitoring of tax incentives and also to reduce Exchequer costs and improve equity for taxpayers. Recommendation 1 will apply only to those schemes which are recommended to continue or to any new schemes which may be introduced. Recommendation 2 does not relate to the specific schemes under review but concerns any new initiatives and is informed by our assessment of the existing schemes. Recommendation 3 is a general recommendation for new schemes but has applicability particularly in relation to investments in third level buildings and in park and ride facilities and this is reflected in our recommendation on the specific schemes. Recommendations 5-8 apply to existing and new schemes.

Table 14.1 General Recommendations on Property-based Tax Incentive Schemes

1.	All tax incentives schemes should require full disclosures of key information to the Exchequer by investors/promoters via a certification scheme or other mechanism to enable the full cost and impact of the schemes to be monitored.
2.	The decision to introduce any new tax incentives should be informed by a formal assessment of the likely costs and benefits.
3.	Where there is justification for government incentives the option of direct public expenditure as an alternative to tax incentives should be considered.
4.	Any tax incentive schemes which are introduced should have a defined lifespan of a maximum of 3 years and extensions should only be considered after evaluation of the results of a formal cost-benefit appraisal.
5.	Developers/investors in any tax incentive scheme should be responsible for securing independent certification that the conditions of the schemes have been met.
6.	Restrictions on capital allowances which focus exclusively on shelters on rental income rather than on personal income should be refocused.
7.	Consideration should be given to introducing a cap on total annual allowances which can be claimed by any individual.
8.	Differential allowances in any tax incentive scheme should be introduced depending on whether these allowances are being claimed at corporate or personal tax rates.

General Recommendation 1

All tax incentives schemes should require full disclosures of key information to the Exchequer by investors/promoters via a certification scheme or other mechanism to enable the full cost and impact of the schemes to be monitored.

A major problem from a public policy perspective which applies to many of the property schemes under review is an absence of information on the level of investment, the nature of investors and the costs of the schemes. With rigorous and innovative approaches Indecon has been able to overcome these significant information gaps for this study. Without this information it is not possible for policymakers to know the costs of the schemes or whether their continuation is valid or otherwise. This applies to all tax incentive schemes and it is in our view essential that policymakers have full and up to date information on an ongoing basis regarding such schemes.

We therefore recommend that all tax incentives schemes should require full disclosures of key information to the Exchequer by investors/promoters via a certification scheme or other mechanism to enable the full cost and impact of the schemes to be monitored. If this is done via a certification scheme as exists in relation to third level buildings it will be feasible to know in advance the likely annual tax costs. If, however, the tax return mechanisms is utilised a delay in obtaining information will arise. The purpose of this information is to inform policymakers in the Department of Finance and other parent departments. Details of whether a certification scheme or a tax return basis is used should be decided on a case by case basis.

General Recommendation 2

The decision to introduce any new tax incentives should be informed by a formal assessment of the likely costs and benefits.

There is a danger for policymakers that tax incentive schemes will be introduced without being informed of their likely costs and benefits. We therefore strongly recommend that a formal assessment of the likely costs and benefits should be undertaken for any new tax incentives schemes. We are aware of the uncertainty in measuring future costs and uptake of schemes but it is clear that policymakers have not always had the benefit of a detailed assessment of the likely costs and benefits of potential new tax incentives. Without this, it is not possible for the Government to make informed decisions in this important area. The approach used in this study and outlined in Section 1.2 may be a useful format for such assessments. Indecon, however, accepts that a formalised ex ante cost benefit appraisal will inevitably be faced with difficulties in predicting scheme uptake but this applies to all investment or taxation decisions and does not take away from the value of ex ante appraisals. Ex post analyses and reviews are also important and this is reflected in Recommendation 4.

General Recommendation 3

Where there is justification for government incentives the option of direct public expenditure as an alternative to tax incentives should be considered. Where a detailed analysis suggests that there is market failure and that there is a justification for government incentives we believe that in all cases the option for providing direct public expenditure as an alternative to a tax incentive should be considered. In a number of these schemes under review, such as third level educational buildings, we believe that the tax incentives are a very inappropriate way to find the much needed investment in this sector. In certain cases where there is no real sharing of risk tax incentives represent a very expensive form of public sector borrowing. We therefore recommend that where there is justification for government incentives the option of direct public expenditure as an alternative to tax incentives should be considered.

General Recommendation 4

Any tax incentive schemes which are introduced should have a defined lifespan of a maximum of 3 years and extensions should only be considered after evaluation of the results of a formal cost-benefit appraisal. Tax incentives frequently result in a much greater level of activity than was originally envisaged. In many cases incentives may be needed to address specific issues at a particular time but are unnecessary after a period. Many of the tax incentives reviewed in this report have had benefits, but their purpose has now been served. We therefore recommend that any tax incentive schemes which are introduced should be introduced on a pilot basis with a defined lifespan of a maximum of 3 years and extensions should only be considered after evaluation of the results of a formal cost-benefit appraisal. Indecon accepts that there is time needed to generate information and analyses on the impact of schemes and there is a danger in stop/start schemes. Significant investment with high levels of tax costs can, however, arise over a 3 year period and we therefore believe a review after 3 years is appropriate.

General Recommendation 5

Developers/investors in any tax incentive scheme should be responsible for securing independent certification that the conditions of the schemes have been met.

To qualify for a number of the property tax schemes requires compliance with a range of non-tax issues including planning and health issues. At present Revenue Commissioners officials in undertaking audits are required to make judgements on the compliance of these non tax issues. Indecon recommends that legislation on tax incentives should require developers/investors to secure independent certification that the conditions of the schemes have been met. At present a range of professionals such as architects are used to certify conditions of planning permission have been met and we envisage a similar approach in relation to areas such as floor certificates or other conditions of tax incentives. The Revenue Commissioners Powers of Audit would of course remain. In some cases this information could be provided by state agencies or by government departments where this information is collected and needed for other purposes (for example, hotel registrations).

General Recommendation 6

Restrictions on capital allowances which focus exclusively on shelters on rental income rather than on personal income should be refocused.

Under a number of the property tax incentives schemes the capital allowances are only available as a shelter on rental income rather than on personal incomes. We fully understand the origins of such restrictions which may have been designed to attempt to limit the Exchequer costs or the scope for sheltering income of the schemes. However, the evidence in this report indicates that there has been an extraordinarily high level of take up in many of the schemes and that restricting allowances to rental income has not dampened demand for the schemes. We do not believe that this change will fuel demand. The existing restriction has had three impacts. Firstly, it has largely focused the incentives on owners of multiple properties who have rental income and has contributed to the inequity of the schemes. Secondly, it has encouraged investor demand in non tax incentive properties to secure rental income which could be sheltered under the schemes thereby fuelling inflation in the property market. Finally, it has restricted the number of potential investors thereby increasing the effective price which the Exchequer has paid for the incentives. If the allowances were permitted against all income then some investors would, in our judgement, have been willing to make the investment with a lower level of capital allowances. This would reduce the net cost to the Exchequer. While this recommendation therefore stands on its own merit it also opens up the possibility of altering allowances and thereby reducing Exchequer costs. An example of one change in

allowance is discussed below in relation to differential allowances between corporate and personal investors. This will reduce the near monopoly on the use of the incentives by high income earners. This combined with Recommendation 7 will help address the equity issue. This change will not only facilitate middle or lower income individuals to invest but will when combined with the proposed cap on allowances fundamentally impact on the equity issue.

General Recommendation 7

Consideration should be given to introducing a cap on total annual allowances which can be claimed by any individual.

Our analysis has indicated that the property tax incentives have been utilised primarily by high income earners to reduce or eliminate their taxable income. To promote equity in the tax system we recommend consideration is given to introducing a cap on the total annual capital allowances which can be claimed by any individual in any one chargeable period. The level of the allowances needs to be set so as to ensure that any desirable schemes can be effectively operated while also addressing the important equity issue.

General Recommendation 8

Differential allowances in any tax incentive scheme should be introduced depending on whether these allowances are being claimed at corporate or personal tax rates.

The net cost to the Exchequer of property tax incentives varies significantly by whether the allowances are being claimed by companies or by private individuals. However, the net benefit of the incentives remains constant and in general there is no control over who claims the allowances. We recommend that differential allowances in any tax incentive scheme should be introduced depending on whether these allowances are being claimed at corporate or personal tax rates. For example, it may be appropriate to permit corporate investors to secure 100% capital allowances and for a lower level for private investors. Differential refers to different levels of relief being available (i.e. based on percentage of expenditure) to individuals and corporates at their marginal tax rates. The main rationale for this is to reduce Exchequer costs for any given impact.

14.3 Specific Recommendations for each Tax Incentive Scheme

Indecon has also made recommendations specific to each incentive scheme. Our specific recommendations are contained in Table 14.2. In many cases while the schemes have had a benefit our analysis suggests they have served their purpose and there is absolutely no case for future government incentives. Continuing to approve new projects would contribute to oversupply and represent a clear waste of scarce public resources.

In a number of cases on-going government support for the activity is needed (for example in case of third level buildings) but the tax incentives are an extremely high cost and wasteful mechanism to achieve the objectives. In a limited number of cases (private hospitals, nursing homes and childcare facilities) increased private sector investment is needed to address the economic and social needs in these sectors and would reduce demands on the public sector and have significant economic estimates.

For the incentives which we believe should not continue there is an important issue for the timing of projects which have already secured approval. We see little or no merit in requiring all of these projects to be completed in a very short timeframe. Such an approach would damage the construction sector and increase inflationary pressures. Permitting a much longer timeframe with an associated adjustment in allowable capital expenditure would reduce Exchequer costs and have other economic efficiency benefits.

Table 14.2 Specific Recommendations for each Property-based Tax Incentive Scheme

1.	There should be no further extension of capital allowances for hotels and holiday camps for projects which have not lodged a full and valid planning application before 31 December 2004.
2.	There should be no further extension of capital allowances for registered holiday cottages which have not lodged a full and valid planning application before 31 December 2004.
3.	The capital allowances scheme for sports injury clinics should be ended with immediate effect at the earliest feasible date.
4.	There should be no extension of the capital allowances for third level education buildings for projects which have not secured Ministerial certificate of approval by 31 December 2004.
5.	Additional public expenditure resources for third level education buildings should be provided.
6.	There should be no extension of the capital allowances for student accommodation for projects which had not lodged full planning applications by December 2004.
7.	The tax relief to lessors in respect of the expenditure incurred on the refurbishment of certain rented residential accommodation should be ended with immediate effect.
8.	There should be no further extension to the capital allowances for investment in multi-storey car parks for projects which had not incurred at least 15 per cent of costs by 30 September 2003.
9.	The capital allowance scheme for associated commercial or residential investments with park and ride facilities should be ended with immediate effect. We would support continuation of the incentive for specific investment in park and ride facilities.
10	Public expenditure to support park and ride facilities should be provided.
11.	Capital allowances for childcare facilities should continue subject to certain amendments.
12	Capital allowances for private hospitals should continue subject to certain amendments.
13.	Capital allowances for private nursing homes should continue subject to certain amendments.
14.	For projects under the hotel, holiday cottages, third level buildings, student accommodation and multi-storey car parks, which have already met the requirements for planning and/or Ministerial or other approvals a five year extension to the timescale for completion of the projects should be introduced but the level of all capital allowances claimed should be restricted to 50%.

Specific Recommendation 1

There should be no further extension of capital allowances for hotels and holiday camps for projects which have not lodged a full and valid planning application before 31 December 2004.

The hotel and holiday camp incentives have had a dramatic impact on the level of investment in the hotel sector and on the quality of the hotel stock. The quality and range of hotel accommodation in Ireland is now better than it has ever been with beneficial impacts for the sector and for Irish tourism. However, there is now a potential oversupply of hotel accommodation and we see no case of market failure which would justify any further extension of capital allowances for hotels and holiday camps. Indeed there is a significant pipeline of projects which have lodged planning before December 2004. We therefore recommend that there should be no further extension of capital allowances for hotels and holiday camps for projects which have not lodged a full and valid planning application before 31 December 2004. (All references to capital allowances relate to the property based tax incentives capital allowances which are the subject of this review and not to 4% capital allowances for hotels/holiday camps which were not examined in this study).

Specific Recommendation 2

There should be no further extension of capital allowances for registered holiday cottages which have not lodged a full and valid planning application before 31 December 2004.

Registered holiday cottages have had some beneficial impact on the supply of tourism but as they are less labour intensive and in general focused on lower spend tourist their economic impact may in many cases have been less than the hotel investments. The rapid increase in supply also means that there may be potential oversupply in many areas. We see no case of market failure which would justify any further extension of capital allowances for such holiday cottages.

Specific Recommendation 3

The capital allowances scheme for sports injury clinics should be ended with immediate effect.

There appears to be very little, if any, take up of capital allowances for sports injury clinics although there are a large number of sports injury clinics in operation. In our survey work there was a low level of awareness within the sector of these allowances. We do not see any strong externalities or other justification for this scheme. We therefore recommend that the capital allowances for sports injury claims should be ended with immediate effect. The precise date of termination is a matter for policymakers but we would support cessation at the earliest feasible date.

Specific Recommendation 4

There should be no extension of the capital allowances for third level education buildings for projects which have not secured Ministerial certificate of approval.

We believe that a quality third level educational infrastructure is of fundamental importance to Ireland's continuing economic success in the context of an increasing knowledge based international economy. We are therefore very supportive of continued expansion of investment in third level educational buildings but believe that the current tax incentives are a very costly and inefficient way of achieving this. Interestingly one university indicated to us that in their view "direct grant funding to universities is significantly more economical from the Exchequer point of view than the mechanism used in Section 843". We recommend that there should be no extension of the capital allowances for third level education buildings for projects which have not secured Ministerial certificate of approval.

Specific Recommendation 5

Additional public expenditure resources for third level education buildings should be provided.

In view of the economic merits of investment in appropriate third level educational infrastructure we would support the establishment of an additional public expenditure fund for third level education buildings. Such a fund could provide an effective financial subsidy to the third level sector in excess of the benefits of the existing schemes and could also be achieved at

much lower Exchequer costs. This fund could have the same conditions for third level institutions as the tax scheme namely require 50% private income etc. Third level institutions could use this fund to subsidise borrowing at a much lower cost to the Exchequer than leasing premises funded under the tax incentives.

Specific Recommendation 6

There should be no extension of the capital allowances for student accommodation for projects which had not lodged full planning applications by December 2004.

The objective of the scheme was to encourage the provision of additional rental accommodation to students and it was widely accepted that student accommodation generally was of a very low standard. The objectives of the schemes have been largely met and there has been an extensive expansion of student accommodation to a level where we would have concerns in some cases regarding utilisation rates. While students will have benefited from the significant improvement in accommodation funded under these schemes, students also have access to the improved overall stock of rented accommodation. We see no economic or social justification for further supports for this area and we recommend that there should be no extension of the capital allowances for student accommodation for projects which had not lodged full planning applications by December 2004.

Specific Recommendation 7

The tax relief to lessors in respect of the expenditure incurred on the refurbishment of certain rented residential accommodation should be ended with immediate effect.

There is no monitoring and very little awareness of the tax relief on refurbishment of certain rented residential accommodation and we believe there has been very little, if any, take up under this scheme. We, however, see no economic justification for this scheme and we recommend that the tax relief to lessors in respect of the expenditure incurred on the refurbishment of certain rented residential accommodation should be ended with immediate effect. Indecon accepts that there remains a significant amount of sub-standard private rented accommodation and that a range of programmes and measures are needed to assist vulnerable individuals and families to secure adequate accommodation. We do not, however, believe that this tax incentive is an appropriate mechanism to achieve this objective.

Specific Recommendation 8

There should be no further extension to the capital allowances for investment in multi-storey car parks for projects which had not incurred at least 15 per cent of costs by 30 September 2003.

Subsidisation of multi-storey car parks either reduces the net cost of parking in cities or simply provides additional profits for investors/owners of such facilities. We believe that provision of such car parks at below full economic costs can accelerate congestion where they are in city areas. There is no economic or transport policy case for subsidising such investment. We therefore recommend that there should be no further extension to the capital allowances for investment in multi-storey car parks for projects which had not incurred at least 15 per cent of costs by 30 September 2003.

Specific Recommendation 9

The capital allowance scheme for associated commercial or residential investments with park and ride facilities should be ended with immediate effect. We would support continuation of the incentive for specific investment in park and ride facilities.

Park and ride facilities which encourage commuters to use public transport and thereby reduce congestion in general have the opposite impact of city centre multi-storey car parks and can reduce congestion. This can have significant positive economic externalities and is in line with government transport policy objectives. Our assessment, however, is that park and ride facilities are by design in suburban areas where in general the cost of parking is low. The capital costs excluding site costs of park and ride facilities also tend to be low. Tax incentives for such facilities are usually not effective in encouraging supply. In cases where they are, we would support their continuation but believe that take-up is likely to be limited. If, however, the allowances are provided to associated developments it is very costly for the benefits achieved, and we recommend that allowances for associated commercial and residential elements should be ended.

Specific Recommendation 10

Public expenditure to support park and ride facilities should be provided.

We believe that funds saved from ceasing tax incentives to park and ride facilities should be used to provide increased public expenditure to support park and ride investments.

Specific Recommendation 11

Capital allowances for childcare facilities should continue subject to certain amendments.

There is a growing demand for childcare facilities and a need to support increased supply. Effective childcare provision has important economic and social externalities. We would therefore recommend the continuation of capital allowances for childcare facilities but subject to certain amendments. There are a number of specific amendments proposed for the childcare scheme as follows:

- An option should be provided to investors to claim all relief in year 1. However, this relief should be restricted to 50% for non owner occupier investors who claim relief at personal tax rates. (Owner occupiers are currently permitted to claim 100% relief in year 1 and this should continue thus not reducing the current incentives in the light of the need to expand supply.) Investors who wish to, as an alternative, claim relief at 100% over 7 years, as at present, should be allowed to do so but this should be reviewed on an on-going basis in the light of supply-demand position. Corporate investors who claim relief at 12.5% should be permitted to claim 100% relief in year 1. The impact of these changes would be to reduce net Exchequer costs in cases where investors wish to claim relief in year 1.
- For any new projects where relief is claimed at personal tax rates, a clawback period of 15 years should apply. In order to encourage corporate investment with the resultant lower tax relief, a 10 year clawback period should apply.
- Tax relief should not be provided on facilities which secure grants under the EOCP programme.

Specific Recommendation 12

Capital allowances for private hospitals should continue subject to certain amendments.

There is a need for on-going investment in private hospitals. This could free beds in public hospitals currently used by private patients, assisting to reduce demands on the public hospital sector and provide a valuable service for those in need of care. We therefore recommend continuation of capital allowances for private hospitals subject to certain amendments

There are a number of specific amendments proposed as follows:

- An option should be permitted to investors to claim all relief in year 1. However, this relief should be restricted to 50% for investors who claim relief at personal tax rates. Corporate investors who claim relief at 12.5% should be permitted to claim 100% relief in year 1. (Investors who wish, as an alternative, to claim 100% relief over 7 years, as at present, should be permitted to do so but this should be reviewed on an on-going basis in the light of supply-demand position.
- For any new projects where relief is claimed at personal tax rates, a clawback period of 15 years should apply. In order to encourage corporate investment with the resultant lower tax relief, a 10 year clawback period should apply.

Indecon would point out that the proposal to permit the claiming of 100% capital allowances in year one against corporate tax would only be feasible if the EU restriction on companies claiming under this scheme is lifted. We believe this issue should be re-visited by the Irish Government with the European Commission. We believe the impact of removing this restriction would be to reduce the level of state aid provided and we do not see any reason on competition criteria for the current restriction.

Specific Recommendation 13

Capital allowances for private nursing homes should continue subject to certain amendments.

There is a need for on-going investment in private nursing homes. This could assist in reducing demands on the public sector and provide a valuable service for those in need of nursing homes. We therefore recommend continuation of capital allowances for private nursing homes subject to certain amendments.

- An option should be permitted to investors to claim all relief in year 1. However, this relief should be restricted to 50% for investors who claim relief at personal tax rates. Corporate investors who claim relief at 12.5% should be permitted to claim 100% relief in year 1. (Investors who wish, as an alternative, to claim 100% relief over 7 years, as at present, should be permitted to do so but this should be reviewed on an on-going basis in the light of supply-demand position.
- For any new projects where relief is claimed at personal tax rates, a clawback period of 15 years should apply. In order to encourage corporate investment with the resultant lower tax relief, a 10 year clawback period should apply.

Specific Recommendation 14

For projects under the hotel, holiday cottages, third level buildings, student accommodation and multi-storey car parks, which have already met the requirements for planning and/or Ministerial or other approvals a five year extension to the timescale for completion of the projects should be introduced but the level of all capital allowances claimed should be restricted to 50%.

In our view there should be no further extensions whatsoever to any projects in hotel, holiday cottages, third level building, student accommodation and multi-storey car parks if they have not met all of the requirements for planning and other approvals.

In cases where approvals have been met the requirement to incur the investment in the period before July 2006 will result in significant pressures on the construction sector and give rise to rapid inflationary pressures in this key sector. While we are concerned with potential over-supply in some of these sectors the proposed extension relates to timing of approved projects and not to additional projects. While we accept that the extension could result in some projects proceeding over the five year period which would not otherwise proceed, we believe the primary impact will be on the timing of projects. In circumstances of potential oversupply phasing of projects over the five years will ease oversupply concerns. Incentivising all of the investment in this very short period will also damage the medium term prospects for the construction sector. We therefore support an extension of the timescale for completion of approved projects by five years. Developers would have the choice of remaining with the existing tax relief which would imply no allowance for qualifying expenditure after end July 2006 or opting for all expenditure to qualify for 5 year extension relief under the new terms. The level of capital allowances on such projects should be restricted to 50% where allowances are claimed at personal tax rates.

It is not suggested that the cessation of capital allowances on the specified schemes would cause a slowdown in the construction sector but it could accelerate any decline in the sector. Providing the proposed 5 year extension would remove this impact, would reduce inflationary pressures in the sector in the period to July 2006 and, if combined with other changes proposed, would reduce Exchequer costs.

Indecon accepts that EU state aid approval would be needed to extend this relief for the hotel sector but believe that as no new projects would be eligible and relief would be restricted to 50%, there is a strong case which could be made for this extension.

ANNEX 1

Annex 1 Case Studies: Conclusions on Financing Structures and Background Calculations

A1.1 Financing Structures[1]

The case studies presented in this report involved a calculation of the fiscal incentive that is necessary to encourage investment (the Incentive Ratio). This ratio was compared with the present value of the tax incentive, assuming that optimal utilization of the incentive was possible. The purpose of this section is to evaluate the barriers to optimal utilization and the rationale for financing structures.

The table that follows summarises the case studies. A number of general observations may be made from the case studies:

- In all cases, the Incentive Ratio is negative. Investors are unlikely to consider any of these investments in the absence of a tax incentive.
- The present value of the tax incentive, if it is optimally utilized, substantially exceeds the Incentive Ratio. Part of this excess is attributable to the decline in interest rates since the late 1990s. As interest rates decline, the Incentive Ratio declines while the present value of the tax incentive increases.
- There is no apparent relationship between the Incentive Ratio and the value of the tax incentive. There is no evidence of fine tuning the incentives for particular circumstances.
- There is substantial variation in the scale of these investments – Park and Ride facilities may exceed €100 million while a refurbishment may involve €50,000.
- The annual yield from each of these investments is, in many cases, too low to ensure optimal utilization of the tax incentives.

[1] Third Level Education Structures are not discussed in this section as they are a particular financial structure and do not involve permanent ownership of the assets by the investor.

Incentive	Incentive Ratio	PV (Tax Incentive)
Park and Ride	-25%	38%
Hospital	-13%	35%
Car Park	-21%	31%
Hotel	-4%	38%
Nursing Home	-6%	38%
Sports Clinic	-14%	38%
Childcare	-12%	41%
Holiday Cottage	-10%	36%
Student Accommodation	-9%	41%
Refurbishment	-17%	38%

The latter observation is the starting point for creating financial structures. Optimal utilization of the tax incentives requires:

- Ensuring that the capital allowances are transferred to entities that have sufficient tax liabilities to immediately utilize the incentives.
- Creating pass-through structures that ensure that these incentives are utilized by individuals that are subject to a 42% tax rate.

The economic significance of these two conditions is best understood by considering a simple example. A real estate investment has an EBITDA/Cost Ratio of 4.5%, an EBITDA growth rate of 3% and 75% debt finance. For an investment of this nature, it will take 25 years to recover the initial investment. Therefore, a 100% capital allowance will not be fully utilized until the twenty fifth year. The following table compares this scenario with optimal utilization of the tax shields.

Tax Shield Value as a % of Construction Cost –

25 year vs. Optimal Utilization

Tax Rate	25 Year	Optimal
12.5%	7%	11%
25%	15%	23%
42%	25%	38%

The previous table values tax incentives at the three tax rates[2] under two assumptions. First, the present value is computed assuming that the recovery of the capital allowance will take 25 years. Second, the present value is computed assuming that recovery takes place at a rate of 15% for the first 6 years and 10% in year 7 (Optimal). It should be evident from the table that the benefits of ensuring that capital allowances are passed to entities that are taxable at 42% and can utilize the investment immediately are substantial. Consider a €5 million investment. If capital allowances are used over 25 years and form part of the active income of a corporation, then the present value of the capital allowances is €0.37 million. Conversely, if the income is received by a 42% tax payer that can optimally utilize the incentive, the present value of the capital allowance will be €1.9 million.

Therefore partnerships and the separation of ownership from the operation of the assets (e.g. leases) are likely to be commonplace. These arrangements are a means of ensuring the optimal utilization of tax shields. Given that there are substantial contracting costs[3] associated with these financial arrangements, they are unlikely to be used for transactions of less than €1-5 million. Therefore, holiday homes and refurbishment are less likely to attract sophisticated financial structures. Rather, optimal utilization of these three schemes is restricted to individuals with unrelieved rental income. For larger schemes, the design of the incentives encourages the creation of sophisticated financial structures.

A1.2 Tax Shield Valuation

Using the Par-Yield Curve for the Euro on June 20, 2005, assume a $1 Million investment and tax shields in the amount of 15% for the first six years and 10% in the Seventh year. Further, assume a personal income tax rate of 42%, that construction is completed within 12 months and that all tax relief is used immediately.

[2] These rates reflect the Corporation Tax Rates for active (12.5%) and passive income (25%). For completeness, the personal tax rate is included.

[3] Contracting costs include legal and taxation advice. Sophisticated partnership and leasing arrangements are likely to exceed €100,000 per transaction.

Computation of Tax Shield

Year	0	1	2	3	4	5	6	7
Tax Shield %		15%	15%	15%	15%	15%	15%	10%
Deduction		63000	63000	63000	63000	63000	63000	42000
Interest Rate		1.99	2.13	2.33	2.52	2.7	2.86	3
Present Value		61771	60400	58794	57030	55143	53194	34150

The sum of the present values in the table is €380,481. For convenience, one can express this as a percentage of the original investment (38.05%). This approach may be applied to the various property based tax incentives to arrive at the tax shield as a percentage of the original investment (full computations available on request). This analysis is presented in the table below. The results in the table consist of two columns. First, the 'Cost' column consists of the tax shield as a percentage of the original allowable cost. Second, the 'Factor' column may be used to compute the cost based on different marginal tax rates. For example, if one assumes a marginal tax rate of 47%, the cost to the Exchequer of a capital allowance of 10% of 10 years is 40.28% (i.e. 47% * .857).

Tax Shields associated with Capital Allowance Schemes

Capital Allowance Scheme	Cost	Factor
15% years 1-6 and 10% year 7	38.05%	0.906
50% year 1 and 4% for 12.5 years	37.19%	0.886
10% for 10 years	35.97%	0.857
4% for 25 years	27.61%	0.657
5% for 10 years	17.99%	0.428

In general, Indecon believes that the form of financing structure should not be of any particular concern to policymakers, provided the targeted benefits of the incentives in terms of increased investment are realised. It can be assumed that structures will be introduced to maximise investor returns. However, an issue for policymakers is that differential levels of allowances should be permitted depending on whether personal or corporate tax is sheltered, and equity questions also need to be addressed.

A1.3 Cost of Capital Computation

The Weighted Average Cost of Capital (WACC) is computed as[4]:

$$WACC = \frac{E}{D+E}k_e + \frac{D}{D+E}k_d$$

This formula states that the cost of capital is a weighted average of the cost of equity and the cost of debt. The weights consist of the amount of equity and the amount of debt in the capital structure.

The following formulae are used to calculate the cost of equity and debt respectively:

$$k_e = r_f + \beta\,(riskprem)$$
$$k_d = (r_f + DefSpread)(1-t)$$

The cost of equity (k_e) is a function of the risk free rate (r_f), the risk (or Beta) of the asset (β) and a market risk premium. The cost of debt (k_d) depends upon the risk free interest rate, the tax rate and the default spread on the debt. For the purposes of this analysis, the following values are assumed.

- The debt to total assets ratio is 75%
- Risk free rate equal to the 10 year rate on the par yield curve for the Euro. A yield curve is used since the current 1 year interest rate of 2% is likely to be transitory and will overstate the present value of future cash flow streams. The 10 year rate on June 20, 2005 was 3.32%.
- The market risk premium is 4.5%. This consists of a mature market premium of 4% and an additional country risk premium of 0.5%.
- The default spread associated with real estate investments is assumed to be 100 basis points when the loan to value ratio is 75%.
- A tax rate of 42% is assumed.

[4] This is a generally accepted valuation procedure. For example, A. Damodaran, *Damodaran on Valuation*, New York: Wiley, 1994.

Beta is the final component of the weighted average cost of capital. Essentially, it is necessary to calculate Betas for residential, commercial, retail, tourist and healthcare properties. In addition, some adjustment is necessary to compensate investors for the relative illiquidity of property investments.

In the absence of suitable Irish data, median sector Betas were computed using *Value Line* estimates for 118 US Real Estate Investment Trusts (REITS). These vehicles are publicly listed entities and hence it is possible to compute meaningful Betas. The median unlevered Betas as of January 2005 are:

Sector	Beta
Commercial	0.65
Health	0.60
Hospitality	0.90
Residential	0.65
Retail	0.65

A Beta of 1 implies that a security has the same risk as an investment in a diversified equity portfolio. A Beta of less than 1 implies a lower level of risk. Real estate investments generally lag equity markets and have a Beta of less than one. Hospitality investments are more closely related to economic conditions more generally since occupancy rates and prices are reset on a daily basis.

To validate the applicability of this approach in an Irish setting, an unlevered Beta was computed for Jury Doyle Hotels. Using *Bloomberg* data on January 1, 2005, the unlevered Beta for Jury Doyle is 0.905. This would suggest that the Betas are meaningful in an Irish context.

Two adjustments are necessary to these Betas. First, Beta is adjusted for the effects of leverage using an assumed debt/equity ratio of 3. Second, an adjustment is necessary to reflect total risk rather than market risk as Irish real estate investments are not publicly traded. This adjustment is based upon the median correlation of the market model for each of these sectors. The resultant Weighted Average Cost of Capital is presented in the table that follows.

Weighted Average Cost of Capital

Sector	Beta - U	Beta - L	Corr.	Beta - P	k(equity)	WACC
Commercial	0.65	1.78	0.39	4.57	23.87	7.85
Health	0.60	1.64	0.36	4.57	23.87	7.85
Hospitality	0.90	2.47	0.45	5.48	27.98	8.87
Residential	0.65	1.78	0.36	4.95	25.58	8.27
Retail	0.65	1.78	0.31	5.75	29.17	9.17

The table consists of unlevered Beta (Beta-U) adjusted for 75% debt to total assets and a tax rate of 42% to arrive at a levered Beta (Beta-L). These Betas are then adjusted to reflect total risk since it is more appropriate for investments that are not publicly traded. This adjustment is achieved by dividing levered Beta (Beta-L) by the correlation coefficient with a broad based equity portfolio. The resultant privately held Beta (Beta-P) is significantly higher. Costs of equity capital (k-equity) are then computed using these Betas and range from 23.87% for commercial properties to 29.17% for retail properties. Finally, a weighted average cost of capital (WACC) is calculated and these range from 7.87% for commercial properties to 9.17% for retail properties.

For the parking industry, Central Parking Corporation (CPC) was the only publicly listed firm that represented a pure play. *Value Line* estimates a Beta of 1.05. Using the procedure described above, this results in a cost of equity for car parks of 49%.

A1.4 The Incentive Ratio

The Incentive Ratio is the Present Value of the Cash Flows to Equity divided by the Cost of a Project. Formally, the ratio is:

$$\sum_{t=1}^{n}\left\{\frac{y(1+g_y)^t(1-\tau_y)-k_d d\left[\frac{1-\tau_y(1-(1+k_d)^{-m+t-1})}{1-(1+k_d)^{-m}}\right]}{(1+k_e)^t}\right\}$$

$$+\frac{(1+g_a)^n-\tau_a((1+g_a)^n-(1+g_y)^n)-d\left[\frac{1-(1+k_d)^{-m+n}}{1-(1+k_d)^{-m}}\right]}{(1+k_e)^n}-(1-d)$$

Essentially the Ratio is driven by three components:

1. The operating cash flows less debt service arising from the project
2. The gain/loss arising from disposal of the asset
3. The extent to which the project is financed by debt

The following notation is used:

Investment Term (years)	n
Cost of Equity	k_e
Borrowing/Investment	d
Cost of Debt	k_d
Term of Loan (years)	m
Tax Rate	τ_y
Yield (EBITDA/Investment)	y
Asset Growth Rate	g_a
EBITDA Growth Rate	g_y
Capital Gains Tax (CGT)	τ_a

ANNEX 2

Annex 2 Additional Sectoral Case Studies

In the following pages, we present some additional sectoral case studies of projects that were eligible for the property-based tax incentive schemes. These are illustrative examples which supplement the detailed case studies presented in the main report.

CASE STUDY 1

Sector: Hotel

Scale of Project:

Over 200 bedrooms and suites, and a number of meeting rooms.

Financing Structure:

The owner builds the hotel to an agreed specification and grants the operator a long-term lease. A put and call option is in place to allow the tenant to acquire the property seven years after the opening of the hotel.

The levels of rent and buyback price will be determined by details of the specification. The transaction on this basis is dependent on the tenant providing suitable security for the annual rent and contributing to a sinking fund for the ultimate acquisition of the hotel.

Benefits of Project:

The city in question has been designated as one of the regional hubs as part of the National Spatial Strategy Plan. This development provides the area with a hotel, conference and leisure centre.

CASE STUDY 2

Sector: Holiday Cottage

Scale of Project: 18 detached cottages

Financing Structure:

A management company is set up to manage the development and ensure compliance with the tax conditions. All rents will be paid to this company. All rents will be paid to this management company, which will also be responsible for the payment of all expenses relating to the properties. A rent of €8,000 per annum is guaranteed to the management company for the first three years. The surplus arising (from the guaranteed rent after payment of expenses) will be paid out as an annual rent to cottage owners. After the initial three year period, there is a pooling of rent.

The management company is 100% owned by the cottage owners. Each individual who purchases a cottage joins this management company. These individuals then lease their cottages to the company. The lease is of 21 years duration, with a break clause after 10 years. The cottages must remain registered with Fáilte Ireland for 10 years to avoid a claw back of the capital allowances. After the 10 years, the owners are free to decide to continue letting the cottage, or they may retain them for private use, or sell them as private residences or holiday cottages.

Benefits of Project:

The cottages are registered with Fáilte Ireland for at least 10 years and must be occupied solely by tourists between the months of April and October. The new holiday cottages serve as a valuable addition to the tourist infrastructure in the region.

CASE STUDY 3

Sector: Student Accommodation

Scale of Project:

Over 50 two-bedroom apartments, three-bedroom townhouses and three-bedroom duplexes.

Financing Structure:

A professional management company is established. Tax relief is available to those purchasers who let the properties to students.

Benefits of Project:

These premises are available for student rental for at least 10 years at a lower cost than would be secured on the open market. The accommodation is also of a high quality standard.

Other Comments:

The development is located within walking distance of the collage campus.

Off-street car parking included (1 space per residence). In Indecon's view, there is a likelihood that the premises will be sold as private accommodation after the ten year period.

CASE STUDY 4

Sector: Third Level Education Buildings, Section 843

Scale of Project: Estimated investment of almost €12m

Financing Structure:

A sinking fund was established by the institution. Donor funding as well as Exchequer payments were placed in this fund. The funds were used to pay the rent to the developers of the educational facility

Benefits of Project:

The building provides additional research& development capabilities to the institution.

Other Comments:

The third level institution leased the site from the local authority for 150 years and has leased the site to developer for 50 years

ANNEX 3

Annex 3 Technical Assumptions and Modelling of Exchequer Costs and Economic Impact

General Schema for Modelling

Indecon has based its calculations for the economic impact and total Exchequer cost of each tax incentive on estimates of the capital expenditure under each scheme. The method used for estimating capital expenditure varies according to each scheme, due to availability of data sources for each one. Estimation methods for the various schemes are outlined in the second part of this annex.

The 'Gross Exchequer Cost' of each scheme is calculated by simply applying the investor profile and the applicable tax rates to the capital expenditure figures. The investor profile is based on Indecon survey responses and the applicable tax rates are the current corporation and PAYE tax rates. The 'Gross Exchequer Cost' is the sum of the annual costs over the lifetime of the scheme. As the initial investment is recuperated over a number of years for the majority of the schemes, the costs for years after 2005 are subject to a Net Present Value calculation, which discounts the actual value of the cost to reflect its current value. A discount rate of 5% has been used.

The 'Gross Economic Benefit' of each scheme is calculated by applying a multiplier to the total capital expenditure of each scheme. We have applied a multiplier of 1.255. The 'Gross Tax Contribution' of this activity is calculated by applying a tax contribution rate of 36% to the 'Gross Economic Benefit'. The 'Net Tax Contribution' is calculated by assuming an opportunity cost of 75%. This relates to the investment forgone in some other part of the economy as investors took advantage of the tax incentive scheme. We have also undertaken a sensitivity analysis of the impact of changing core underlying assumption.

The 'Net Exchequer Cost' of each tax scheme is calculated by deducting the 'Net Tax Contribution' arising from increased economic activity from the 'Gross Exchequer Cost' figure. This 'Net Exchequer Cost' figure is further adjusted for Deadweight, which accounts for projects which would have gone ahead in the absence of the tax incentive, to give the 'Net Tax Foregone' figure. The deadweight figure varies for the different scheme and is based on Indecon survey responses of professionals.

This model is outlined in Table 1 below.

Table 1: Calculation of 'Net Tax Contribution' and 'Net Tax Foregone'

Calculation of Net Tax Contribution
Total Capital Allowances
multiplier factor: 1.255
Gross Economic Benefit
tax contribution: 36%
Gross Tax Contribution
opportunity cost: 75%
Net Tax Contribution

Calculation of Net Tax Foregone
Total Capital Allowances
less: applicable tax rates
Gross Exchequer Cost
less: Net Tax Contribution
Net Exchequer Cost
less: Deadweight
Net Tax Foregone

Source: Indecon

Computation of Capital Allowances

The total capital allowances for each scheme are calculated differently, in function of the data available to Indecon. The following provides a brief description of the estimation of total eligible tax allowances under each scheme. We also provide details of how we calculated our projections of future investment under the tax incentive schemes as well as the overall costs and economic impact of the schemes.

Hotels and Holiday Camps

Indecon's estimate of capital expenditure under the tax incentive scheme from 2001-2005 is based on our analysis of Fáilte Ireland's data on certificates issued and on the results of our survey evidence. The Fáilte Ireland figures were analysed by the projects' year of completion, giving us complete capital expenditure data for the years 2003 and 2004. Taking the 2003 figure as being equal to the average capital expenditure for the previous three years, we calculate the total capital expenditure for the period to be €664,351,000. However, if we take the 2004 figure as representing the average expenditure in the previous three years, we arrive at a figure of €747,109,000. As there is some evidence to suggest that the capital expenditure in the years for which we do not have complete data was lower than in 2004, we adopt the lower of these figures and estimate total capital expenditure at €664,351,000. This gives an average annual spend of €132,870,000.

In order to calculate the future uptake of the tax incentive under this scheme we have estimated future planning permission approvals based on outstanding applications and historic approval rates. If we were to assume that 50% of these schemes will avail of the tax incentive, the total remaining investment under this scheme would total €1,302,404,000, based on average capital expenditure per hotel as per the Fáilte Ireland figures. If, however, only 25% of the projects were to proceed then the total expenditure would be half the figure stated above i.e. and estimated capital expenditure of the order of €651,202,000. For the purposes of our analysis we assume a mid-point of €858m although the figure could be in excess of this level.

Table 2 below outlines the calculation of the economic impact and foregone Exchequer revenues for this tax incentive scheme.

Table 2: Calculation of Exchequer Costs and Economic Impact for the Hotel and Holiday Camps Tax Incentive Scheme

	2001-2005		2006-2011
	€'000		€'000
Estimation of Annual Capital Allowances			
Total Expenditure	664,351		
Total Capital Allowances	**294,820**		**369,531**
Estimation of Gross Tax Cost			
Investor Profile			
PAYE (42%)		64.60%	
Corporate (12.5%)		35.40%	
Gross Exchequer Cost 2001-2005	93,036		
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)			102,726
Total Gross Exchequer Cost		**195,762**	
Estimation of Economic Benefits			
Total Capital Allowances	664,351		
Gross Economic Benefits (Multiplier = 1.255)	833,761		
Gross Tax Contribution (36.1%)	300,988		
Net Tax Contribution (adjusted for opportunity cost)		**75,247**	
Net Exchequer Cost		**120,515**	
Tax Contribution Adjusted for Deadweight (6%)		70,732	
Net Tax Foregone		**125,030**	

Source:: Indecon Analysis

Registered Holiday Cottages

Indecon has based it estimate of total capital expenditure under the registered holiday cottages scheme on responses to our survey and on our estimate of total number of schemes in operation. Based on average spend per development and the total number of registered schemes in the country, we estimate a total capital expenditure of €103,000,000 for the period 2001-2005. This gives an annual average expenditure of €20,600,000.

In order to calculate future uptake of the tax incentive under this scheme, we have estimated future planning permission approvals based on outstanding applications and historic approval rates. If we were to assume that 50% of these schemes will avail of the tax incentive, the total remaining investment under this scheme could total €28,870,000, based on average expenditure per scheme from our survey. However, in our survey we observe a somewhat higher potential uptake on the tax incentive scheme, so we estimate that future investment will be of the order of €38,494,000. If all of the projects which have lodged planning applications before the deadline were to secure the incentive, the future capital spend would be of the order of €58m.

Table 3 outlines the method used by Indecon to calculate the impact of the tax incentive on Exchequer revenues.

Table 3: Calculation of Exchequer Costs and Economic Impact for the Registered Holiday Cottage Tax Incentive Scheme

	2001-2005	2006-2011
	€'000	€'000
Estimation of Annual Capital Allowances		
Total Expenditure	103,000	
Total Capital Allowances	**30,900**	**72,100**
Estimation of Gross Tax Cost		
Investor Profile		
PAYE (42%)	80%	
Corporate (12.5%)	20%	
Gross Exchequer Cost 2001-2005	12,978	
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)		24,885
Total Gross Exchequer Cost	**37,863**	
Estimation of Economic Benefits		
Total Capital Allowances	103,000	
Gross Economic Benefits (Multiplier = 1.255)	129,265	
Gross Tax Contribution (36.1%)	46,664	
Net Tax Contribution (adjusted for opportunity cost)	**11,666**	
Net Exchequer Cost	**26,197**	
Tax Contribution Adjusted for Deadweight (5%)	11,082	
Net Tax Foregone	**26,780**	

Source:: Indecon Analysis

Private Hospitals

Initial uptake on the tax allowance scheme has been low, with one hospital completed and another under construction. For confidentiality reasons, specific figures are not provided in this report but in this report we estimate the total capital expenditure under this scheme to be of the order of €154,000,000.

Data on this sector suggests that there are currently 7 projects which will come on line in the coming years. The total capital expenditure of these projects is estimated to be of the order of €810,000,000. However, this figure must be adjusted to reflect the fact that the tax allowance scheme does not allow for site-acquisition costs. We therefore estimate future capital expenditure under this scheme to be of the order of €453,600,000.

Table 4 presents the calculations of Exchequer costs and economic impact for the private hospital scheme.

Table 4: Calculation of Exchequer Costs and Economic Impact for the Private Hospital Tax Incentive Scheme

	2001-2005	2006-2011
	€'000	€'000
Estimation of Annual Capital Allowances		
Total Expenditure	154,000	
Total Capital Allowances	**31,500**	**122,500**
Estimation of Gross Tax Cost		
Investor Profile		
PAYE (42%)	50.0%	
Corporate (12.5%)	50.0%	
Gross Exchequer Cost 2001-2005	8,584	
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)		28,648
Total Gross Exchequer Cost	**37,232**	
Estimation of Economic Benefits		
Total Capital Allowances	154,000	
Gross Economic Benefits (Multiplier = 1.255)	193,270	
Gross Tax Contribution (36.1%)	69,770	
Net Tax Contribution (adjusted for opportunity cost)	**17,443**	
Net Exchequer Cost	**19,789**	
Tax Contribution Adjusted for Deadweight (20%)	13,954	
Net Tax Foregone	**23,278**	

Source:: Indecon Analysis

Sport Injury Clinics

Indecon has not provided estimates of capital expenditure under this scheme as reliable information was not available.

Nursing Homes

Indecon's estimate of investment in the nursing home sector is based on data from the Irish Nursing Home Organisation on average numbers of registered homes, as well as Indecon research on average levels of investment in the sector[35]. This gives a figure on total capital expenditure over the period 2001-2005 of €171,091,000, or an annual average investment of €34,218,200.

As there is currently no time limit to the nursing home tax allowance scheme, it is difficult to estimate with certainty future investment under the scheme. Indecon have examined estimates on the level of planning applications. We estimate a possible scenario for total future investment of the order of €30,169,000 however this depends on whether the incentives continue whereby the level of investments could be significantly higher.

Table 5 presents Indecon's calculations for the economic impact and Exchequer costs of this scheme.

[35] From the Indecon confidential survey of private nursing homes

Table 5: Calculation of Exchequer Costs and Economic Impact for the Nursing Homes Tax Incentive Scheme

	2001-2005		2006-2011
	€'000		€'000
Estimation of Annual Capital Allowances			
Total Expenditure	171,091		
Total Capital Allowances	**76,991**		**94,100**
Estimation of Gross Tax Cost			
Investor Profile			
PAYE (42%)		74.1%	
Corporate (12.5%)		25.9%	
Gross Exchequer Cost 2001-2005	26,454		
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)			28,498
Total Gross Exchequer Cost		**54,952**	
Estimation of Economic Benefits			
Total Capital Allowances	171,091		
Gross Economic Benefits (Multiplier = 1.255)	214,719		
Gross Tax Contribution (36.1%)	77,513		
Net Tax Contribution (adjusted for opportunity cost)		**19,378**	
Net Exchequer Cost		**35,574**	
Tax Contribution Adjusted for Deadweight (15%)		16,472	
Net Tax Foregone		**38,480**	

Source:: Indecon Analysis

Third Level Buildings

Under the tax allowance scheme for third level educational buildings, all schemes must be certified by either the Higher Education Authority or the Department of Finance. As Indecon has had access to this data, we are able to provide exact levels of investment under this scheme. Capital expenditure to date has been €`347,984,000.

Based on information from the Department of Finance, we understand that there are 3 more schemes to be approved under this scheme with an estimated value of €79m.

Indecon's estimation for the Exchequer and overall economic impact for this scheme is presented in Table 6. There have been two elements of this scheme, PRTI and non-PRTI projects. Investors in PRTLI schemes have been obliged to claim tax back at the corporate rate and we have had access to the estimations of these figures, provided by the investors. The non-PRTLI estimations are based on Indecon's assumption of 100% private investment.

Table 6: Calculation of Exchequer Costs and Economic Impact for the Third Level Educational Buildings Tax Incentive Scheme

	2001-2005	2006-2011
	€'000	€'000
Estimation of Annual Capital Allowances		
Total Expenditure	347,984	
Total Capital Allowances (non-PRTLI)	**66,378**	**81,129**
Estimation of Gross Tax Cost		
Gross Exchequer Cost PRTLI Schemes		29,162
Gross Exchequer Cost non-PRTLI Schemes		57,913
Total Gross Exchequer Cost		**87,075**
Estimation of Economic Benefits		
Total Capital Allowances	347,984	
Gross Economic Benefits (Multiplier = 1.255)	436,720	
Gross Tax Contribution (36.1%)	157,656	
Net Tax Contribution (adjusted for opportunity cost)		**39,414**
Net Exchequer Cost		**47,661**
Tax Contribution Adjusted for Deadweight (15%)		33,502
Net Tax Foregone		**53,573**

Source:: Indecon Analysis

Student Accommodation

Indecon's estimate of capital expenditure under this scheme is based on certificates issued by the Department of Education. In order to calculate the total capital expenditure to date, Indecon applied average cost per apartment/house to all completed and approved schemes. Under this method, we calculate that total capital expenditure to date under this scheme is of the order of €510,474,000.

The Department of Education also lists schemes which have yet to be completed and Indecon has applied the cost-per-apartment measure to calculate the total remaining capital expenditure. This figure is of the order of €935,574,000. However, this assumes that all of the projects which have applied for the tax relief will proceed. To the extent that some do not proceed the level of capital spent will be reduced accordingly.

Indecon's calculation of the economic impact and Exchequer cost for this tax incentive scheme are outlined in Table 7. It should be noted that under this scheme all of the capital expenditure can be reclaimed in the year of certification, so there is no capital allowances after 2005.

Table 7: Calculation of Exchequer Costs and Economic Impact for the Student Accommodation Tax Incentive Scheme

	2001-2005
	€'000
Estimation of Annual Capital Allowances	
Total Expenditure	510,574
Total Capital Allowances	**510,574**
Estimation of Gross Tax Cost	
Investor Profile	
PAYE (42%)	100,0%
Corporate (12.5%)	0.0%
Total Gross Exchequer Cost	**214,399**
Estimation of Economic Benefits	
Total Capital Allowances	510,474
Gross Economic Benefits (Multiplier = 1.255)	640,644
Gross Tax Contribution (36.1%)	231,273
Net Tax Contribution (adjusted for opportunity cost)	**57,818**
Net Exchequer Cost	**156,581**
Tax Contribution Adjusted for Deadweight (5%)	54,927
Net Tax Foregone	**159,472**

Source:: Indecon Analysis

Childcare Facilities

Indecon has based its estimate of total capital expenditure under this scheme on data from our survey of private childcare facilities as well as census data on the total number of childcare places in the economy. Using this method, we have estimated a total capital expenditure over the period 2001-2005 of €30,710,000.

Given that there is currently no time limit on approvals under this scheme, it is difficult to estimate future investment accurately. Indecon has therefore estimated likely investment based on current planning applications for childcare facilities. Indecon has estimated illustrative investment levels for existing planning applications of between €12,597,000 and €21,211,000, while there is significant uncertainty regarding future investment levels.

Indecon's calculations of the economic and Exchequer impact of this tax incentive are outlined in Table 8.

Table 8: Calculation of Exchequer Costs and Economic Impact for the Childcare Facilities Tax Incentive Scheme

	2001-2005	2006-2011
	€'000	€'000
Estimation of Annual Capital Allowances		
Total Expenditure	30,710	
Total Capital Allowances	**13,820**	**16,890**
Estimation of Gross Tax Cost		
Investor Profile		
PAYE (42%)	59.3%	
Corporate (12.5%)	40.7%	
Gross Exchequer Cost 2001-2005	4,145	
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)		4,465
Total Gross Exchequer Cost	**8,610**	
Estimation of Economic Benefits		
Total Capital Allowances	30,710	
Gross Economic Benefits (Multiplier = 1.255)	38,541	
Gross Tax Contribution (36.1%)	13,913	
Net Tax Contribution (adjusted for opportunity cost)	**3,478**	
Net Exchequer Cost	**5,132**	
Tax Contribution Adjusted for Deadweight (15%)	2,957	
Net Tax Foregone	**5,653**	

Source:: Indecon Analysis

Park & Ride Facilities

Available evidence on capital expenditure under the tax incentive scheme for park and ride facilities shows that there has been a limited uptake of the scheme and correspondingly limited private investment. Based on survey responses from county councils, Indecon estimates that eligible expenditure under the tax incentive scheme totals around €15,900,000.

Based on existing planning approvals and Indecon survey responses on average construction costs for park and ride facilities and eligible related investments, we estimate that future investment under this scheme could be in the region of €25,000,000, though it must be noted that this figure probably represents a maximum potential investment and we would not be surprised if no investment occurred unless subsidised by tax relief on associated investment.

Indecon's calculations of economic and Exchequer impact are presented in Table 9.

Table 9: Calculation of Exchequer Costs and Economic Impact for the Park & Ride Tax Incentive Scheme

	2001-2005	2006-2011
	€'000	€'000
Estimation of Annual Capital Allowances		
Total Expenditure	15,900	
Total Expenditure used for calculation of Gross Cost	15,000	
Total Capital Allowances	**9,300**	**5,700**
Estimation of Gross Tax Cost		
Investor Profile		
PAYE (42%)	0.0%	
Corporate (12.5%)	100.0%	
Gross Exchequer Cost 2001-2005	3,906	
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)		1,869
Total Gross Exchequer Cost	**5,775**	
Estimation of Economic Benefits		
Total Capital Allowances	15,900	
Gross Economic Benefits (Multiplier = 1.255)	19,955	
Gross Tax Contribution (36.1%)	7,204	
Net Tax Contribution (adjusted for opportunity cost)	**1,801**	
Net Exchequer Cost	**3,974**	
Tax Contribution Adjusted for Deadweight	-	
Net Tax Foregone	**3,974**	

Source:: Indecon Analysis

Multi-Storey Car Parks

Figures on investment in multi-storey car parks come directly from the county councils, who have to certify each scheme. These figures show that the cumulative investment in these facilities, as well as related investment eligible for the allowances, totalled €61,045,000 for the period 2000-2004.

Under the extension of the scheme approved under the Finance Act 2004, a development must have had incurred at least 15% of its total costs before 30/09/2003. In order to calculate the remaining capital expenditure under this scheme, Indecon has examined the planning approvals up until 2003 and determined how many have not yet gone ahead. This gives us a forecast of €12,792,000.

Indecon's calculations of economic and Exchequer impact are presented in Table 10.

Table 10: Calculation of Exchequer Costs and Economic Impact for the Multi-storey Car Park Tax Incentive Scheme

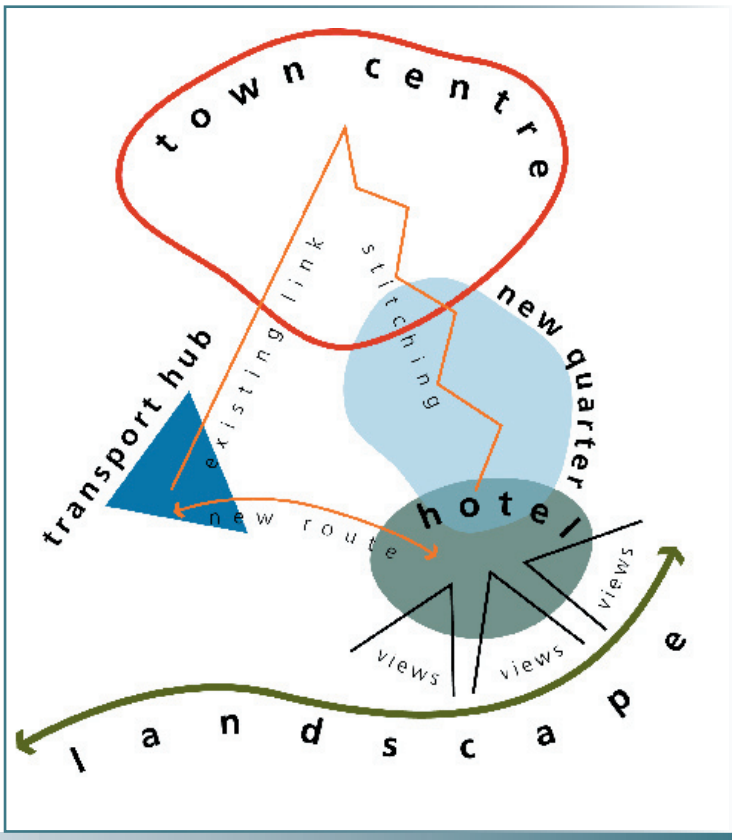
	2001-2005		2006-2011
	€'000		€'000
Estimation of Annual Capital Allowances			
Total Expenditure	61,045		
Total Capital Allowances	**34,320**		**26,725**
Estimation of Gross Tax Cost			
Investor Profile			
PAYE (42%)		100.0%	
Corporate (12.5%)		0.0%	
Gross Exchequer Cost 2001-2005	14,415		
Gross Exchequer Cost 2006-2011 (subject to NPV calculation)			8,464
Total Gross Exchequer Cost		**22,878**	
Estimation of Economic Benefits			
Total Capital Allowances	61,045		
Gross Economic Benefits (Multiplier = 1.255)	76,612		
Gross Tax Contribution (36.1%)	27,657		
Net Tax Contribution (adjusted for opportunity cost)		**6,914**	
Net Exchequer Cost		**15,964**	
Tax Contribution Adjusted for Deadweight (20%)		5,531	
Net Tax Foregone		**17,347**	

Source:: Indecon Analysis

ANNEX 4

Annex 4 Case Study of Physical Design Issues

Hotel Case Study, Murray Ó Laoire Architects



Review of Property Based Tax Incentive Schemes

Capital Allowances for Hotels and Holiday Camps
Hotel Case Study

murrayōlaoire architects

Draft Report 21 July 2005

Review of Property-based Tax Incentive Schemes.

Capital Allowances for Hotels and Holiday Camps - Hotel Case Study

Introduction

This report is a case study based analysis of hotel development under the Government Capital Allowance Scheme (Finance Act 1997). It forms part of an independent review of property-based tax incentives by Indecon Economic Consultants for the Department of Finance.

Significant large-scale investment in hotels has resulted in a quantum of new and refurbished hotels opening across the country that have benefited directly from the Capital Allowance Scheme. This case study will evaluate the contribution made to the public realm by a selected hotel development under the Capital Allowance Scheme. The design-based evaluation is preceded by an examination of the planning context and procedure. The aim is to understand and elaborate on the tangible benefits brought to the public by facilitating development of this type.

Assignment Approach

The approach undertaken in this study is qualitative, combining an analysis of statutory legislation and guidelines with specific on-site assessment. An urban design audit is used to observe and appraise an unnamed case study site. The audit sets out a number of design considerations that relate directly to the interaction of public and private realms. The audit is generic which means it can be applied to any other development of this type. The audit process allows for a discourse on the tangible benefits that a hotel scheme can bring, highlighting the key issues that should be addressed.

In reviewing potential case study examples for this report hotels are divided into the following categories: small (10 -30 bedrooms), medium (30 – 100 bedrooms) and (large 100 – 200+). The hotel that has been selected for this case study falls into the large category. It is a typical model of this building typology and was chosen by virtue of its urban context and its significant landscape setting. In our opinion it is representative of many similar hotels built under the Capital Allowance Scheme.

Planning Framework

The Planning and Development Act 2000 consolidated all previous Planning Acts and set the framework for strategic planning policy at each level of government. The national planning structure consists of a hierarchy of planning policy documents from the broad scale of the National Spatial Strategy and Regional Planning Guidelines, to the localised context of Development Plans, Integrated Area Plans and Local Area Plans.

The implementation of planning policy is the responsibility of local government. In order to receive planning permission for any type of development or redevelopment afforded under the Capital Allowance Scheme a design proposal must adhere to the stated objectives and requirements set out in the Development Plan for that area. The Development Plan maps out the zoning classification for land that falls within the administrative boundary of a City or County Council. It is a statutory binding document and is renewed every six years.

Typically, Development Plans allow for hotel development on a wide range of zoning classifications, which is set out in the form of a zoning matrix. The applicability of hotel development to a wide range of zoning classifications is understandable, as hotels are a very versatile land use type that can provide local employment, promote tourism, and facilitate urban regeneration.

Department of Finance

Under the Tax Consolidation Act 1997, the Department of Finance introduced a seven year Capital Allowance Scheme for investment in hotels. Under the scheme allowances of 15% are available in the first 6 years and 10% in the seventh year up until 31 December 2004.

The Finance Act 2004 (Section 25) provides for an extension of the transitional arrangements for the existing Capital Allowance Scheme from 31 December 2004 to 31 July 2006, provided a full and valid planning application is received by the planning authority on or before 31 December 2004. The extension to the 2006 deadline also applies where the work involved is exempted development for the purposes of the Planning and Development Act 2000, provided the following conditions are met by 31 December 2004: a detailed plan in relation to the development work is prepared, a binding contract in writing exists under which expenditure is incurred, and work to the value of 5% of the development costs have been incurred.

Failte Ireland (formerly Bord Failte)

Failte Ireland set out the regulations for hotel certification in accordance with the powers conferred on it by the Tourist Traffic Acts 1939 to 2003, and under the Hotel and Renewal of Registration Regulations 2003, The regulations include the minimum design standards and specifications for such criteria as internal layout, room sizes, facilities and available services. Following on from the Finance Act 2005 hotel developers must first receive certification from Failte Ireland in order to qualify for Capital Allowances.

Case Study

The Study Team undertook both desktop and field studies as part of the compilation of base material for the urban design audit. The research was carried out within the localised context of the case study and included the following task items:

Desktop Study
Planning Context Review
Environmental Context Appraisal

Field Study
Photographic Survey
Landscape and Visual Study
Human Patterns: social infrastructure, desire lines, magnet/destinations, amenity/tourism attractors

Urban Design Audit

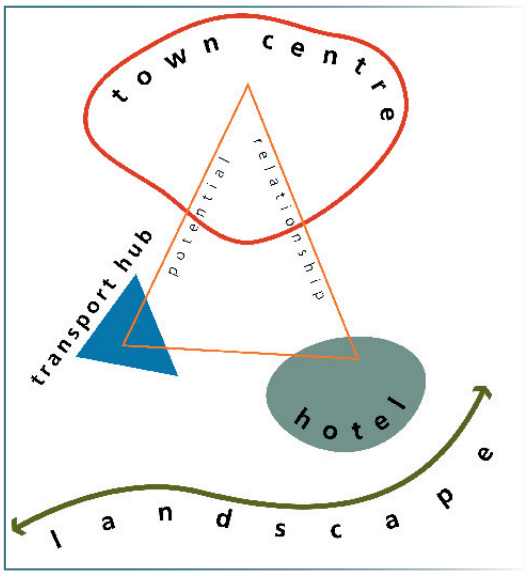
The urban design audit adheres to the following structure: a description of the site location and hotel, and a review of the contextual response, the interface with the public realm and the urban linkages it creates. The response of the hotel design to what are considered key urban design considerations forms the basis of the summary of findings.

Location

The hotel overlooks a significant landscape asset, which forms part of larger picturesque setting that has national prominence. It is located within walking distance of an urban centre and forms a gateway to one of main approach roads to the town centre. The hotel is located adjacent to a multi-modal transport hub.

Description of building

The hotel complex is between four and six storeys in height and includes multi-story basement car parking provision. Entry to the hotel is off the main thoroughfare and the space is enclosed by adjacent buildings which include a leisure facility and mixed use accommodation currently under construction.



Existing Context

Contextual response

The hotel complex has acted as a catalyst and provided the platform for significant new development schemes. In this sense the hotel has acted as a magnet, allowing other activities to cluster in the locality. The culmination of this volume of development has contributed to the creation of a new high-end retail and apartment quarter which has been stitched into the urban fabric of the town centre. The development has therefore brought forward a new urban context to what was previously a greenfield site with a single dwelling, adjacent to a low grade surface car park. The surrounding area is now characterised by a mix of architectural styles and consists of residential and mixed use multistory buildings.

Interface with public realm

The design of the external perimeter of a building has significant impact on the public realm: that is the streets, public squares, parks, playgrounds etc. The significance of the ground floor use as a means of providing animation to the public realm is one of the basic principles of good design. The hotel building in itself provides a good, strong edge to the landscape asset it fronts onto. A series of terraces bring the landscape into the building. However, the terraces are set back from the building line, creating a divide between the lively hotel congregation spaces and the public street outside. The main entrance is also located away from the public thoroughfare with limited visual presence and access for the passerby.

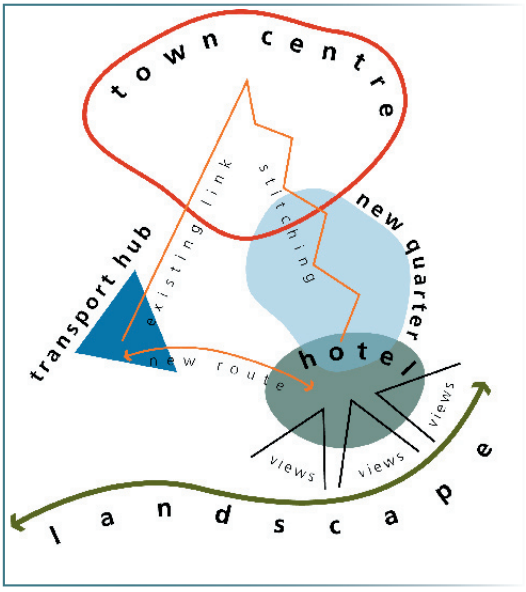
Movement Network

Significantly this development provided the basis for the opening up of a new road and consequent series of potential connections to the transport hub and the town centre. There are three entry and exit points allowing for efficient vehicular circulation around the building, reducing the risk of congestion on the main road. There are spaces for both hotel patrons and pay parking for the general public, all accommodated in basement carparking. The single service access point for deliveries, which fronts onto the landscape asset is quite conspicuous and does not relate positively to its setting.

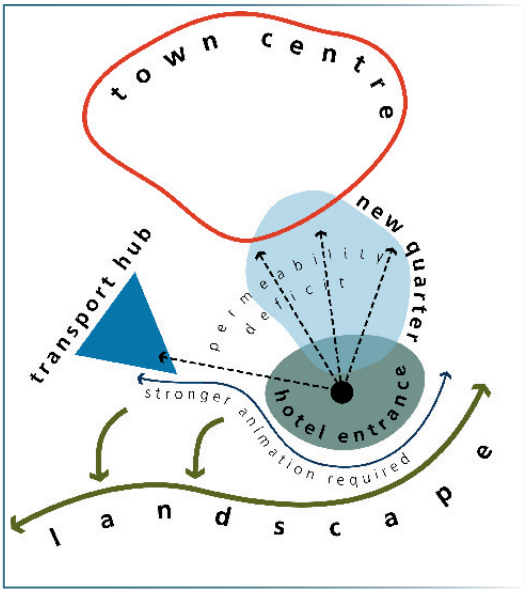
Case Study findings

In this case study it is felt that the design of this hotel has contributed positively to the public realm, principally in the macro urban context scale. The siting of the hotel shows a clear understanding of the synergy between its proximity to the adjacent transport hub and town centre, in particular contributing an overlapping public car park supply that has contributed to the existing social infrastructure. The siting of the hotel has also acted as a catalyst to appropriate town centre development opportunities and importantly opened up connection routes back to the transport hub and alternative modes of transport.

The building is less successful on a micro level. While the design of the hotel did respond to the significant landscape asset in terms of taking advantage afforded by the views at the upper levels, more interaction at street level would have contributed to the public thoroughfare and promoted a much needed animated frontage to the new streets created by the development. An opportunity for a new sense of place and integration into the existing context was not fully grasped in the context of the external perimeter of the building at ground floor level. Finally, while the main entrance to the hotel fulfills a number of criteria with regards to sense of arrival, adequate space for pedestrian and vehicular movements, it could have done more to interface with the street and to provide linkages back to the desire lines of the adjacent transport hub and town centre.



Macro Response



Micro Response

Summary of Findings

This report has assessed the contribution made to the public realm by a hotel complex which was financed with the aid of the Capital Allowance Scheme by the use of an urban design audit. The audit has shown that such a template of urban design considerations could apply across a diverse range of hotel developments and indeed building types. An audit of this kind serves to demonstrate that the development of a hotel goes beyond one single isolated development and is in real terms a legacy to our social infrastructure, public realm and environmental assets.

The audit clearly shows that location and response to contextual factors is very important for the ultimate successful integration into the public realm. A characteristic of this particular Capital Allowance Scheme is that location parameters are not part of the eligibility criteria governing this scheme. In the case of Capital Allowances for Section 50 Student Accommodation, a series of design guidelines are set out, one of which states that the scheme must be located within an 8 Km radius of the main student campus. Planning authorities must have regard to these design guidelines in assessing applications for planning permission.

The Development Plan with its land use zoning framework and in particular the detailed zoning matrix provided under each land use category is the method by which location parameters can be assessed. The Development Plan review and the Strategic Environment Assessment process is an important mechanism to monitor and review the immediate effects generated by an upsurge in development in one particular category as it allows for the control of specific land use types. Furthermore, as a new Development Plan is issued every six years, strategic policy issues can be formulated and implemented in time to respond to perceived development pressures.

In conclusion, the recently defined statutory link between eligibility for Capital Allowances and Failte Ireland certification process is positive. It provides a valuable quality control mechanism for new hotel developments and is also regulated by an ongoing review process which maintains standards set out under certification.

References

The Irish Hotels Federation and Kieran Ryan & Co. Chartered Accountants & Registered Auditors (2003): *The Case for the Retention of Hotel Capital Allowances* (Submission to the Department of Finance)

The Irish Hotels Federation and Horwath Bastow Charleton (2003): *Benefits of Capital Allowances to the Irish Economy* (Post Budget Submission to the Department of Finance)

Statutory documents and legislation:

Registration and Renewal of Registration Regulations for Hotels 2003

Tax Consolidation Act 1997

Planning & Development Act 2000

Finance Act 2004

Finance Act 2005

Information on government legislation and statutory documents can be found on:

www.environ.ie
www.failteireland.ie
www.finance.gov.ie