

## Land Value Capture to Promote Local Development in Baltics: a Comparative study of Estonia, Latvia and Lithuania

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**Abstract.** By capturing value increase, it should be used for specific purposes in the way that would support implementation of infrastructure projects and promote local development. Accordingly, the stakeholders' interests have to be balanced and fair decision-making promoted. The research emphasises on comparative analysis of Estonian, Latvian and Lithuanian experiences in covering development costs and absorbing value increase. The purpose of the study is to give an overview of the land value capture as well as to discuss how it promotes local development and what is an institutional environment supporting it in three Baltic countries with similar historical evolution during last two decades. The functions of local authorities and spatial planning systems have been analysed in the study. The comparative analysis and synthesis, the logical-constructive and graphical methods mainly are used for the research. Direct and indirect models, which are used for the absorption of the surplus value of developed land, have been observed in the study. The outcome of the research shows an interim conclusion for Estonia, Latvia and Lithuania, and it may contribute to comparative analysis in larger – European context – in order to get an overview of land value capture across Europe.

**Keywords:** land value capture, local development, comparative study, Baltic countries.

**Conference topic:** Sustainable urban development.

### Introduction

Municipalities take a responsibility on implementation of land policy and land use management measures in their administrative territories, thus may be considered as central linkage between the set of national priorities and land users' interests. It is often argued that investments in infrastructure development improve the accessibility of the locations connected to the infrastructure, with the result that property values in those locations increase. However, such an argument needs to be tested through empirical research by exploring the institutional framework and land use planning and development practice. Land use planning may be considered as an integrated part into land management system. Land development is concerned with implementation of spatial development / land use plans, thus promoting new development proposals and developing sites appropriate to either urban or rural environments. However, in practice, the distinction between both environments often is not clear. In any case, the potential for development should be assessed, and then supported by the municipal decisions.

Alterman (2012) indicates to increasing of real property values, which have profound social, economic, and distributive-justice implications. Land value capture (LVC) is closely linked to institutions that define property in land. Value capture focuses on realizing as public revenue, i.e. through taxes, fees, or in-kind services, some portion of the increase in land value that stems from these latter changes (Ingram, Hong 2012). A concept of public value capture can be seen as a method or a strategy to capture value increase to use it for specific purposes (de Wolff 2007), e.g. for improvement of public infrastructure through local development. Land development measures refer to qualitative changes in land use intensity, involvement of various stakeholders, and facing noteworthy challenges and problem issues during its implementation.

*The purpose of the study* is to give an overview of the LVC as well as to discuss how it promotes a local development and what is an institutional environment supporting it in three Baltic countries with similar historical evolution during last two decades. *The objectives* were set: (1) to explore the performance of local authorities and spatial planning systems, (2) to analyse the direct and indirect value capturing by using appropriate models, and (3) based on the outcomes of both previously stated, draw interim conclusions regarding land value capturing in Baltic countries.

In order to meet the aim and objectives of the research the competence of local authorities and spatial planning systems has been explored applying comparative analysis and synthesis *methodology*. Direct and indirect models proposed by Alterman (2012) and used also for recent comparative study (Hendricks *et al.* 2017) have been adopted

to analyse the capture of the surplus value of developed land. The roots of increasing values were categorised into five main categories based on the study of Hong and Brubaker (2010), but “value steps” constructed based on Christensen (2011). Main results of the study showed and discussed on the basis of logical-constructive technique, but interim conclusions designed by graphical method.

### **Local authorities and planning systems**

All three Baltic countries faced administrative territorial reforms recently. The reform still is not finished in Estonia. These reforms have an impact towards allocation of local governmental (municipal) functions. According to the enforced legislation and documents of spatial planning policy in specific country a municipality determines the procedures for land use and development as well as provides the lawfulness of the construction process in the relevant administrative territory. In general, municipalities are responsible for organisation and provision of public services and goods in relation to land infrastructure and territorial improvements, e.g. building, utilities, public space, and social infrastructure. Municipalities are responsible for spatial development planning (comprehensive planning and its detalisation) as well as for issuing building permits and building control in all three Baltic countries.

#### *Briefly about planning systems*

The planning as a land use and development control system in Baltic countries follows “comprehensive integrated” and participatory approaches, and locus of power towards decentralisation can be observed there. However, the local municipalities have to consider the national and regional priorities and interests acknowledged by respective strategies as guidelines for sustainable development planning (COMMIN 2007). If considering the relative roles of both public and private sector in planning, on the one hand, the public-led planning dominates developing comprehensive plans and local plans, but, on the other hand, the market-led planning dominates initiating the land use changes and developing detailed plans.

There are four types of plans in the *Estonian planning system*: (1) a national spatial plan, (2) county plans, (3) comprehensive plans, and (4) detailed plans (Riigi Teataja 2015a). Comprehensive plans and detailed plans are the plans of a local level. The aim of a comprehensive plan is to define the principles and directions in the spatial development of the entire municipal territory or a part of such territory. A comprehensive plan forms a basis for the preparation of local government designated spatial plans and detailed plans. In cases where the preparation of detailed plan is not mandatory, a comprehensive plan is used for the issuing of design specifications in construction process. The local authority arranges the preparation of the comprehensive plan. On the basis of the comprehensive plan, restrictions may be imposed on immovable property. A local government designated spatial plan is prepared in order to perform the construction work that has a significant spatial impact and whose location has not been determined in the comprehensive plan. A local government designated spatial plan is prepared in respect of the territory of the local authority or a part of such territory. On the basis of the designated spatial plan, restrictions may be imposed on immovable property. A designated spatial plan forms the basis for preparing the corresponding building design documentation. A detailed plan is prepared in respect of a part of the territory of a local authority and, where necessary, to plan construction works that have a permanent connection to the shore or that are functionally connected to the shore. The purpose of the detailed plan is, above all, to implement a comprehensive plan and to create an inclusive spatial solution for the planning area. The detailed plan forms the basis for the construction work to be conducted in the near future. On the basis of the detailed plan, the restrictions may be imposed on immovable property. Where detailed plan exists or where the preparation of a detailed plan is mandatory, it forms the basis for the preparation of building design documentation. The local authority arranges the preparation of detailed plans. The adoption of the new detailed plan suspends the validity of the previously adopted detail plan in respect of that planning area. Additionally, the detailed plan or a part of such plan may be repealed in two cases. Firstly, if at least five years have elapsed since the adoption of the plan, and implementation of the plan has not commenced. Secondly, if the authority that arranged the preparation of the plan, or the owner of the registered immovable that was dealt with in the plan wishes to forego its implementation (Riigi Teataja 2015a).

The *Latvian planning system* includes more specific statements at local level, covering descriptions of existing land uses, preconditions for development, development objectives and directions, existing planning policies, land use and building provisions with zoning for future uses, and public participation. Since new Spatial Development Planning Law was adopted in 2011, a local plan as an additional planning document in hierarchy between both comprehensive and detailed plans was introduced. The municipalities must elaborate and approve comprehensive plans covering entire its territory. A comprehensive plan is a long-term document of spatial development planning, laying down the requirements for land use and development, includes a functional zoning, public infrastructure, regulations regarding land use and building as well as other conditions for land use, e.g. land use restrictions. A local plan is a long-term spatial development planning document, developed for a part of the city, a municipality town or its part, a village or its part, or a part of rural territory for solving a planning task or detailing or amending a comprehensive plan. The local plans, like comprehensive ones, have also legally binding parts, which among other provisions may provide changes into permitted land use if those are in compliance with the objectives of sustainable development strategy of the

municipality. A detailed plan of a part of municipal territory should be developed in order to lay down the requirements for the use of specific land units and building parameters as well as to adjust the borders of land units and restrictions. The detailed plans have also legally binding parts, but these cannot provide changes into permitted land use. A detailed plan is mandatory before commencing new construction or subdivision of land units if it creates a necessity for complex solutions and unless laid down otherwise in laws and regulations. A local government shall define in the work task the necessity for the developing of a detailed plan and the level of detail, taking into account the justification for the developing. A local government shall approve a detailed plan with a general administrative act, relating it to the land unit, and it shall come into effect after announcement thereof. A detailed plan shall be in effect until it is cancelled or repealed. A detailed plan shall lose validity also in the case if the time period for commencing the implementation thereof has expired and it has not been extended within a year after the end of such time period (Latvijas Vēstnesis 2011).

The *Lithuanian planning system* consists of three types of plans: (1) comprehensive plans, (2) detailed plans, and (3) special plans (Lietuvos Respublikos Seimas 1995). All these plans could be presented in national level (except detailed plan), municipal and locality (the part of municipal territory) levels. The scales of these plans are set according to levels and necessary accuracy. The aim of the comprehensive plan is to define the principles and directions in the territorial development of the entire municipal territory or a part of such territory. All restrictions and permissions for construction in different spaces of planed territory are shown on the main drawing of comprehensive plan – land use plan. Since 1<sup>st</sup> of January, 2014 the detailed plans are needed only in urbanised territories, if necessary to make changes in comprehensive plan (Lietuvos Respublikos Seimas 2013). If a comprehensive plan allows constructing the same types of buildings in chosen territory, the detailed plan is not necessary to prepare. A comprehensive plan is a long-term document of spatial development planning, laying down the requirements for land use and development and including a functional zoning, public infrastructure and regulations regarding land use and building as well as other conditions for land use, e.g. land use restrictions. A detailed plan forms the basis for the construction work to be conducted in the near future. Based on the detailed plan, the restrictions may be imposed on immovable property. Where detailed plan exists or where the preparation of a detailed plan is mandatory, it forms the basis for the preparation of building design documentation. The local authority arranges the preparation of detailed plans.

#### *The relation between planning and construction processes*

Most regulatory planning systems have two levels of statutory (legally binding) plans at local planning level: an overall (comprehensive) plan and a detailed plan (Kule, Røsnes 2010, 2011). When designing the relation between spatial development planning and construction processes in simplified way, there are basically found similar approaches and institutional performances in all three Baltic countries. Accordingly, a comprehensive plan, a designated spatial plan, and a detailed plan form basis for issuing building design documentation and initiating a construction work in Estonia; a comprehensive plan, a local plan, and a detailed plan form basis for issuing a building permit, developing a building design and initiating a construction work in Latvia and in Lithuania. Land use planning and spatial development is basically a local governmental concern in Baltic countries.

A detailed plan shall be implemented according to an administrative contract concluded between the local government and the developer *in Latvia*. The regulations regarding to land use and building are concerned with the provisions for land use and development and form a binding part of comprehensive, local and detailed plans. The provisions contain various requirements for different types of plans considering the appropriate level of detailing and specificity. But, in general, the regulations determine, e.g. requirements for land use at each functional zone and subzone (land-use pattern), building parameters and restrictions. In addition, for detailed plans the conditions regarding accessibility to environment, improvements, engineering and architectonic/landscape solutions are to be specified. The regulations on land use and building can be considered as a source for direct value capturing in a municipality, e.g. they may determine that prior to get building permit for residential building, the developer has to ensure the erection of a street, electricity supply, water supply, and sewerage drain within a development territory.

Also *in Estonia* the authority that arranges the preparation of the detailed plan is obligated, at its own expense, to complete the construction, according to the plan, of any public roads together with the related civil engineering works, vegetation, street lighting and technical infrastructure, unless the authority and the party interested in the preparation of the plan have agreed otherwise. The authority that arranges the preparation of the detailed plan may conclude, with the party interested in the preparation of the plan, a contract under public law by which the interested party assumes the obligation to complete the construction, according to the plan, of the civil engineering works referred previously, or assumes the obligation to bear a part or the entirety of the costs connected to the completion of the corresponding construction work (Riigi Teataja 2015a).

Nowadays *in Lithuania* a detailed plan should be prepared only like a block detailed plan, which occupies more than one lot and shows main function for planned territory development. The organizer of these plans could be only administration of municipality. The content of detailed plan is concerned with the regulations, determining, e.g. requirements for land use at each functional zone and subzone (land-use pattern), building parameters and restrictions. The main task for transportation system and engineering communication development in planned territory belongs to

developers, who organize all construction works for building construction and for civil works according to public procurement law.

### **Direct value capture**

To analyse the capture of the surplus value of developed land, the direct and indirect models are used in the study. The direct value capture is characterised with such aspects as: transport infrastructure and public space, engineering communications (utilities), external and social infrastructure, development design and control, development agreements, and capital gain tax.

#### *Transport infrastructure and public space*

The development territories include several types of facilities related to transport infrastructure and availability of public space. These facilities follow the planning regulations and are managed generally considering provisions of land use and building. Usually, if the transport infrastructure (e.g. roads and streets) and public spaces as “commonly used places” (e.g. green areas, territorial improvements, space for leisure, sports and waters) are placed on developers’ (property owners) land, they are responsible for the construction and maintenance costs. In such a case there could be concluded an agreement between developer and municipality on sharing management costs. The municipality is responsible for the infrastructure and space/land that belongs to it. In case there are several property owners developing/using the infrastructure, common amenities and space, the agreements should be concluded to distribute and cover the costs.

#### *Utilities*

After approving of the detailed plan, the technical project of a utility (building design) should be carried out for development territory. The development of territory follows the implementation arrangements of the detailed plan in which the construction sequence and responsibilities for main engineering communications (e.g. electricity, water, sewerage, electronic communication (telecommunication), heating) have to be determined. The main structures should be placed within technical and transport infrastructure areas (land-use patterns), but inner engineering communications of the land property unit should be placed according to either the technical project of the utility or technical provisions. The initiator of the detailed plan (developer) provides designing and construction of main engineering communications (joint utilities), but an owner/user of the building provides construction of the connections to the building. The costs for provision of utilities involve also ones for surveying, topography, territorial improvements, and resurfacing. The owner of the utility network (a company) or its lessee according to contract is responsible for management of the utility network. Maintenance costs of the utilities normally are covered by user charge (an annual or based on actual consumption). Some networks are managed by the municipality or municipally owned companies, e.g. water supply, sewerage disposal, heat supply, but some – by public or privately owned companies, e.g. power supply, telecommunications, and gas supply.

#### *External and social infrastructure*

External and social infrastructure refers to an area outside the development territory and indirectly influences value increase of developed land. Facilities like main roads, broader green areas and main amelioration systems have been regarded as responsibility of a public sector, as it is determined, for instance, by the national strategy in Lithuania (Lietuvos Respublikos Vyriausybė 2003). However, the developer may carry out some external infrastructure that is considered as necessary prerequisite for the development. The objects of social infrastructure like schools, kindergartens and sport grounds may be partly financed on contractual base by developers, however, there are no legal regulations issued by central government regarding development agreements in Baltic countries. Thus, the development and management of social infrastructure correspond to a public function and should be funded by using municipal tax revenues. Currently, the Law of municipal infrastructure development is under preparation in Lithuania. The aim of the law is to ensure the public meet the needs of municipal infrastructure, e.g. main utility networks. Therefore, the infrastructure development should be carried out in accordance with comprehensive plan and special document for territorial planning solutions.

#### *Development design and control*

A building permit and a building design (project) are issued apart (following) of the planning and thus belong to the construction process and regulated by the Construction Law. A building permit is an administrative act with conditions for implementation of a building conception on site – for designing and construction work – until the developed building to be commissioned for exploitation. A building permit shall be issued if the construction conception conforms basically to the spatial development (comprehensive) plan and detailed plan (if such is necessary in accordance with laws and regulations) of a local government (planning documentation), except cases when a construction conception is related to an object of national interest. Additional conditions in relation to the level of detail of a building design may be determined in the regulations of the local government for land use and building, if they are necessary for a

structure to blend with the landscape or the urban environment. A building design is an aggregate of graphic and textual documents necessary for the implementation of a building conception. After receipt of a building permit the fulfilment of its conditions is commenced, ensuring drawing up of a building design in the extent laid down in general and special construction regulations, as well as in conformity with the provisions for the land use and building included in the planning documentation of a local government (if it is necessary in accordance with laws and regulations). Both a building permit and a building design are required for the construction of new buildings, for the extensions and for considerable changes in the layout and application of buildings. The construction works and control shall be performed, in accordance with the competence specified in the Law (Lietuvos Respublikos Seimas 1996), by the building authorities, institutions carrying out the functions of the building authority and building inspectors of the office – persons employed at the relevant institutions. For instance, in Latvia those persons who have acquired the right of professional practice in the field of architecture or construction and are registered with the register of building inspectors<sup>1</sup> (Latvijas Vēstnesis 2013). These obligations have to execute local authority in Estonia<sup>2</sup> (Riigi Teataja 2015b). The costs of building permit, building design and building control normally covers a developer. A fee for building permit is rather formal and relatively is not large.

#### *Development agreements*

A reason to conclude the development agreements appears when the rights and obligations of developers/property owners and municipalities are not defined by statutory regulations. These agreements mainly represent a detailed distribution of costs for infrastructure development. As indicated above a detailed plan shall be implemented according to “administrative contract” concluded between the local government and the developer in the case the developer owns the land and initiates its development. In the case the municipality owns the land, the conditions on land allocation and the price for the land is a matter of negotiation between the municipality and the developer. According to national and EU regulations about state aid requires that the land must be sold at market value. The development agreements sometimes represent the initiative for urban development on the basis of public-private-partnership. Therefore, the benefits of the buildings remain with the private developer (income and profit) and the benefits of the increasing real estate value remain with the municipality (fees and taxes).

#### *Capital gain tax*

The capital gain tax is applied if private real properties have been sold in the market. The standard tax rate is 20% in Estonia, 15% in Latvia, but 21% in Lithuania of the capital gain – the difference between the acquisition and selling price with a deduction of demonstrable improvement cost. In Estonia, the income of non-residents from the sale of real property is subject to income tax by way of assessment. Moreover, gains from the sale of a summer cottage or garden house are exempt if owned for more than two years in Estonia. Capital gain tax goes to the tax income of central government, but it may be assumed that through a distribution of public goods (e.g. main roads, public transport, etc.) it in general contributes to the increase of the property value in the territory.

### **Indirect value capture**

In general, a tax related to immovable property represents the indirect model, however, any other types of tax income and fee may be used for improving public infrastructure in the territory of the municipality according to financial (budget) plans in Baltic countries. Basically, the immovable property tax (PT) in Latvia, but land tax (LT) in Estonia and Lithuania as well as a personal income tax (IT) in all three countries benefit to local authorities and constitutes the main part of their resources. The shares of municipal revenues in national consolidated budgets and the shares of municipal tax revenue in national tax revenues are considered as meaningful indicators reflecting overall development potential. Locally, such a reflection has to be identified when assessing tax revenue in the revenue structure of municipal core budgets. Although PT and LT for 100% are held by municipalities, the financial means from IT source prevails significantly. If considering the purpose to use tax revenue related to immovable property (PT and LT), it is rather obvious that in practice represents the “infrastructure tax”. Currently, Municipal Infrastructure Law is under preparation in Lithuania.

#### *Property tax*

Land in Estonia and Lithuania (Lietuvos Respublikos Seimas 2011) is a subject to annual LT, levied on the taxable value of land. The rate is established by the municipal councils and varies between 0.1% and 2.5%. The Land Tax Law determines it in Estonia<sup>3</sup> (Riigi Teataja 1993). LT is generally payed by landowners, but land users (tenants) may be liable to pay the tax in some cases. LT is collected into the budgets of local governments (Riigi Teataja 1993).

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<sup>1</sup> Construction Law, Sections 1 and 15–18

<sup>2</sup> Building Code, Section 130

<sup>3</sup> Land Tax Law, Section 5

PT shall be imposed upon tangible things which are located in the territory of the Republic of Latvia and which cannot be transferred from one place to another without being externally damaged – land, buildings, including the buildings registered in the Cadastre Information System but not transferred into exploitation, and engineering structures<sup>4</sup> (Latvijas Vēstnesis 1997). Either property owners or its legal possessors pay PT based on the cadastral value. The State Land Service determines the cadastral value according to common methodology, which in general prescribes the cadastral value base (base values and correction coefficients based on market data analysis)<sup>5</sup> (Latvijas Vēstnesis 2005). A municipality determines the tax rate different to land and buildings in the range 0.2% – 3% of cadastral value and indicates it in binding regulations. General tax rate is 1.5% from cadastral value of property unit. Residential property is taxed at a rate 0.2%–0.4%–0.6% depending on value of the property. 3% shall be paid, for instance, for degraded property or neglected agricultural land (Latvijas Vēstnesis 1997).

#### Other taxes, fees and conditions

There are identified other tax income that contributes to the increase of the property value indirectly in the territory. IT tax rate is 20% in Estonia, 23% in Latvia and 21% in Lithuania. This tax shall be paid by natural persons for their income to the municipality budget, in which the person has been declared residence. In Estonia from this tax rate the budget of municipality benefits 11.6%, but the budget of central government – 8.4%<sup>6</sup> (Riigi Teataja 1999). Some other taxes shall be paid to the municipality budgets, but all together they constitute insignificant shares. Municipalities are empowered to impose fees according to binding regulations and use these incomes for infrastructure improvements as well. However, the financial equalization funds of local governments (FEF) exist in Estonia and in Latvia and try to organise in Lithuania, which are concerned with a distributional models among the municipalities to promote “equal opportunities” to execute their functions. These models in a great extent influence a financial capability of each municipality, including the public investments for land value increase.

#### Interim conclusions

The following figure summarizes the value steps of real property development in Baltic countries if considering interim research results (see Fig. 1). All types of taxes and fees that create the municipal revenues and are distributed for benefits of local society in a great extent applicable to all property value increase independently of the roots of increasing values 1–5. Value surplus due to private investments is subject to LVC. Increase in land value due to extension of property rights benefits both a developer/landowner and a municipality. However, the extent of the involvement of a developer through extension of property rights (planning), internal infrastructure development and construction of buildings shows that the appropriate institutional environment could be more investment friendly in all Baltic countries.

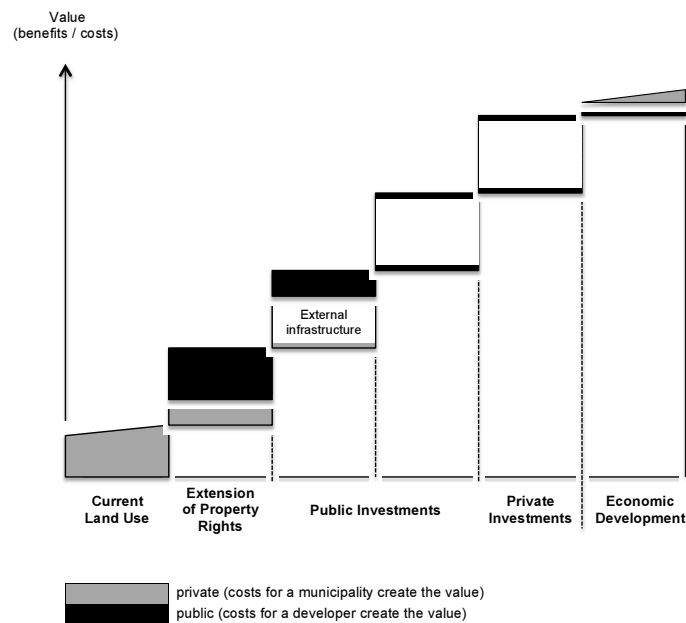


Fig. 1. Value capture in Baltic countries

<sup>4</sup> Law On Immovable Property Tax, Section 1

<sup>5</sup> Immovable Property State Cadastre Law, Section 7

<sup>6</sup> Income Tax Law, Section 5

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