

## The housing land market in Scotland



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One of the strategic objectives of the new Scottish Land Commission is to ensure that the ownership and use of land delivers greater public benefit. In exercising its functions the Commission can carry out research and recommend changes to law and policy. It has commissioned *Land Lines* - a series of independent discussion papers on key land reform issues, and has now published the first of these: *The housing land market in Scotland*.

The discussion paper considers how the operation of the land market could be improved, and the supply of land for new housing could be increased, through public sector intervention. The views in the discussion paper are those of its author, and do not necessarily reflect the Commission's views. The principal purpose of the *Land Lines* papers is to stimulate public debate.

The dynamics of the housing land market in Scotland are complex, and we remain unconvinced that the implementation of these proposals, if they were to be taken up by the government, would provide the silver bullet that would solve the perceived issues with the housing crisis. Land value taxation has been attempted before without success and it is unlikely that public sector finances would be in a position to take on the responsibility of significant housing development.

### The need for reform

The paper describes the housing land market in Scotland as 'dysfunctional'. It submits that the lack of housing supply, and rising house prices, which in turn contribute towards social and economic inequalities, are due to increasing land prices. These arise, the paper suggests, because of the way the market for housing land operates, characterised by five key features:

#### 1. The speculative model of house building

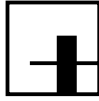
The process of development relies on a speculative process: a developer raises finance, buys land, obtains planning permission, and builds the homes without having a known purchaser or known price in place. It is only at the end of the process that the buyers are found and the homes are sold. As a consequence, much of the early process has risk attached, and developers will therefore seek to reduce that risk, such as by land-banking sites or buying land which is already allocated for housing by the planning system. Acquisition and construction costs are all calculated according to the estimated final sales value of the houses: that value has to be maintained for the development to be financially viable, therefore the developer cannot risk lowering the value of the land by releasing too many houses for sale at one time.

#### 2. The legislative framework that assigns planning gain to landowners, not public authorities

Since the late 1950's, Town and Country Planning legislation has followed the principle that, on compulsory purchase of land by a public authority for the purposes of building homes, the landowner is entitled to the benefit of any 'hope value' of the land, meaning that the compensation they receive is based, not on the value of the land at the time, but on what it could be worth in the future if it got planning permission for residential development. This significantly increased the cost to authorities of land for development, and started the decline of public sector house building. It was landowners who benefited from rising land values, not the general public.

#### 3. An expanded mortgage market

The liberalisation of the mortgage credit market tempted new players into it. Previously the sole province of building societies, the mortgage market became increasingly populated by the retail banks due to financial deregulation in the early 1970's, bringing with it an increased flow of available credit. The result of the combination of a flexible credit supply and a fixed land supply is higher house prices.



#### 4. A taxation system that is relatively benign towards ownership of land and property

Comparatively speaking, housing receives a favourable treatment from the tax system, including capital gains tax and inheritance tax, and there is no tax which discourages the 'passive ownership' of vacant land. With rising land values, it can be preferable to buy land and simply hold onto it, instead of developing it.

#### 5. Insufficient publicly available information on land values and ownership

Having information about land values is a key factor in understanding the dynamics of the land market. However there is hardly any publicly available data on land values, making it difficult to analyse the economic significance of the land market in any meaningful way.

#### The impact of the current housing land market

The paper identifies a number of consequences of the increase in land prices: the increased cost of housing has had an effect on disposable incomes, acting as a constraint on living standards, as people have less money to spend on goods and services, which in turn has a broader knock on effect: volatility in house prices translates into volatility in the wider economy. Higher house prices tend to impact adversely on labour market mobility, as people feel their ability to move for work is constrained. Economic growth is stifled.

Considerable amounts of public money go towards benefits to assist people to pay their rent, and statistics reveal that housing costs were the cause of an extra 160,000 people falling into absolute poverty in 2015-16. With the increasingly prohibitive cost of housing, homeownership is unaffordable for many more people, shifting the pattern of occupation towards the rented sector.

Many hectares of land in Scotland are vacant or derelict, the vast majority of which is in private sector ownership. The paper opines that this is neither in the public interest, nor a sign of an efficient land market.

House price inflation has resulted in an uneven distribution of property wealth, but while the windfall from rising land values has increased net wealth, there is no change in the total productive capacity of the economy, since no new assets are created as a result. So while individual wealth may benefit, the wider society does not. On the contrary, it faces increased costs in the form of higher rents and larger deposits.

#### Options for Public Policy

Having identified the shortcomings of the current housing land market, and the social and economic consequences, the paper presents for discussion and consideration a selection of proposals which could help to address some of the challenges that the market presents. Some of these suggestions reflect recommendations made by the Government's Land Reform Review Group in its 2014 Report: *The Land of Scotland and the Common Good Land capture value*.

The current system that prevents public authorities from buying land at its current use value keeps land prices high, and accordingly presents a substantial impediment to unlocking land availability for housing supply. Reverting to the previous town and country planning arrangement and allowing public authorities to acquire land at the current use value could, in the view of the paper's author, "potentially have a transformative effect on the land market". Public authorities would get the benefit of the uplift in the value of land, bringing them funds for development of infrastructure. This is a model that operates in a number of other jurisdictions.

#### Compulsory sale order

As a means of tackling the issue of land that has been vacant or derelict for a long time, the paper suggests considering the introduction of compulsory sale orders. Using a CSO procedure, a local authority could sell long-term vacant or derelict land at auction, as a way of releasing it back into potential productive use. Such a power is seen as being a powerful incentive to encourage owners to use the land more productively, or face losing it.

#### Housing land development agency

It is recognised that, on its own, the private sector cannot deliver all the new homes that are required, and so the public sector needs to step up and play a more proactive part.

So that such a role would be properly coordinated, the paper suggests that a new public body could be created (or an existing body given additional powers) to ensure that sufficient land is available for new homes. This has also been suggested by the Land Reform Review Group, and others.

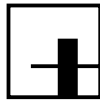
This body would have power to buy, develop and sell land. It might even go so far as being able to develop 'new towns'. Combined with the compulsory sale procedure, and the ability to acquire at current use value, land could be acquired at low cost, and infrastructure could be paid for in a more efficient way than relying on section 75 agreements, while also ensuring that more land is owned and used in the public interest.

#### Taxation

While the suggestions so far relate to ways to encourage the supply of new homes, the second-hand housing market also has an impact on new development: prices in the second-hand market effectively determining the price of new housing.

The favourable treatment of land and housing in the current taxation system contributes to instability in house prices, and is a disincentive to the efficient use of land, so a different approach to taxing land and buildings could provide the necessary stability and incentive.

One way to achieve this could be to retain the existing pool of taxes, but remove the exemptions affecting land and housing: revalue council tax bands; remove the capital



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gains tax exemption for principal homes; alter inheritance tax arrangements; and include derelict and vacant land in the rates system.

Alternatively, more radical reform could be considered, such as applying a land value tax to owners of land, which would discourage acquisition of land on a speculative basis. Land value taxation is hard to evade or avoid, since land cannot be concealed, or transferred to a tax haven.

Land value taxation has been proposed and attempted in the past, and the paper recognises that there are inevitable difficulties, not only with issues of practical implementation, but also since such proposals are politically unpopular. Owners of high value land don't always have liquid funds for tax bills, and sudden significant changes in the tax regime can have unintended effects, as well as destabilising ones. Such concerns might be addressed by introducing a land value tax in substitution for existing taxes; payment of the tax by cash poor owners could be deferred until the land is sold, or upon their death. It might be effective to apply a land value tax on a split basis: by which tax on land is higher than tax on buildings. This would encourage new development, and discourage speculative acquisition and stockpiling of undeveloped land.

### Data and transparency

A comprehensive database of land values in Scotland, which is currently absent, would provide crucial information

to researchers and policy makers alike, and those active in the property market, to assist in assessing policy, tax and economic issues, as well as providing greater market transparency.

### Impact

The author concludes that addressing the issues set out in this discussion paper would not only tackle Scotland's housing needs, but in addition would:

- generate a more dynamic and productive economy, encouraging investment towards productive assets and stimulating growth;
- produce a fairer and more inclusive society, by applying more of the enhancement in value of land for the public benefit, and improving the quality of, and conditions in housing stock;
- reduce the relative cost of housing, freeing up resources to be used on other goods and services, and so improve standards of living; and
- improve public finances, by reducing the need for housing benefit and providing a new source of funds for investing in infrastructure, allowing existing revenues to be used on other projects.



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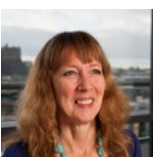
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