CBI
THE VOICE OF BUSINESS
MINERALS

13 March 2007

Mr Mark Fine,
H.M. Treasury,
1 Horse Guards Road,
London,
SW1A 2HQ.

Dear Mark,

Planning Gain Supplement (PGS) and Minerals

I write on behalf of the CBI Minerals Group further to our recent meeting with yourself and Lester Hicks from DCLG.

Our delegation were somewhat disappointed that we left the meeting without a clear idea of what specific issues the industry needs to address in more detail to ensure that the current review of the applicability of PGS will lead to a complete exemption for minerals from this measure.

You asked for any arguments or evidence that we could assemble to reinforce previous submissions we had made and where possible to identify where there are material differences between housing, other forms of development and the minerals industry.

We set out below those issues which we consider collectively justify recognition that not only are minerals developments materially different to housing development but which are sufficiently different to virtually all other forms of development that they can be described as 'unique', a descriptor used by Miles Gibson in his address to the All Parliamentary Minerals Group on 16 January.

In the absence of any specific agenda underpinning our discussions to date I hope that what I set out below can form a more structured framework for future dialogue and the submission of further evidence where required.

Point of origin

We reiterate our view that the original Barker suggestion of the proposed PGS was focussed on housing and took no account of other forms of development. Subsequently the scope was widened but no apparent consideration was given either to the applicability to minerals or the impacts of including minerals and if it was no evidence of the potential impact on the sector has been made available.

Consequently the onus has fallen upon the industry to evidence the potential negative consequences of PGS against a backdrop where the dynamics of the industry have not been evaluated by the Treasury nor are they apparently clearly understood.

Fundamental differences

- Unlike virtually all other forms of development **minerals can only be extracted where they lie.** Current active mineral operations occupy less than 1% of the surface area of the UK and this is unlikely to change for the foreseeable future.

- Minerals can often lie in areas attractive to other forms of development which are more lucrative and less controversial to landowners. Convincing landowners that mineral

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development should be the preferred development option is never easy particularly on sites in urban areas or capable of serving urban areas.

- Mineral development produces materials for use by others as opposed to an amenity as is the case with built development which depends upon the materials produced by the minerals industry.

- Mineral developments generate far lower land values than housing developments and any reduction in the potential return available to landowners from minerals will make it less likely that they will release land for mineral development.

- Mineral developers subjected to PGS will find it difficult to pass on the additional tax burden to customers in markets where its competitors do not carry PGS. Housing developers are more likely able to be able to pass on the additional PGS costs to customers as timescales are shorter, developments do not compete on a day to basis in the same way as mineral developments and margins are far higher.

- Mineral development is long term, typically 10 to 25 years, often more.

- Mineral developments normally operate on a leasehold basis.

- Mineral development captures value continuously as each tonne is removed.

- Mineral development is a temporary use of land notwithstanding its typically long term nature. The land is borrowed and returned to beneficial after use typically agriculture, recreation or for biodiversity or conservation purposes.

- Mineral development is a blend of surface and subsurface operations with no final development as such.

- Surface rights and mineral rights are often in separate and fragmented ownership involving more than one interested party.

- Mineral development can create a final negative land value.

- Section 106 agreements properly applied work effectively for mineral developments.

- Unlike built development mineral developments do not create additional demand in the locality for additional infrastructure such as schools, hospitals and roads they respond to and supply this demand.

Quantum and value of minerals

Around 324 million tonnes of minerals are extracted from UK land each year and this is likely to continue for at least the next 10 to 20 years and probably beyond. Minerals extracted from land represent the largest primary material flow in the economy and make a direct contribution of around £3.5Bn. They underpin and enable the construction and housing industry to function and are critical to many other of our manufacturing and energy industries.

Operating environment

Whilst mineral development operates within the same planning system as housing and other forms of development it is regarded by Government as a contested form of development albeit crucial to national infrastructure. Opposition to mineral development is nearly always hostile and lead times from exploration to production are typically 5 to 15 years with 10 years becoming typical for major developments.

Replenishment rates are worsening in many mineral sectors. In aggregates for example, which represent about 77% of total mineral consumption, replenishment rates have been below 50% on average since 1999 and with so few applications in the pipeline this trend looks likely to continue. Whilst generally speaking most applications are ultimately approved the time taken to consider

applications is increasing as is the time needed prior to submission in order to minimise the risk of refusal.

Cumulative taxation

Most mineral developments require restoration as an inherent part of the process consequently waste management is also of paramount importance to the minerals sector. The quarrying industry is arguably unique in so far as it is not only subjected to normal corporate taxation it is also affected by the landfill tax and the aggregates industry by the aggregates levy.
In addition our cement producers and other large operations are affected by the climate change levy and the EU Emissions Trading Scheme. None of these apply to housing or most other forms of development.

Geological uncertainty and valuation

Unlike housing and other forms of development which are largely spatial in nature and capable of accurate and certain assessment mineral development is anything but. All mineral development is dependant upon some form of geological evaluation normally based upon field exploration by means of geophysics, excavator or boreholes. Very often all 3 techniques will be employed depending on the merits and suitability for each site.

Although the ultimate financial valuation will apply risk factors for geological uncertainty, amongst other issues, it is not uncommon for the quality or quantity of commercially workable reserves to be materially less than that estimated at the outset. Depending upon the nature of the mineral deposit this could be due to faulting, wash outs, old underground workings or shallow extraction or just down to inadequate exploration coupled with complex geology.

Quality variations are extremely important for industrial minerals such as coal, silica sand, ball clay and cement. Geochemical variations aside market changes may render previously commercially viable material valueless. One of our cement producers has already had to significantly downgrade their reserve estimates as emission targets change the specification of the materials that can be extracted for processing.

Permitting and planning risk

Unlike housing minerals are typically long term developments and as such they can be affected by changes in regulation and legislation or changes in other ways which can impact on the tonnage of mineral that can be extracted.

One example is the Water Act which is currently in the process of being converted into regulations which will materially alter the existing operating environment by removing the existing exemptions quarries enjoy with regard to dewatering. The exemption system will be replaced by a licensing system which will require new licences to be secured or extended every 6 years with no guarantee that these will be granted beyond 12 years.

For sites with permitted reserves in excess of 12 years, which is commonly the case, this introduces a new and potentially material risk to the value of the asset particularly where existing permissions have 20 to 30 years life remaining.

Many mineral developments are granted subject to on going archaeological evaluation. This work is often phased throughout the life of a site and finds can be discovered which require preservation in situ with consequent sterilisation of reserves previously thought workable.

A proposed investment by one of our major cement companies was suspended due to the uncertainty over future CO2 strategy in the UK. To minimise the economic impact the company is now constructing a new grinding and blending facility for blended cements elsewhere.

These are just three non geological examples which demonstrate that however prudently a site is valued it is entirely feasible that PGS paid up front on an estimated recoverable tonnage of mineral may be an overestimate or how a current use can be curtailed due to planning, policy or taxation uncertainties.

As currently proposed no appeal mechanism or ability to secure a rebate based upon the actual tonnage recovered is proposed. Given the cumulative uncertainties posed by the combination of both geological and non geological factors it is hard to envisage how such a scheme could be designed.

Market factors

Unlike housing minerals have competitive alternatives. For our internationally traded commodities such as coal, cement, silica sand and industrial clays importation is an option for customers and each additional regulatory or cost burden such as PGS impacts on the competitiveness of indigenous materials whether used domestically or abroad.

Our coal industry is already suffering from increased importation and a further tax on indigenous extraction will only hinder their ability to compete in their international marketplace.

The UK china clay industry has already seen major cutbacks in production as overseas sources gain improved competitiveness relative to indigenous extraction in the South West.

For aggregates, recycled and secondary materials already feature in the supply chain and in local markets these will see advantage as primary materials incur further costs through PGS.

Current operations in areas capable of import penetration will be particularly at risk as their competitiveness is reduced by additional costs which encourage overseas sources to increase delivery distances from ports and wharves.

With many of our cement and industrial mineral businesses now owned by international companies some have the option to switch off UK production in favour of imports as the regulatory and resultant cost burden increases.

Commercial issues

A number of global and local pressures bear down upon mineral operations today. For the multinational organisation performance is measured and compared in pence per tonne by product in and between its geographical market areas. The continual increase in operating costs driven by regulation and legislation registers and influences investment decisions. Over time all new planning permissions will be subject to PGS and as this feeds through site by site it will have a measurable impact.

Locally, whether an operation is owned by a multinational or SME, the next permission is always crucial although for SMEs it can be potentially fatal. Securing planning permission is in itself a costly, uncertain and demanding process but for operators to then have to maintain a hard earned market position with the additional financial burden imposed by PGS against competitors who may be PGS free for many years to come may in itself prove terminal.

PGS will undoubtedly herald in the prospect of ‘local unlevel playing fields’ distorting existing markets unfairly for those who just happen to need to seek planning first with potential impacts in the national and international marketplace for coal, cement and certain industrial minerals.

Landowners are already alert to the potential influence of PGS and are unsurprisingly unwilling to pick up the bill just at a time when mineral developers are also under pressure to improve returns on investment. This is likely to create potential drag on the time required to complete land transactions hindering potential future supply.

Section 106 agreements and the capture of value

As indicated at our last meeting we believe that properly applied the current Section 106 (and Section 75 agreements in Scotland) arrangements work acceptably and effectively for mineral development. We attach material evidence which demonstrates that PGS would effectively hit the industry with an additional burden as we would still require Section 106 agreements to cater for those issues directly related to our developments such as screening, tree planting, access, restoration and the wide variety of matters encompassed in the schedule provided. (Annex 1)

We are happy to table more examples from all our sectors if required but we hope that what you have seen is sufficient to make this point.

Financial considerations

As indicated previously even with comparatively low value aggregates and PGS levied at say 20% of the planning uplift impacts of between £0.05 and £0.50p per tonne are estimated to be likely for most mineral production excluding the cost of up front financing.

For many operations the added up front cash penalty imposed by PGS will impact materially upon investment decisions.

If we took a PGS equivalent figure of say £0.25 per tonne on a typical sand and gravel reserve of say 1.5mt this would represent an additional £375k, excluding finance costs, in addition to other capital requirements which could be in the range of £0.75m to £1.5m. This is a significant increase in up front funding.

Of course this additional cash flow hit would also undermine an operator's competitiveness and he would quickly lose market share until competing sites were also subject to PGS.

Much larger reserves are permitted for crushed rock, cement, industrial sands and clays and the consequences would be proportionately greater. We estimate that for reserves in the order of 25mt an up front payment of between £1.25m and £3.75m would be likely.

In order to demonstrate just how PGS could impact upon investment decisions we attach one worked example submitted in **COMMERCIAL CONFIDENCE** by Tarmac. A summary briefing note and the more detailed financial model informing it are attached. (Annex 2 and Annex 3)

Before referring to this I should stress that this is just one example from one company relating to one aggregate mineral. It is submitted in order to demonstrate what the relative impact of PGS could be.

Each and every mineral site will have its own unique mix of circumstance ranging from geological factors, location, third party interests, market considerations and operational factors.

I have extracted a summary table from the briefing note to refer to and this is shown below.

PGS factor	**PGS (£000)**	**IRR %**	**PGS cost per tonne***
No PGS	N/A	**22.2**	N/A
PGS @ 10%	207	20.4	5.0 ppt
PGS @ 20%	414	**18.9**	9.9 ppt
PGS @ 30%	621	17.4	14.8 ppt

The key point to recognise here is the relative reduction in IRR if no PGS is applied compared to that achieved if PGS is applied at say 20% of the uplift in value. The reduction in IRR from 22.2% to 18.9% is material and in a competitive corporate environment, particularly a global one, can make the difference between a project receiving authority to proceed or not.

The tension would be no less and arguably more profound for an SME.

SUMMARY

The industry continues to be concerned about the prospect of yet another tax influencing and disturbing an already difficult operating environment.

Securing land at the right price often in the face of competing forms of development continues to be challenging.

Obtaining economically viable permissions in an ever more complicated, uncertain and costly planning and permitting system is increasingly demanding.

We believe that minerals development is demonstrably different to other forms of development as indicated above and does not sit comfortably within the PGS model.

The impacts of PGS upon the industry will make it less likely that the right sites can be brought forward at the right time to ensure that the construction and other manufacturing industries receive the steady and adequate supplies of material of the right quality that they rely upon.

Replenishment rates for some minerals are already of concern in the South East and this takes no account of the acknowledged additional demand that will be created over the next 10 years or so by the 2012 Olympic Games, Thames Gateway, Crossrail and other nationally significant built developments.

We hope that this submission captures the various points we have continually raised over the last year or so and either confirms the need to exempt minerals from PGS or provides a more structured basis for further dialogue.

I look forward to hearing from you in due course.

Yours sincerely

NC Jackson
Chairman CBI Minerals Group