

The Real Hope for Home-ownership¹

How to solve the housing crisis with tax reform

by Dr Tony Vickers²

The past half-century in Britain has seen housing policy switch from successful active intervention to ensure every family had a decent home to a situation where no newly-formed household without access to private wealth or a frighteningly onerous mortgage can hope to own their own. Even renting becomes unaffordable almost everywhere. The housing market is hopelessly dysfunctional, in that only those who do *not* need this vital ‘commodity’ can afford it. There has to be a better way of meeting housing *need* without compromising either national economic policy or the legitimate desire of the majority to be home *owners*.

This paper sets out one way to achieve this, based on principles of economic justice and efficiency and by correcting inherent market failure. The paper is initially addressed to Liberal Democrat policy makers for discussion. It is hoped that the eventual readership will include those who have long struggled with housing market reform outside the Party and who accept the principle of Land Value Capture being the solution – if only a ‘sellable package’ of measures could be devised³. Hence it does not attempt to argue the overall case for Land Value Taxation (LVT) but to deal with the particular problems of its application to residential land at this time in this country.

Nor does the paper deal in any detail with two ‘technical’ areas for debate: valuation and tax administration. That is because the target readership is politicians: professional valuers and tax specialists generally accept that reform is achievable only if and when LVT has become politically acceptable. It is not that reform will be technically easy but that it only becomes worth seriously studying the technical issues when there is the political will to do so, which does not exist yet. This paper aims to help create that will.

Some people say that applying LVT to housing is just far too difficult politically, so we should focus our efforts on reform of business rates because businesses don’t vote. To them I say that to do so would embed new and fundamental flaws in the property market and tax systems. These could make replacement of council tax, inheritance tax and stamp duty land tax, which are

¹ The present Conservative Government’s renewed enthusiasm for Right to Buy (RtB) feeds off the same legitimate hope that many renters have to be able to own their home. However RtB can only work by subsidising home ownership, which the Government openly admits. Since subsidies are both an acknowledgement and a feature of market failure, they can only make the situation worse overall, in the longer term, for society – especially for the most vulnerable. They are an appallingly bad way to spend public money on housing. The title chosen for this paper is largely a response to this.

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³ The author draws on a document which he co-authored for the Coalition for Economic Justice (www.c4ej.com) and submitted to HM Treasury in 2011: *An Implementation Plan for LVT*.

all totally dysfunctional, much more problematic, both politically and technically in the long run. I will briefly explain why, before going on to set out the features and benefits of ALTER's proposals for applying LVT to housing in more detail than is in our current 'flyers' on the subject.

Why not start with business rate reform?

There are four reasons:

- a) Valuation is much more difficult for non-residential land than for residential land;
- b) Mixed use land is an added complexity, making simultaneous reform across the res/non-res 'divide' preferable;
- c) Local government finance needs comprehensive and fundamental reform, including altering the balance between local tax-raising powers and central government grant or 'equalisation'. Tackling business rates without also planning to reform council tax makes that harder.
- d) If LVT is a potential game-changer for our national economy, as most of its proponents argue, then plans for its introduction should encompass *national* taxation as well as local finance. Local government accounts for a mere 5% of total public expenditure, so reform of local finances alone will barely touch the national economy.

This is *not* to say that in a comprehensive local/national LVT implementation it is essential – or even desirable - to do everything at once; or to *start* with residential land and leave business rate reform until later. Much will start to change across the whole property market if a comprehensive plan is announced at the outset, as market players anticipate the impact. That is all to the good. But reform is bound to be disruptive in proportion to the speed of its implementation, so it is as important to be gradual as it is to be transparent, comprehensive and yet flexible.

Because businesses do not vote and because the economic gains from reform of business rates are high (land values in city centres are much higher than in suburbs and market towns), it is highly likely that LVT *will* actually be introduced somewhat earlier and somewhat faster for non-residential land than for housing land. But the plan for LVT must include residential land from the start.

Key features of LVT for housing land

Some 'key features' of LVT apply to all land. For example, it must be seen as *primarily* a national tax, not just a reform of local property taxes. House prices in London are far higher than in Lancashire not because of anything local councils do but because London is an international city and land is at a higher premium there. So it would be unfair on less prosperous areas of the country to allow all the revenue from land values that London's councils can collect to remain in London.

Similarly LVT must be levied on owners of land and not occupiers, because owners *per se* create no value: they merely passively syphon off the 'economic rent' that entrepreneurs create and which circulates in the wider economy through spending. It is reckoned that up to 20% of total GDP is removed from the active economy by the 'drag' of conventional taxation

which bears overwhelmingly on wealth creators because of the lack of measures to ‘recycle’ that wealth back into society at large. So a ‘tax shift’ off wealth creators onto rent seekers (wealth accumulators) is hugely important to the economy and society: that is *the main* point of introducing LVT.

For some reason, it has long been assumed that local taxes are collected principally in order that *exclusively local* residents receive local services. This argument is seldom deployed for national taxes. In his 1976 report on local government finance, Lord Layfield’s main reason for rejecting LVT was that a tax on owners would be unfair. He rightly pointed out that many owners were neither resident nor operating businesses in the council area where the tax was levied and services were received through council spending.

Layfield conveniently ignored the fact that absentee owners receive benefit from that spending, as their property (land / location) value rises as a result. (Think of the impact on house values of being in the catchment area of a good school or near a transport hub.) Moreover in almost every other country that uses *ad valorem*⁴ property taxes, it is the owner and not the occupier who pays. Yet such taxes are also invariably used to finance local government, much less often for national.

Specifically relating to housing and taxes that householders pay, the following features⁵ are seen as essential if we are to make LVT politically acceptable to a “home-owning democracy”. Each is discussed in more detail later.

1. A tax-free element or Homestead Allowance (HA) should apply to owner-occupiers, in recognition of the basic human right to shelter⁶.
2. There must be no exemption for social housing but any form of non-profit rented housing should attract lower tax rates than market for-profit renting, since affordable housing is a valid charitable purpose.
3. Owner-occupation should be treated like ‘notional’ or unearned income, assessed for tax purposes on the basis of what the owner *could* have earned in rent. Thus LVT could be merged with income tax⁷.
4. There should be an option for home-owners to defer payment of the tax until death, sale or re-mortgage, i.e. when there are funds to pay it.

⁴ *Ad valorem* means “according to value”. It applies to any property tax based on an assessment of value, as opposed to a transaction (such as sale) or event (such as award of planning consent). *Ad valorem* property taxes are levied annually.

⁵ All except ‘3’ are alluded to in 4.2.4. of the Liberal Democrat policy paper “Fairer Taxes”, approved overwhelmingly by Federal Party Conference in 2013.

⁶ This right does not extend to second homes.

⁷ This was the case with ‘Schedule A’ income tax until 1963, when Gerald Nabarro MP successfully tabled an amendment to the 1963 Finance Bill to abolish it. This had meant a previously taxable ‘income’ (notional rent of owner-occupied domestic property) for which mortgage interest relief had been justifiable, remained as unearned income (untaxed) but was no longer taxed. This gave a large tax advantage to owner-occupiers with a mortgage over those paying market rents or owner-occupiers without mortgage payments. It greatly incentivised growth of household debt, wealth inequality and owner-occupation through the period late ‘60s to early ‘90s. [Source: Note of a meeting between the author and Lord Best, 2014.]

1. Homestead Allowance

HA is a part of property tax policy in several cities in the US and also in Taiwan. If there can be a tax-free allowance for earned income, there is no reason why the principle could not be applied to property taxes too. Indeed one could argue that there is a greater *moral* case for HA, because everyone needs shelter and it shows self-reliance to have built or bought one's own home.

This argument does not apply for homes which are rented to others for profit. Where the landlord/tenant relationship is a purely commercial, it would be wrong to allow a landlord to benefit exclusively by receiving HA in respect of his/her 'service' to provide a home to tenant[s] at market rent.

However where a landlord is willing to transfer a share of ownership in the underlying land value to tenants, which would need to be at least equal to the threshold for HA, then the tenants would become in part their own 'landlord'. In that case, like all owner-occupiers, they would be liable to pay a share of LVT due on that site – equal to the share they have in its equity - and also be eligible for HA. This would have the effect of enabling 'superior' (non-resident) landlords to find tenants more easily, because the cost of the home to tenants who are part-owners and eligible for HA would be less than the cost to tenants who are *ineligible* for HA. Both landlord and tenant reduce their costs.

The landlord in such a shared ownership situation would in effect now be in a partnership with the tenant, where both stand to profit from any land value uplift (or lose from any land value fall). By becoming a part-owner of the property and of the underlying site, the tenant now has greater incentive to work with neighbours – whether owners or not – to improve the neighbourhood, as well as to care for the fabric of their own home.

This completely transforms the market relationship between would-be home-owners and their landlords. The former are in an almost hopeless situation now, virtually forced to rent privately. Currently landlords can out-compete first-time buyers, because they can use their existing properties as collateral for a loan, treat mortgage interest as a business cost (until recent legislation, this cost attracted tax relief) and finally pay no council tax on their rented properties. Unless a newly-formed family has wealthy home-owning parents (the "bank of mum and dad") or have themselves saved enough for a deposit, which is increasingly unlikely with nearly 50% of young people having student loans to service, they are forced to pay more in rent alone than they would in mortgage payments for the same property.

The Conservative Government's solution of 'Help-to-Buy', in which first-time buyers have their mortgage partly underwritten by the taxpayer, is really a subsidy to lenders and puts at risk the future financial security of both the nation and the borrower. LVT with HA would avoid this and be a better route onto the housing ladder for all concerned – except the banks. It would also make buy-to-let much less attractive (unless landlords enter equity sharing arrangements with tenants) and 'buy-to-leave' – home purchase for purely 'investment' reasons, resulting in swathes of homes deliberately left empty – would be virtually ended overnight.

This 'pro-ownership' feature is an important political selling point for LVT with HA, because it is seemingly ingrained in the British psyche that home-ownership is a 'good thing', despite the fact that in most other developed societies renting is regarded as a perfectly acceptable alternative to owning. It is no accident – indeed it is an 'accident' waiting to happen! – that Britain also has the highest level of household debt and lowest level of public investment of any major developed economy. By tying up such a high proportion of national wealth in home-ownership, the economy is denied the ability to invest that wealth for the good of the wider economy – either through public investment or through private enterprise.

Property ownership is not 'enterprise', rather it is anti-enterprise and creates an illusion of wealth that is all too easily dissipated when the national economy suffers any external shock. Entrepreneurship involves risky endeavour: a landowner need do absolutely nothing to be almost certain of making a profit over the long term, because land is a finite resource and the numbers competing for access to it are growing. Indeed by withholding land from the market – deliberate *inaction* - owners can create artificial shortage and make *more* profit than by using their land productively. The result is increasing misery for those *not* owning land, a shrunken GDP and steady national decline. In what other 'free' market would the producers experience higher profits alongside lower output, as happened with the major volume house-builders during the recession of 2008-2013?

With LVT combined with HA, the losers among market players will be those in the buy-to-let market. Unless they professionalise their role as landlords and start to treat tenants as customers or partners, as happens in Germany, rather than sources of largely unearned income, these 'investors' will find the yield from owning rented property falls as more of that unearned wealth is captured by LVT for the wider community benefit. The resulting switch to investment in wealth *creation* instead of what is now very rational rent-seeking behaviour can only be good for the economy.

2. Social housing

The Party has not really addressed how the social housing sector would be treated under LVT. These are my personal thoughts and they assume no fundamental change in planning policy relating to affordable housing.

If Right-to-Buy (RtB) results in the effective privatisation of land occupied by social rented homes, this will have a major impact on tax liability under LVT for housing associations and their tenants. It would not of course affect Council Tax liability of those homes in the same way. Since the Government has decided to adopt a Voluntary Agreement with housing associations rather than attempt to force RtB through Parliament in the Housing Bill, it will remain unclear for some time how their policy will develop.

When a new housing development includes 'affordable housing' as a Planning Condition (known as a Section 106 Agreement), the land occupied by such housing is designated in perpetuity for that purpose. This has a major effect on its value: in theory, it can never be sold at full market value and current

maximum rent that social landlords can charge is reflected in a lower land value for tax purposes.

Whilst the definition of “affordable housing” covers shared ownership, the share which specific types of tenure have within any development is specified in each S106 Agreement: individual homes cannot normally be moved between one type of tenure and another, ever (in theory).

Shared ownership homes could be treated just like private rented homes for LVT purposes, as described above, with tenants benefiting from HA and treated as part-owners of their home.

However most social housing occupants *need* to continue purely renting, largely because they have little or no desire *nor capability* of taking on the responsibilities of ownership nor of finding the funds to acquire even a part of the equity in their homes.

Many housing associations are charities and the provision of affordable housing is their principle, if not only, charitable purpose. There are also almshouse charities and other organisations, including local authorities, which provide housing to ‘licensee’ occupiers at low cost, or with residential care. Where this is provided on a non-profit basis and if the landlord is registered both as a charity and as housing provider, this should enable them to either have the land valued at a lower assessment, or to be charged at a lower rate of LVT – or to offset their LVT bill against other taxes due. Perhaps the simplest and fairest solution would be for a landlord to pay a rate of LVT that is lower than the norm in proportion to how much lower its rents are compared to the market norm in that area: a social rent set at 60% of market rent would mean the Registered Provider pays only 60% of the LVT.

Whatever happens, owners of sites used for charitable purposes should not have to pay as much tax as owners of equivalent sites *not* used for charitable purposes.

It is important that the liability of a charity to pay LVT runs with the site and its use and not with the charity itself. In the US, all property owned by charities is exempt from their *ad valorem* property taxes. Because much high value land in city centres was historically acquired by churches and governments early in its settlement by Europeans, there are large holes in the revenue base of these cities caused by the extensive exemptions that such sites attract, even where the use of these sites has changed: many are now in highly profitable commercial uses but their charity owners pay no property tax. This is a huge market distortion.

So in the UK, where the property tax treatment of public bodies and charities is currently less advantageous, ALTER would caution against following the US model. We would limit LVT exemption (or any discount) to sites *used for charitable purposes*. As soon as a charity sells such sites or converts them to non-charitable use, they should be treated just like other sites for LVT purposes.

Thus as soon as a tenant succeeds in RtB, they would become fully liable to pay LVT. In the case of a block of flats where only one or a few tenants follow

RtB, this could be complicated. We would strongly support housing associations being allowed to block such RtB applications or be able to offer alternative properties to applicants where it will not result in mixed tenure on a single site.

It is likely that after some years in which LVT was operating as a significant source of public revenue the division between 'market' and 'social' housing sectors would become blurred. House prices should fall – or rise no faster than prices in general – as site owners are incentivised to develop sites with planning permission or zoned for housing, which is proven elsewhere to happen. However for the foreseeable future even with LVT there will continue to be a social housing sector unless it is first destroyed by this Government by policies such as RtB and forcing landlords to reduce their rent and lose their credit rating – essential for obtaining funds to invest in more homes.

3. Merging property taxes with income tax

It is already the case that Sweden treats owner occupation as a source of taxable 'income'. There are other countries that do so but the Swedish model is attractive because it also involves regular valuation of all land on the basis of 'highest and best use' (HABU) and the separation of the land value element from the building element – even though it is the whole value (land plus buildings) that is taxed.

The Swedish system was studied by the author in 2005 as part of his PhD on Land Value Mapping. It has also been the model for the Baltic States (Estonia, Latvia and Lithuania), which have all adapted it to introduce various forms of LVT since they gained independence in the post-Soviet era. The ease with which these countries did so, despite not having a mature property market upon which to base assessments of taxable value at the time they began the process, is a good indicator of the feasibility of adopting LVT along Swedish lines.

In Sweden, every adult completes an income tax form every year⁸. However the form arrives in the post largely pre-completed, based on the previous year's return. In order to assess a person's property tax liability, all that is necessary is for the taxpayer to confirm the schedule of properties that they own, state which is their principal residence and declare any changes in ownership. The tax authorities can check with the land registration authorities in any case.

From the address of each property, the Swedish tax authorities can check the latest assessed taxable value from a publicly accessible Value Map (and associated register), which is updated every two years by an independent land valuation agency. For owner-occupiers the assessed value is converted into a 'notional income' by the tax authority and appears already calculated on the form for the previous year's declared principal residence of that person, so

⁸ This could be seen as a disadvantage in the UK. However every household already receives a Council Tax return and the system proposed would do away with that. With the trend towards self-employment and portfolio careers, a higher proportion of the workforce than ever already has personal tax assessment. Also every employee is included in the PAYE system, which would 'host' the proposed LVT system.

it can be checked against the register and challenged. For other (rented) properties that the taxpayer owns, actual rental income is entered: this can be used by the tax and valuation authorities for their next update of the Value Map. However tax paid on rental income would, under LVT, also be 'notional', because it is due whether or not the property is actually let.

There are significant differences between the way planning decisions impact on developers in Sweden and in Britain. This is explained in the box below because it has nothing to do with the subject discussed in this paper, although it has a significance to the rate at which new housing is built.

But probably the main political benefit of integrating the property tax and income tax systems is that it avoids the psychological 'in your face' impact of a separate tax bill – the only one that many households ever receive. To the extent that the property tax is 'hidden' within the income tax bill, it will have become a 'stealth tax'! It is far less likely that households would object to their 'council tax' if they never saw a separate demand to pay it. Indeed it is quite common for a Swedish person to assert that there is no local taxation in their country: they may not even realise how their local council is financed.

The tax is also far simpler to collect, because there is no need for any local tax administration department. The relationship between

Comparing Sweden's Planning System

The revenue from property taxes is assigned mainly to local and regional tiers of government, which can each set their own tax rates. This is similar to 'precepting' which operates in two-tier and/or 'parished' parts of England and Wales, except that instead of the District, Borough or Unitary Authority administering the system on behalf of county or parish councils, it is the national government that operates it on behalf of all other tiers.

The only role of local authorities in Sweden's property tax system (apart from receiving and spending the revenue from it) is through the spatial planning system., As in Britain, it is the decisions of local authorities regarding what use land can be put to by owners and occupiers that decides to a great extent what value sites have – whether developed or not. Planning decisions do not just affect the value of the sites subject to planning applications: nearby sites are affected too.

One significant difference between the way planning decisions impact on local taxes in Sweden and in Britain relates to how sites that have recently had planning consent awarded are treated. In Britain, there is an up-front charge levied by the local authority on the developer, justified purely as mitigation for the impact of the proposed development on local infrastructure. This is usually payable before development can begin and therefore comes at the worst time for the developer's cash-flow, although it is understandable from the local authority perspective because they need the money to invest in the necessary infrastructure.

In Sweden there is no 'developers contribution' (technically now a Community Infrastructure Levy – CIL – or S106 Agreement), indeed the higher tax rate due on the property that generally results from the award of planning permission is automatically deferred for a number of years. This gives an incentive for the developer to implement consent as quickly as possible, in order to receive benefit from it before the higher tax becomes due.

In Britain, the system has the opposite effect: although the capital value of sites rises upon award of planning consent, it takes longer for the owner to recoup construction costs. By not immediately implementing consent, the developer suffers no costs and incurs no tax liability.

local government and local resident is not lost just because either the national government or the landlord (if a person doesn't own their home) acts as the collecting agency. The relationship is much more one of service provider and customer, with services free at point of use.

Finally by merging income tax and property tax systems *and* by having a tax-free allowance on both elements, it would be quite easy to merge these allowances. Hence a person with less income than their tax-free earnings allowance but who is an owner-occupier with a higher LVT liability than their HA, could offset some the 'unused' portion of one against the other. This helps deal with the 'poor widow' (any income-poor but asset-rich person) problem that so besets LVT politically. However the next and last of the four features covered here does this even better!

4. Deferment of property tax

Like HA, this is not unique to LVT and is already in use in other countries. Indeed it was proposed by John Prescott in 1999, when his responsibilities as Deputy Prime Minister included local government.

Because landed property cannot be moved, any charge on the title of a property is a rock-solid debt against which a council can borrow. Therefore a council ought to be relaxed about accepting property tax payments due as a charge against the owner's title. This is not so easy to accept if, as now the tax is normally paid by the occupier rather than the owner. However LVT is always payable by the owner.

This overcomes the most common justification for claims that LVT is unfair on those who are asset-rich but income-poor: the 'poor widow' being the classic victim of hardship. Any owner-occupier unable to pay their LVT bill would be entitled to apply to their local council for the debt to be deferred until one of the following events occurred: death, sale or re-mortgage.

It might even be possible to allow the debt to be paid interest-free or for a fixed charge to cover administration, which would be only payable at the time of the event that triggered final payment. If the owner-occupier wished to pay before any trigger event (e.g. to avoid their Executors having to pay upon death), then that could also be done.

The only losers in this case would be those who stand to inherit the owner's estate: normally the children of the deceased former owner. Only if the deceased died with debts that exceeded the net value of their home would the government be facing a potential loss. The state would in this case have a prior call on the whole estate and might choose to retain ownership of the property for public purposes: e.g. as an 'affordable' home for local people.

This feature might not entirely dispose of the claim that LVT could become what the Daily Mail calls a 'Death Tax', although the vast majority of pensioners would probably plan to continue paying LVT, just as most pensioners today continue to pay their council tax. If LVT was implemented with *all* the features that have been described, it won't even be pensioners 'rattling around' in very large homes who need suffer. But they probably ought to have sold and 'down-sized' long ago and their children have no 'right' to

inherit unearned wealth. By planning ahead, the pensioners of the future under LVT would generally avoid this situation, whereas now with the single persons discount on council tax pensioners are actually encouraged to under-occupy⁹.

Conclusion

I began by asserting ALTER's claim our proposals for LVT in the housing market have attributes of economic justice and economic efficiency.

The losers in our policy will be those living in – or due to inherit - the most expensive homes and those who are commercial landlords. Among the winners will be all who currently occupy homes in Bands A-D, especially those in rented accommodation those trying to get a foot on the housing ladder. We believes this justifies our claim of economic justice.

By greatly reducing the proportion of national wealth tied up in mortgage debt on under-occupied or over-priced and privately rented housing, and by incentivising better use of land for desperately needed housing, ALTER believes that LVT with the features described here would result in a much more efficient land and housing market. This must make the whole national economy more efficient and remove one of the greatest risks to social cohesion.

ALTER believes that LVT could be made quite acceptable to a majority of voters¹⁰. There is little point in having a policy that has so many benefits and then not campaigning for it. The sensitivity with which LVT for residential land has long been treated is understandable but I hope this paper has shown that it need not be so.

I have not covered the actual implementation process, only its main features. Any implementation should be carried out gradually. There is no reason for existing property taxes to be abandoned on 'day one': council tax could be frozen at current levels and then reduced progressively as LVT is brought in to replace it. This would have the benefit of allowing the details of almost every aspect of its implementation plan to be adjusted with experience, not least the land value assessments themselves which could even begin through self-assessment.

If the Party is serious about supporting LVT – and a bid to remove it from the latest (2013) tax policy motion at Conference received even fewer votes than one to remove Mansion Tax – then it needs to start to get serious about how to present the policy to voters in **and about** their own homes. As the age when young people can first join baby-boomers like me as happy home-owners get ever higher – it approaches 40 now – there are more and more votes in a policy that benefits, the young, working, renting but aspiring-to-own voter. If we turn these ideas into campaigning material, their votes will be ours.

⁹ See *The Hoarding of Housing*, which is one of ALTER's flyers, for a detailed revelations on the inter-generational 'wealth gap'.

¹⁰ A poll of nearly 1000 voters conducted by MORI in 2012 showed that *when they know just a little about LVT*, most voters would support reform of property taxes.