



**IPPR Commission on Economic Justice**

# **The Invisible Land**

**The hidden force driving  
the UK's unequal economy  
and broken housing market**

*Discussion Paper*

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Launched in November 2016, the Commission brings together leading figures from across society – from business and trade unions, civil society organisations and academia – to examine the challenges facing the UK economy and make practical recommendations for reform.

The Commission is undertaking a wide-ranging programme of research and policy consultation on issues including industrial strategy, macroeconomic policy, taxation, work and labour markets, wealth and ownership, sub-national economic policy and technological change. Through a major programme of communications, events and stakeholder engagement it aims to contribute to both public debate and public policy on the economy. Non-partisan, it has been welcomed by both government and opposition parties.

The Commission's Interim Report, *Time for Change: A New Vision for the British Economy*, was published in September 2017. Its Final Report will be published in autumn 2018.

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# Summary

**Conventional wisdom suggests that the UK has a problem with house prices but the reality is that we have a problem with land. The value of land held by households has soared over the past two decades and is now worth more than double the value of the property that sits on top of it.** The UK's dysfunctional land market and soaring land values have helped drive growing wealth inequality, create the conditions for a broken housing market, and are a root cause of an unproductive and unstable economy. Reform of the land market must therefore be focused on reducing the financial speculation that occurs in land and sharing the benefits of increases in land values for the benefit of the public good. Reform is essential if the UK is to be a more equal, more productive and stable economy. It is also vital to creating a better functioning housing market that delivers the affordable and quality homes the country needs.

This conclusion is based on five key propositions.

**1. The broken land market has a key role in driving wealth inequality in the UK.**

Rising land values have helped drive up house prices and rents, reducing home ownership, and driving increases in wealth inequality.

- Since 1995, the value of land in the UK has increased by 412 per cent, from £918 billion to over £5 trillion, representing 51 per cent of the UK's total net worth (£9.8 trillion) in 2016.
- The value of land held by households has soared since 1995 by 544 per cent to £3.9 trillion, while the combined value of the property built upon it has risen by only 219 per cent. In 1995 land made-up a fifth (£600 billion or 22 per cent) of UK households net wealth and by 2016 this had risen to two-fifths (£3.9 trillion or 39 per cent). IPPR projections suggest that over the next two decades the value of land will rise to almost three-fifths (£22.8 trillion or 57 per cent) of households' net wealth.
- Property wealth is very unequally shared amongst the population, with the top 10 per cent holding property wealth averaging £420,000 in value compared with the bottom 30 per cent who own no net property wealth.
- The distribution of property wealth is the single largest source of regional wealth inequality – the total value of housing stock in London is now greater than the housing stock of all of Wales, Scotland, Northern Ireland and the North combined.

**2. The broken land market is the driving force behind England's broken housing market.**

- In 1995, the price paid for a home was almost evenly split between the value of the land and the property. In 2016, the cost of the land had risen to over 70 per cent of the price paid for a home. New IPPR projections suggest that on current trends this will rise to 83 per cent over the next two decades (by 2036).
- Since the most significant cost involved in building a new home is the land it sits on, the price of a new home is driven by the cost of land.
- The high cost of land makes it more expensive, difficult and risky to build homes at affordable prices, all of which reduces the rate at which new homes are built.

- Where agricultural land is granted planning permission for housing, the typical increase in its value is up to 100 times. For instance, a hectare of agricultural land in Oxfordshire is typically worth £25,000 but with residential planning permission the value is typically £5.6 million (South Oxfordshire) - an increase of 224 times.

### **3. The broken land market has played a key role in the financialisation of the UK economy and is a cause of the UK's poor productivity.**

- Financial deregulation in the 1980s saw banks apply a greater focus on creating credit collateralised by property, shifting away from their more traditional role of directing savings into productive investments.
- This liberalisation helped drive a rapid increase in house prices which increased nearly tenfold between 1979 and 2017.
- This process of financialisation has been identified as a root cause of the UK's poor productivity performance because investment in housing, and the underlying land, is crowding out more productive investment.

### **4. The broken land market and high house prices are feeding macroeconomic instability.**

- The majority of bank lending and household liabilities are now made up of mortgage debt in the UK.
- In the UK, where house prices are an important driver of consumption, falling house prices can result in reduced residential investment, lower consumer spending, rising unemployment and a fall in GDP.
- Maintaining house prices is intrinsically linked with securing macroeconomic stability – mortgage debt held by UK households has been consistently highlighted as a risk to UK financial stability and the broader UK economy by the Bank of England.

### **5. The systems for regulating and taxing land do not seek to target or fail to adequately capture the 'economic rents' that arise from land.**

- Development measures such as Section 106 are more focused on mitigating the impact of developments than on capturing land value for the public.
- The land value uplift that arose from the awarding of planning permission in 2014/15 was £12.4 billion, but the combined receipts captured by development measures were less than a quarter of that at £2.7 billion. It is estimated that the amount lost could accumulate to £185 billion over the next two decades.
- Council tax and business rates in particular fail due to their design to effectively capture the 'economic rents' that accrue to landowners as a consequence of public and private investment.
- In this context, we argue for a fundamental reassessment of the role of land within the UK economy, and set out a series of proposals to regulate the use of land, build more affordable homes, and share the proceeds of rising land values.

## **REFORMING THE LAND MARKET**

**The government should reform compulsory purchase laws to allow local authorities and public bodies to buy land at a fair value that enables the delivery of high quality development.** To achieve this the 1961 Land Compensation Act should be amended to remove speculative 'hope' value based on prospective future planning permissions. The landowner could still expect to receive a return on their investment, which provides them with an incentive to bring forward their land.

This is the approach taken in a number of countries including Germany, the Netherlands and in the UK prior to 1961.

**The government should give planning authorities in England the powers to ‘zone’ areas of land for development and freeze its price close to its current use value, as happens in Germany.** Landowners would still get a fair return, but any windfall would accrue to the state to pay for infrastructure and affordable housing to benefit the local community. Authorities would have the power to determine what would be built on the land, ensuring that these new developments deliver high quality and sustainable communities.

**The fire-sale of public land to the highest bidder should be ended.** Public land should instead be prioritised for the delivery of genuinely affordable and high quality developments. The Treasury should clarify its Best Value rules to allow public bodies to manage their assets in the public interest. In most cases, public bodies could retain the freehold of their public land and enter into partnerships with housing associations, community land trusts and custom or self-builders to develop it.

### REFORMING THE HOUSING MARKET

**The cap on local authority borrowing to finance housebuilding in England should be abolished.** To achieve their potential housebuilding capacity, local authorities must be allowed to borrow. Given that housing investment earns a return in rents paid or sales made, it makes no sense for councils’ borrowing to be capped as at present.

**The government should exempt borrowing for council housing under its measure for calculating UK debt, bringing the country in line with the accepted international criteria which does not include council housebuilding.** At present, this type of borrowing by local authorities to fund the building of council homes is counted towards the government’s measure of debt – and is therefore subject to its fiscal rules under the Public Sector Net Debt (PSND) measure. By adopting international rules, this type of borrowing for investment would be excluded and would bring the UK in to line with its international counterparts.

**Government should set new guidelines in England for the minimum proportion of new housing developments which must be genuinely affordable.** Local authorities would be able to set their own targets in local plans based on what is viable at a local level, taking into consideration local land values. In the absence of a local target, the national measure would set the ratio – a reasonable split for the national minimum in the absence of a local target could be one-third of all new housing as social housing for rent, one-third genuinely affordable (in perpetuity) for sale, and one-third for sale at market prices.

**Community Land Trusts (CLTs) and other co-operative housing organisations should qualify for lending through the regional divisions of our proposed National Investment Bank.** This would assist with access to finance, the lack of access to which is consistently identified as a significant barrier to CLTs and housing co-ops.

### REFORMING LAND AND PROPERTY TAXATION

**The government should introduce an annual property tax to replace council tax and eventually stamp duty.** There is a clear case for abolishing council tax, including its banding system and replacing it with a property tax which is based on the current value of homes. Such a tax would be far more progressive than council tax, and would effectively capture increases in land values and house prices in a way in the current system does not.



**The government should introduce a land value tax to replace business rates.**

A land value tax on business land would be the most economically efficient means of taxing commercial land. It would support, rather than deter, productive investment; it would capture some of the unearned windfalls from the ownership of land; and it would reduce incentives for further speculation. It should be introduced incrementally over time as business rates are gradually phased out. It has been estimated that a rate of 4 per cent of the value of the land could replace business rates on a revenue neutral basis.

**REGULATING THE FINANCE SECTOR**

**The government should reform macroprudential policy, both to counter systemic risk and limit house price inflation.** The Financial Policy Committee (FPC) of the Bank of England could, for example, be given an explicit house price inflation target, set by government. This would be analogous to the mandate the Monetary Policy Committee (MPC) has to control consumer price inflation. The aim of such a target would be to set property price expectations (a critical driver of house price inflation), reduce excessive debt, and reduce capital inflows by disincentivising property investment. Measures the Bank of England could take to implement such a target could include controlling mortgage lending, in the form of limits on loan-to-value and loan-to-income ratios.

Together, the proposals set out in this paper for regulating our land and housing market – and for a more progressive taxation system focused on land – will reduce speculation in land, lead to a decrease in wealth inequality, and allow a greater focus on productive economic investment. They will also help deliver a better-functioning housing market, capable of delivering the number of homes we need to meet demand – particularly genuinely affordable homes.

# Introduction

*“Buy land, they’re not making it anymore”*

Mark Twain

Land is an essential factor of all economic activity alongside capital and labour but it also has distinctive features. It is immobile: unlike capital and labour it cannot be moved. It is fixed in supply: unlike capital and labour, more of it cannot be produced.

What makes land valuable, therefore, is its location. Inability to move it or make more of it means that the value of a piece of land increases with public and private investment in the surrounding area. Investment in a railway station or road improves access to jobs, and means that the value of the land rises. The building of a school, ensuring an area is more desirable, means that the value of the land rises. Investment in a local park, increasing access to green space for the community, means that the value of the land rises. It also rises with the rising wealth and growth of the population.

In most cases, the increases in the value of land come about not as a result of the exertion or the labour of the landowner, but instead, as John Stuart Mill argued, from the “labour and outlay of other people” (Mill 1871). But this fact is one that mainstream economic thinking has largely ignored in recent decades and that public policy appears to have forgotten (Ryan-Collins 2017). And the real-world consequences have been substantial and universally negative.

Land is now the most valuable asset in the UK – at £5 trillion, the UK’s land is worth more than all homes, commercial property, machinery and equipment and all other non-financial assets in the UK combined. Since 1995, the value of land held by households has soared by 544 per cent, while the combined value of the property built upon it has only increased by 219 per cent.

In this discussion paper, it is argued that soaring land values, and the failure of public policy to either regulate the use of land or tax it appropriately has had disastrous consequences for the UK economy and society.

We make the following propositions.

1. **The broken land market has a key role in driving wealth inequality in the UK.** Rising land values have helped drive up house prices and rents, reducing home ownership, and driving increases in wealth inequality. The increasing capital gains from housing, and the underlying land values, have driven the increase in the wealth-to-income ratio cited by Piketty (2013) that has occurred since 1970<sup>1</sup> (Ryan-Collins et al 2017; Macfarlane 2017).
2. **The broken land market is the driving force behind England's broken housing market.** In 1995, the price paid for a home was almost evenly split between the value of the land and the property. In 2016, the cost of the land had risen to over 70 per cent of the price paid for a home (ONS 2017a). New IPPR projections suggest that on current trends this will rise to 83 per cent over the next two decades (by 2036) (IPPR analysis of ONS 2017a). Since the most significant cost involved in building a new home is the land it sits on, the price of a new home is driven by the cost of land. The high cost of land makes it more expensive, difficult and risky to build homes at affordable prices, all of which reduces the rate at which new homes are built. Where agricultural land is granted planning permission for housing, the typical increase in its value is up to 100 times. This

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<sup>1</sup> Analysis shows that it has fallen after the impacts of housing are removed.

dysfunctional market drives what is called the ‘speculative’ housebuilding model in England. The largest gains which developers can make in the housebuilding process is through land, and therefore market competition occurs over land. The winner is the housebuilder able to pay the most – often the developer most confident about squeezing out other costs. These costs include build quality, affordable housing, and infrastructure. This competition serves to drive land prices up further.

3. **The broken land market has played a key role in the financialisation of the UK economy and is a cause of the UK’s poor productivity.** Financial deregulation in the 1980s saw banks apply a greater focus on creating credit collateralised by property (and the underlying land value), shifting away from their more traditional role of directing savings into productive investments (Ryan-Collins et al 2017). This liberalisation drove a rapid increase in house prices (Blakeley 2018), which increased nearly tenfold between 2017 and 1979 (ibid). This process of financialisation has been identified as a root cause of the UK’s poor productivity performance because investment in housing, and the underlying land, is crowding out more productive investment.
4. **The broken land market and high house prices are feeding macroeconomic instability.** The majority of bank lending and household liabilities are now made up of mortgage debt in the UK (Bank of England 2018, Stirling 2017). In the UK, where house prices are an important driver of consumption, falling house prices can result in reduced residential investment and lower consumer spending, increasing the likelihood of bad loans thereby reducing the capital of banks and lenders (Muellbauer 2018). In turn, credit markets become riskier and banks find it more difficult to lend, as a consequence residential investment and consumer spending fall further, and unemployment and GDP fall (ibid). Therefore, maintaining the asset value of homes is now intrinsically linked with achieving macroeconomic stability – mortgage debt held by UK households has been consistently highlighted as a risk to UK financial stability and the UK economy by the Bank of England (2018).
5. **The systems for regulating and taxing land do not seek to target or fail to adequately capture the ‘economic rents’<sup>2</sup> which arise from land.** By failing to recognise the unique features of land, they serve to exacerbate many of the issues that arise as a consequence of its distinctive qualities. Development measures such as Section 106 are more focused on mitigating the impact of developments than to capture land value for the public. Moreover, council tax and business rates are not designed to effectively capture the ‘economic rents’ that accrue to landowners as a consequence of public and private investment. Council tax is highly regressive, and the failure to update the property prices on which the system relies (1991 property values) means it is wholly inadequate a means to capture land value. Business rates, meanwhile, have significant exemptions which renders them similarly ineffective – they are far more effective at taxing productive investment in the form of capital and machinery than they are land.

In summary, the current system actively encourages speculation in the housing and land markets, which makes existing housing ever more unaffordable and new affordable homes ever harder to build. It works to entrench wealth inequalities, helping to drive regional and intergenerational inequality. The current system of property taxation also promotes economic inefficiency, distortionary behaviour and unproductive investment.

In this paper, we argue for a fundamental reassessment of the role of land within the UK economy and set out a series of proposals to regulate the use of land, build more affordable homes, and share the proceeds of rising land values.

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2 Economic rent is generally defined as excess returns that accrue as a consequence of positional advantage in a market, for example as a result of exploiting a monopoly (Dolphin 2012).

# 1. The role of land within the UK economy

*“Land is limited in quantity while the demand for it, in a prosperous country, is constantly increasing. The rent, therefore, and the price, which depends on the rent, progressively rises, not through the exertion or expenditure of the owner, to which we should not object, but by the mere growth of wealth and population. The incomes of landowners are rising while they are sleeping, through the general prosperity produced by the labour and outlay of other people.”*

John Stuart Mill, 1871<sup>3</sup>

## LAND AND ITS UNIQUE FEATURES

‘Land’ means ‘locational space’ (Ryan-Collins et al 2017), which could, for instance, be farmed for agriculture, used as the site for industry, or utilised for the construction of domestic property.

Within classical economics,<sup>4</sup> the main proponents of which were David Ricardo, John Stuart Mill and Adam Smith, land was understood to be one of the three factors of production alongside capital and labour - on the basis that economic activity requires all three (ibid). Crucially, land has several unique features which mark it out from capital and labour. First, land is immobile: unlike capital and labour it cannot be moved. Second, the supply of land is fixed: which means that more of it cannot be produced.

The unique features of land are crucial to understanding its role within the UK economy. The fact that those unique features have been ignored by mainstream economics helps to explain how land has become a driving force behind rising inequality, the broken housing market, and the financialised, unproductive and unstable UK economy (Ryan-Collins et al 2017).

Classical economists recognised that highly concentrated landownership leads to rentier behaviour and a whole host of economic and social problems. Land, due to its scarcity, immobility and permanency is a unique form of production (ibid). Consequently, it has always been subject to a series of laws and customs regarding its access and use (Tomaney 2017).

However, neo-classical economics – in its pursuit of achieving an ‘objective science’ – disregarded the political, legal and cultural context by seeking to treat land as a “generically substitutable form of capital” (Ryan-Collins et al 2017; Tomaney 2017). In simple terms – an input to production that can be used in greater or lesser quantities depending on its price relative to other available types of capital.

However, the unique features of land – its immobility and fixed supply – mean that characterising it as just another type of capital doesn’t really work. Unlike other forms of capital, an increase in demand for land tends to drive an increase in its price rather than in its supply. This means there is a much greater propensity for the price of land to rise through no effort on the part of the individual who owns

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<sup>3</sup> Quoted in Bentley (2017)

<sup>4</sup> A school of economic thought, exemplified by Adam Smith’s writings in the 18th century, that states that a change in supply will eventually be matched by a change in demand – so that the economy is always moving towards equilibrium.

it, compared to other forms of capital. In short, landowners are much more likely than owners of other types of capital to benefit from what is called ‘an economic rent’ – a financial return that they did not earn.

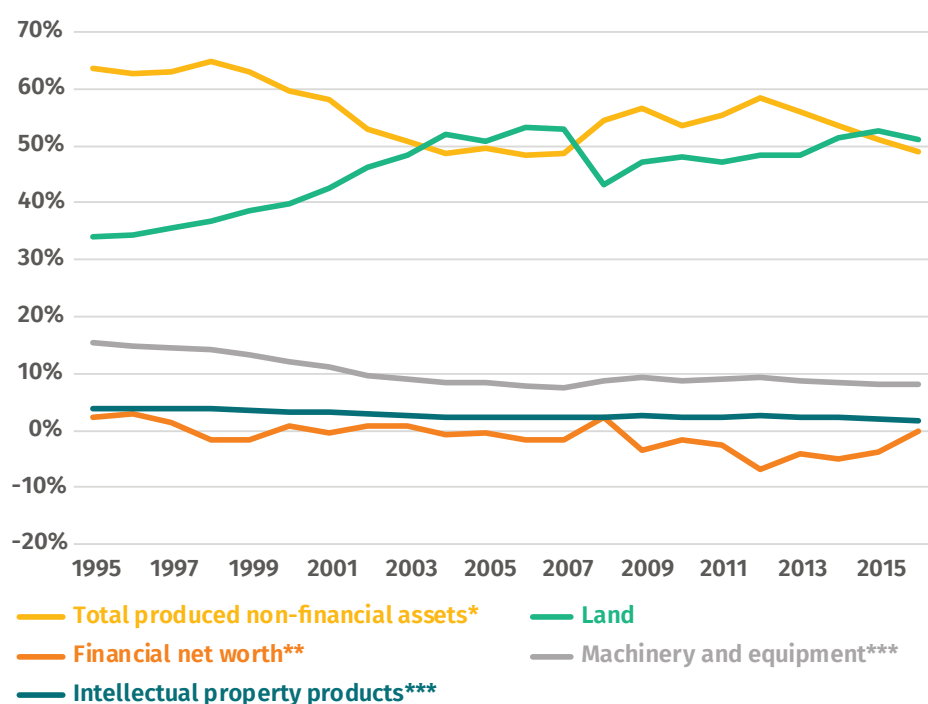
### THE VALUE OF LAND IN THE UK

The failure within economic and public policy to recognise the unique characteristics of land has contributed significantly to soaring land values. Since 1995, the value of land in the UK has increased by 412 per cent, from £918 billion to over £5 trillion, representing 51 per cent of the UK’s total net worth (£9.8 trillion) in 2016. Over the same period, the significance of land has grown with respect to other assets: machinery and equipment, and intellectual property, for example, have both declined as a share of our net worth over the same period. On average the value of land has risen at an annual rate of 8.1 per cent between 1995 and 2016; this compares with an equivalent rate of 2.8 per cent for machinery and equipment.

**FIGURE 1.1**

**The value of land in the UK has increased significantly as a proportion of the UK’s total net worth while other assets such as machinery and equipment have fallen**

*Selection of asset classes as a share of total UK net worth 1995 to 2016*



Source: ONS, The UK national balance sheet, 2017 estimates

\*Total produced non-financial assets includes dwellings, building and structures; transport, ICT and machinery equipment; intellectual property and inventories.

\*\*Financial assets include gold, currency and deposits, debt securities, and loans; equities, stocks and shares, insurance and pensions schemes.

\*\*\* Also incorporated within non-financial assets in the above but included as a comparison to land.

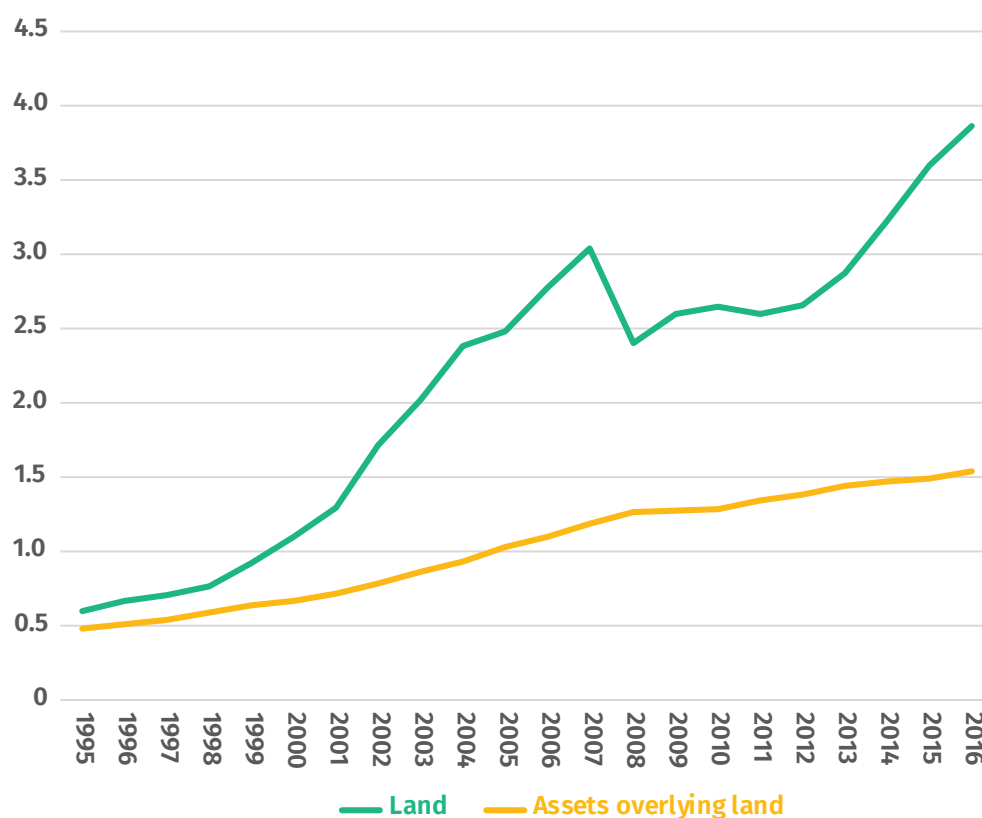
Crucially, the value of land held by *households* has soared since 1995 by 544 per cent to £3.9 trillion, while the combined value of the property built upon it has risen by only 219 per cent (ONS 2017a). New analysis by IPPR shows that in 1995 land made up a fifth (£600 billion or 22 per cent) of UK households net wealth and by 2016 this had risen to two-fifths (£3.9 trillion or 39 per cent). IPPR projections suggest that over the next two decades the value of land will rise to almost three-fifths (£22.8

trillion or 57 per cent) of households' net wealth (IPPR analysis of ONS 2017a). The ONS uses the 'residual method' to calculate the underlying value of the land by subtracting the estimate of the cost of construction from the gross development value.<sup>5</sup> In 1995, the cost of a dwelling was almost evenly split between the value of the land and the building, but, by 2016, the cost of the land had risen to over 70 per cent (ONS 2017a). New IPPR projections suggest that on current trends this will rise to 83 per cent over the next two decades (by 2036) (IPPR analysis of ONS 2017a). This implies that it is largely increases in the value of land that are driving house price inflation.

**FIGURE 1.2**

**The value of land held by households has increased by 544 per cent since 1995, the values of the properties above have only increased by 219 per cent**

*Households sector value of land and its overlying assets, £ trillion, 1995 to 2016*



Source: ONS, The UK national balance sheet, 2017 estimates

5 In 2017, the ONS published figures for the value of land in the UK for the first time. The ONS cite four methods (2017b) for valuing land as set out in full in the Eurostat and Organisation for Economic Co-operation and Development (OECD) Compilation guide on land estimation (2015); the direct method, the hedonic method, the residual method and the land to structure ratio method. There are advantages and disadvantages of each method when being used to estimate different types of land. The ONS states that the limiting factor for the chosen method for the UK are the data sources available for each of the land types. The method chosen to estimate the value of the asset land underlying other buildings and structures, land underlying dwellings, and forestry land was the residual method. The direct method was chosen to estimate agricultural land. More detail can be found in ONS 2017b.

## WHERE DOES LAND VALUE COME FROM?

A number of factors determine the value of land. These include macroeconomic influences such as population growth and rising wealth, public investment in infrastructure, changes to land use regulation, investment by the landowner, and the intrinsic value of the land itself (Suzuki et al 2015). Table 1.1 sets out these factors in more detail.

**TABLE 1.1**

**Factors determining the value of land**

Driver of land value increase	Detail	Who should benefit?
Population growth and economic development	<p>Population and economic growth create demand for land with accessibility and agglomeration benefits</p> <p>In urban areas, there are regional and local trends as not all areas experience the same growth rates</p> <p>Factors impacting this might include demographic patterns, eg international migration and an ageing population</p>	The state, at a local, regional or national level, should retain the uplift in land value on behalf of the general public
Public investment in infrastructure and changes to land use	<p>Investment in transport infrastructure such as roads, railways and transport stations often result in an uplift in land values by improving access to jobs and/or wealth creation</p> <p>The planning system and the availability of developable land also have an impact on land value</p> <p>Planning regulations such as densities, design and quality requirements also influence land values</p> <p>Capacity, skill and competency of public/state institutions such as local government and transport determine their ability to maximise land value</p>	The state, in either the form of government or public transport providers, should capture this portion of the increment to cover the costs of public infrastructure and local service provision
Increases in land value due to landowner's investments	Investments made by the landowner in the improvement of the land drive this portion of the increase	Private landowners should profit from this portion of the increment
Intrinsic land value	Reflects the value of the land absent of any improvements or investments	Land buyers pay sellers to obtain the property rights of land

Source: IPPR adaption of Suzuki et al 2015

In the absence of effective regulatory and tax systems, land markets internalise the productive value from elsewhere in the economy and return the benefits to landowners, including homeowners (Lloyd 2018).

A number of studies have shown, for example, the impact of proximity to transport infrastructure on land and property values: Benjamin and Sirmans (1996) show that rent decreased by 2.4 to 2.6 per cent per tenth of a mile distance from the metro station in Washington DC; Gu and Zheng (2008) show that house prices are

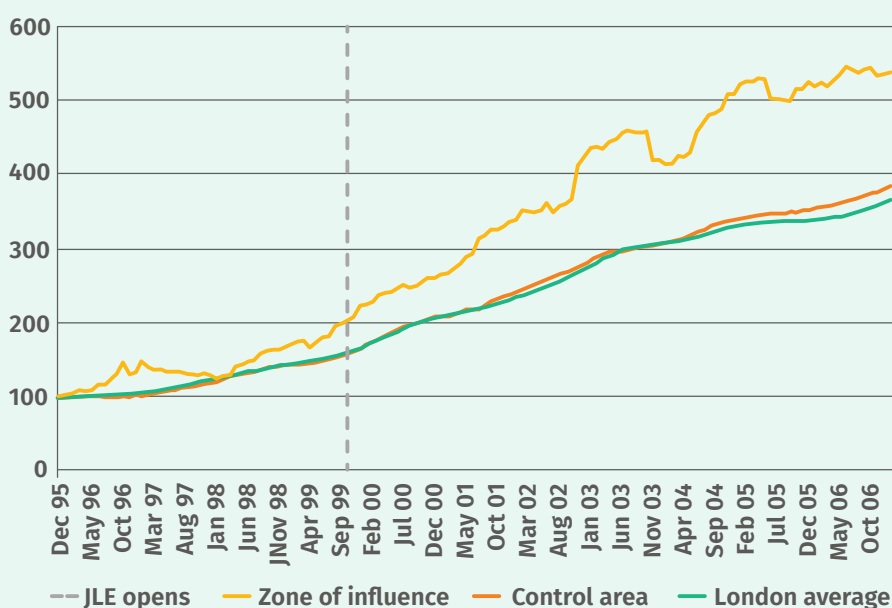
nearly 20 per cent higher within 1,000 metres of transport stations; and Armstrong and Rodriguez (2006) show that properties within circa 1/2 mile of commuter rail sell for an approximate 10 per cent premium, and that each additional minute of driving distance from the station is associated with a 1.6 per cent decline in price (adapted from Suzuki et al 2015).

### THE JUBILEE LINE EXTENSION

Research by KPMG and Savills (TFL and GLA 2017) has demonstrated the impact of major transport infrastructure investment in the UK on existing residential housing stock. Utilising transactions data from the Land Registry and controlling for background price inflation and local influences, their research demonstrated that the Jubilee line extension (JLE), produced an estimated land value uplift of 52 per cent.<sup>6</sup>

**FIGURE 1.3**

**Land values rose significantly in the areas near to the Jubilee Line Extension**  
Land value uplift in London related to the Jubilee Line Extension



Source: Savills 2018

### THE IMPORTANCE OF LOCATION IN LAND VALUE

As figure 1.4 shows, there are significant variations both within and between different parts of the country (Falk 2017). The highest values are found within London, with a hectare of land in the borough of Kensington and Chelsea with residential planning permission valued at £181 million (MHCLG 2018a). In Redcar and Cleveland, Bolsover, and Bassetlaw a similar piece of land would be valued at £370,000. Significant differences are found within some areas such as in

<sup>6</sup> They also found the Docklands Light Railway (DLR) extension to Woolwich and the upgrade and incorporation of the North London line into the Overground network produced land value uplifts of 23 per cent and six per cent respectively. They found Crossrail had no discernible impact on residential property prices but that it had produced uplifts in commercial property values (1-2.5 per cent per annum relative to controls).

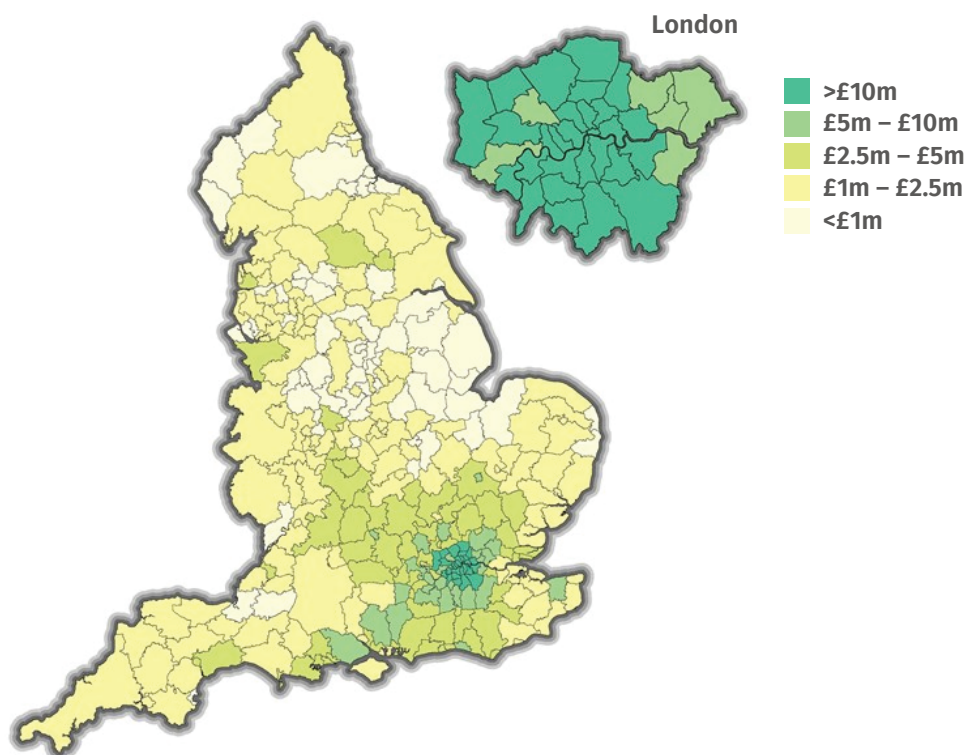


Warwickshire where a hectare of land with residential planning permission would be valued at £4 million but in North Warwickshire it would fetch £1.6 million (ibid).

**FIGURE 1.4**

**The majority of local authorities with residential land values of £5,000,000 per hectare and upwards are in London and the South East**

*Indicative values for residential land by local authority*



Source: Tindale 2018

With the location accounting for much of the value, and that value being largely created by collective efforts (Falk 2017) how that value is then distributed through regulation by the planning system or the taxation system is crucial. Moreover, as we seek to understand in the next chapter, the failure to regulate or tax the value that arises from land can have significant negative impacts for the economy and society.

## 2. Land is playing a destabilising role in the UK economy and England's housing market

*“Search out every problem, look into these questions thoroughly, and the more thoroughly you look into them you will find that the land is at the root of most of them. Housing, wages, food, health...”*

David Lloyd George, 1912<sup>7</sup>

The consequences of ignoring the central role of land within our political economy are not abstract. They include increased wealth inequality, large geographical economic imbalances, a volatile housing market, and wider macroeconomic stability.

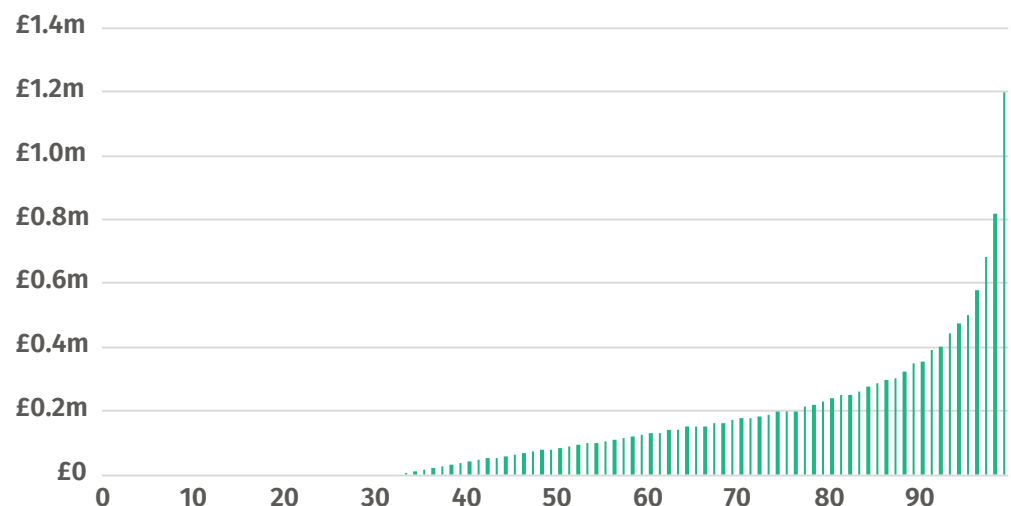
### THE ROLE OF LAND AND PROPERTY IN DRIVING WEALTH INEQUALITY IN THE UK

Land and property play a key role in driving wealth inequality in the UK. Property wealth, after pensions, is the single largest source of net wealth in the UK, comprising 35 per cent of the total (£3.9 trillion) (Roberts and Lawrence 2017). However, this wealth is very unequally shared amongst the population, with the top 10 per cent holding property wealth averaging £420,000 in value, compared with the bottom 30 per cent who own no net property wealth (ibid).

**FIGURE 2.1**

**The top 10 per cent hold property wealth averaging £420,000 in value compared with the bottom 30 per cent who have no net property wealth**

*Distribution of total property wealth (net £) by income percentile, Great Britain, July 2014 to June 2016*



Source: ONS 2018c

\*These are percentiles for all private households in Great Britain - 32 per cent of households do not have any property wealth.

<sup>7</sup> Speaking at Aberdeen, 29th November 1912. See: <https://libdemsalter.org.uk/en/page/quotes-in-support-of-land-tax>

Trends in property wealth and home ownership have caused wealth inequality to fluctuate over the past few decades. In the 1990s to the mid-2000s, the growth in home ownership and increase in net property wealth across the population was the key driver in reducing overall wealth inequality (Corlett and Gardiner 2018). However, since the financial crash, this trend has been reversed with falling rates in home ownership driving inequality up. While home ownership rates have increased since the mid-2000s for the wealthiest 10 per cent of adults, it has fallen by 12 per cent for those in the bottom half of the wealth distribution (ibid).

There is a distinct intergenerational aspect to the recent increase in overall wealth inequality, driven by divergent rates of home ownership between the generations. In 1990, one in two people aged between 25 and 34 owned their own home; by 2017 it had fallen to one in four. By contrast, for those over 65 one in two people similarly owned their own home in 1990 but by 2017 it had increased to three in four (Resolution Foundation 2017). People born in the 1980s have just one-third of the property wealth at age 28 of those born in the 1970s.

The distribution of property wealth is also the single largest source of regional wealth inequality – the total value of housing stock in London is now greater than the housing stock of all of Wales, Scotland, Northern Ireland and the North combined (Savills 2017).

Moreover, the increasing capital gains from housing and the underlying land values have driven the increase in the wealth-to-income ratio cited by Piketty (2013) that has occurred since 1970<sup>8</sup> (Ryan-Collins et al 2017). If capital – or land in this case – were owned equally throughout the population, then the appreciation of property assets would not result in rising inequality. However, the differential rates of ownership for individuals and households mean that this is not the case.

Furthermore, rising house prices are also worsening social exclusion for those who won't inherit wealth from their parents or get assistance from the 'bank of mum and dad'. This is because local house prices increasingly reflect access to public goods such as education, good transport links and alike (Muellbauer 2018).

## THE ROLE OF LAND IN ENGLAND'S HOUSING MARKET

The treatment of land within our economy and rising land values has created particular challenges within our housing system. The value of a house is comprised of two distinct factors: the value of the home itself, and the value of the underlying piece of land (Macfarlane 2017). Moreover, as outlined earlier, the cost of land as a proportion of a home has risen from being roughly equal with the construction cost in 1995, to over 70 per cent today (ONS 2017a).

As we have determined, the ingredient that gives land most of its value is its location. What governs the value of a piece of land in a particular location is population growth, wealth creation, access to jobs and public investment in schools, hospitals, and transport infrastructure.

A major part of the reason that new homes are expensive is that landowners make significant gains when residential planning permission is granted. Because of the geographical monopoly which landowners possess as a consequence of their ownership of land they are able to decide when and where to release land for development and at what price (Bentley 2017). Landowners are incentivised to seek the highest price for their land, holding out from selling until a development scheme provides them with the level of profit they are seeking. Landowners are incentivised to provide their land for schemes which will maximise their profit, an objective which runs in direct conflict with the needs of a local community seeking

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8 Analysis shows that it has fallen after the impacts of housing are removed.

high quality and affordable homes. They are also incentivised to drip feed land on to the market so as not to raise supply and lower potential prices and their profit (ibid). The average price of a piece of agricultural land in England is £21,000 per hectare. But, for land with planning permission to build homes, it is over £6 million per hectare (for industrial land it's nearly £500,000) (MHCLG 2018a). This huge 'planning gain' is created by the state in granting planning permission but, at present, it accrues almost entirely to the landowner as an unearned windfall.

Since the cost of land is a significant determinant of the cost of the housing built on it, this has a substantial impact on other aspects of our housing market. It determines who builds our homes – the developers who have the most financial power and a willingness to acquire land at a high cost. It determines the quality of our homes – a high price paid for land means there is a need to cut costs elsewhere on design and construction materials. And it determines the provision of affordable housing, roads and schools – overpaying for land squeezes out the provision of other infrastructure.

It is also a fundamental cause of the housing supply shortfall over the past few decades. The high cost of land makes it more expensive, difficult and risky to build homes at affordable prices and, due to the higher risk, the rate at which new homes can be built is limited. A negative feedback loop is created, in which the high cost of land is driven by the shortage of homes, but, as land prices rise, it becomes more difficult to build more homes, driving prices up further (Bentley 2017).

#### ENGLAND'S SPECULATIVE HOUSEBUILDING MODEL

Most housing developers in England operate what could be described as a 'speculative' or 'trader' housebuilding model (Jeffreys et al 2015 and 2017; TCPA 2018). As Jeffreys et al explain (2017), speculative developers take large risks in the hope of achieving substantial rewards. Their biggest risk is the purchase of land, the value of which they assess against what they estimate they will sell homes for once they're completed.

Because the largest gains which developers can make in the housebuilding process is through land, that is where competition in the housing market occurs. The winner is the housebuilder able to pay the most – often the developer most confident about squeezing out other costs. These costs include build quality, affordable housing, and infrastructure. This competition serves to drive land prices up further.

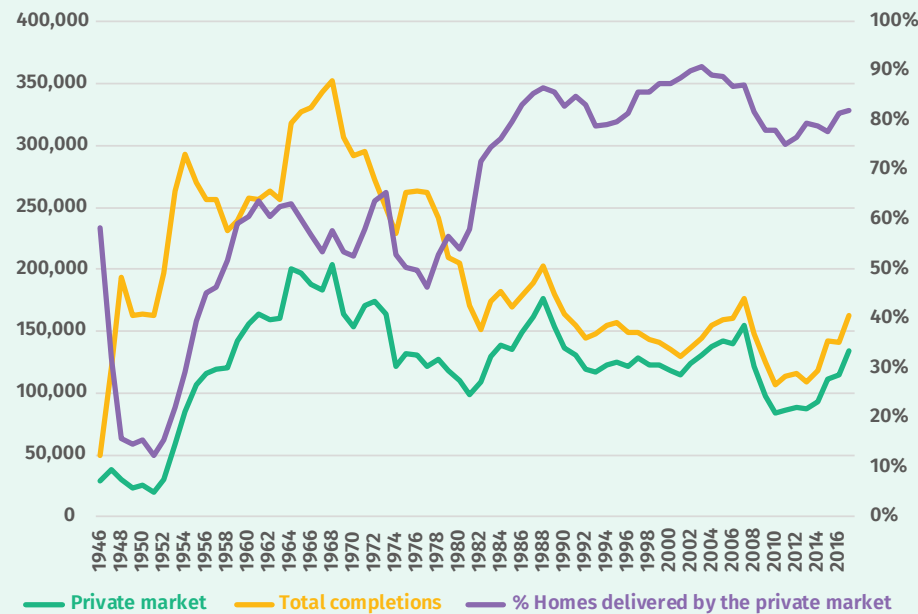
This system is an inevitable consequence of the failure to recognise the unique role of land, its monopolistic qualities and the effects of competition over a scarce resource in a speculative market (Jeffreys et al 2017). Because of the high cost of land and the risk of holding on to it, speculative developers do not seek to compete by lowering the sale prices of their product – they therefore do not seek to increase supply rapidly and only add gradually to the housing stock.

Despite house prices rising by 3 per cent on average over the last 40 years, supply has not increased to match it (Jeffreys et al 2015). In fact, rapid house growth has been followed by only a moderate increase in housing supply. By contrast, supply has contracted rapidly whenever house prices have fallen: after every house price fall, housing supply by the private market has ratcheted down, never returning to its pre-price crash peak (see figure 2.2). These issues are intimately linked with the dysfunctional land market and England's speculative housebuilding model which has grown up around it.

**FIGURE 2.2**

**Private housebuilding output has ratcheted down following every house price crash never returning to its pre-crash peak**

*England private sector housing and total completions since 1946*



Source: IPPR analysis of MHCLG 2018b drawn from Jeffreys et al 2015

The speculative housebuilding model will never deliver the number of homes, let alone the affordable homes, that England needs.

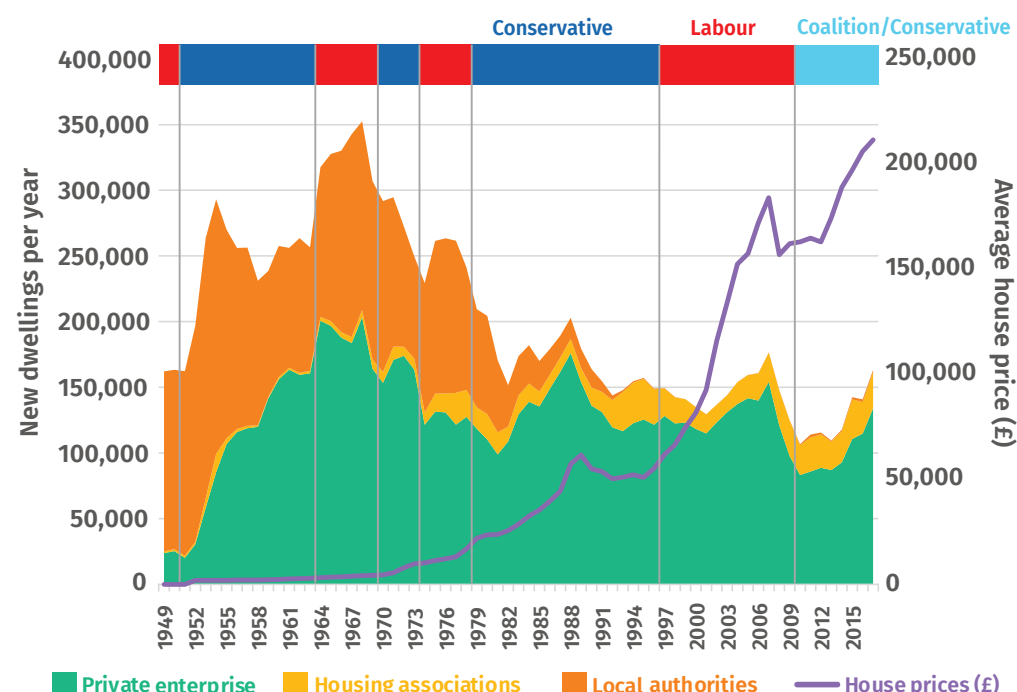
As the larger private housebuilders have become ever more focused on land speculation, there has been increasing concentration in the industry. For instance, the number of small to medium-sized building companies today is barely a quarter of what it was in the 1980s (12,000 in 1988 compared with 3,000 in 2015) (Turner et al 2017; Muellbauer 2018).

Over-reliance on the speculative housebuilding model has been exacerbated by an increasing reliance on the private sector to deliver new homes overall. The contribution of the public sector to housing supply has shrunk significantly over the past 50 years. In 1968, of the 353,000 homes built, 58 per cent of homes were delivered by private housebuilders and the remainder by the public sector. By 2017, of the 163,000 homes built the proportion delivered by private sector housebuilders had increased to 82 per cent, with the contribution of the public sector (local authorities and housing associations) dwindling to 18 per cent.

**FIGURE 2.3**

**Housing supply has never met demand without a significant contribution from the public sector**

*England housing completions by tenure and median house prices since 1949*



Source: MHCLG 2018b; Nationwide 2018

This dramatic reduction has been driven by the long-term decline of the role of local authorities in housebuilding. Significant reductions in capital investment in social housing in recent years have also limited the ability of housing associations to build genuinely affordable homes (Baxter and Murphy 2017). In 2009, the government invested £11.4 billion in building new homes in England, equivalent to 0.7 per cent of GDP, yet, by 2015, this had fallen to £5.3 billion, or 0.2 per cent of GDP (NHF 2017a). Moreover, recent analysis from the Chartered Institute for Housing revealed that the majority of financial support by government has shifted away from affordable housing and towards supporting private home ownership (Baxter and Murphy 2017).

As a consequence, private developers are now expected to deliver a large share of affordable homes through planning requirements but several policy changes have watered down the effectiveness of these measures, including the introduction of viability assessments which are regularly used by developers to escape their obligations, particularly in areas with high land values (see next chapter). Recent research by the New Economics Foundation (NEF 2018) found that the local authorities with the top 10 per cent of land prices experienced a 70 per cent drop in the numbers of affordable or socially rented homes being built over a four-year period (2011–2015) compared with a 20 per cent England-wide average.

The combination of these issues has meant that the supply of homes in England has consistently failed to meet demand. The real life consequences of this have been dramatic. Since 1979, UK house prices have increased tenfold since 1979, compared with consumer prices which increased just five times over the same period (Blakeley 2018). House prices are now nearly 7.7 times the average annual wage (2017), up from 3.6 times in 1997 (ONS 2018d). Home ownership has fallen from a peak of 71 per cent in 2003 to 63 per cent today (2016/17), while private renting

has increased rapidly from 10.8 per cent to 20.3 per cent over the same period (MHCLGc 2018). Moreover, private renters are paying 34 per cent of their earnings on rent, compared to mortgaged property owners who pay 18 per cent (ibid).

As fewer people are able to own their own home, rising house prices benefit an increasingly small group of (generally older) homeowners – and now increasingly owners of second homes – exacerbating wealth inequality even further, as outlined above.

## THE ROLE OF LAND IN THE FINANCIALISATION OF OUR ECONOMY

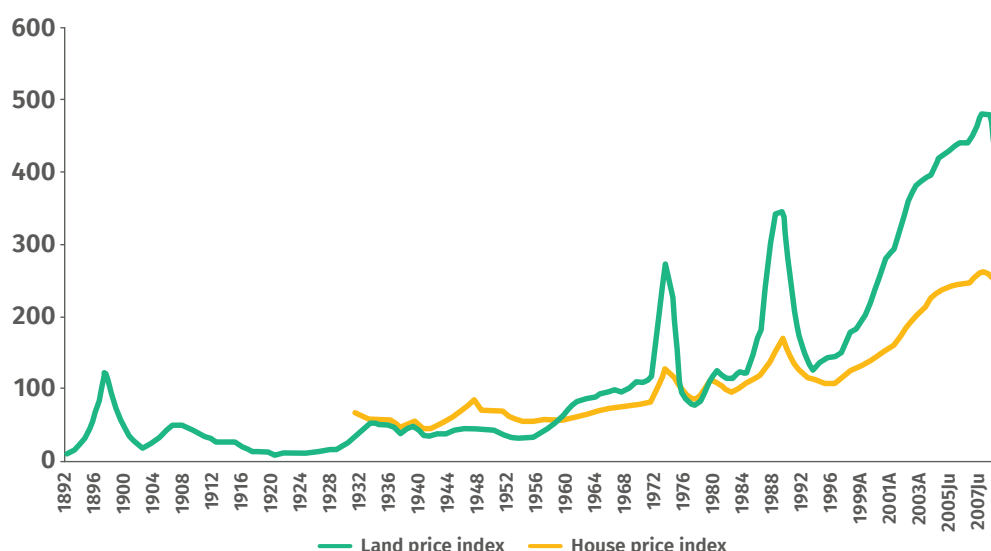
The failures in our land market have been significantly exacerbated by the process of financial deregulation which occurred in the 1980s which saw banks apply a greater focus on creating credit collateralised by property (and the underlying land value), shifting away from their more traditional role of directing savings into productive investments (Ryan-Collins et al 2017). The liberalisation in the 1980s ensured a rapid expansion of private credit that has driven up house prices (Blakeley 2018, Muellbauer 2018). Between 1979 and 2017, house prices rose nearly tenfold, while consumer prices increased by half the rate over the same period (Blakeley 2018).

When the price of land is separated out from the price of the buildings occupying it, it is clear that what is characterised as a volatile housing market is actually a volatile land market, and that it is land, rather than property, that responds to financial market swings. The way land prices responded in the wake of the financial crash exemplify this relationship: in 2008, the value of land dropped by £913 billion, a fall of 23 per cent, while the cost of buildings remained more or less constant.

**FIGURE 2.4**

**The value of land has responded to both financial deregulation and the planning system allowing landowners to expect ‘hope value’**

*Real land and house prices 1892–2008 (1975 = 100)*



Source: Cheshire 2009

As Blakeley (2018) highlights, rising asset prices (and the underlying land values) have also had broader consequences: they have supported high levels of consumer borrowing and over-consumption relative to our own domestic production; they



have increased international demand for UK property assets, pushing up the value of the pound; and that strong pound has made it more difficult for UK industry to compete internationally, worsening the current account deficit.

In addition, this process of financialisation has also been identified as a central cause of the UK's poor productivity performance, as investment in housing is crowding out more productive investment (Collins et al 2017, Stirling 2017). As Stirling argues (2017), bank lending in the UK is particularly focused on real estate lending – real-estate loans to business and individuals account for over 78 per cent of all loans to non-financial UK residents (ibid). Far from raising the productive capacity of the economy, raising wages or GDP growth, the primary impact is to drive up asset prices (Werner 1997, Stirling 2017, Muellbauer 2018).

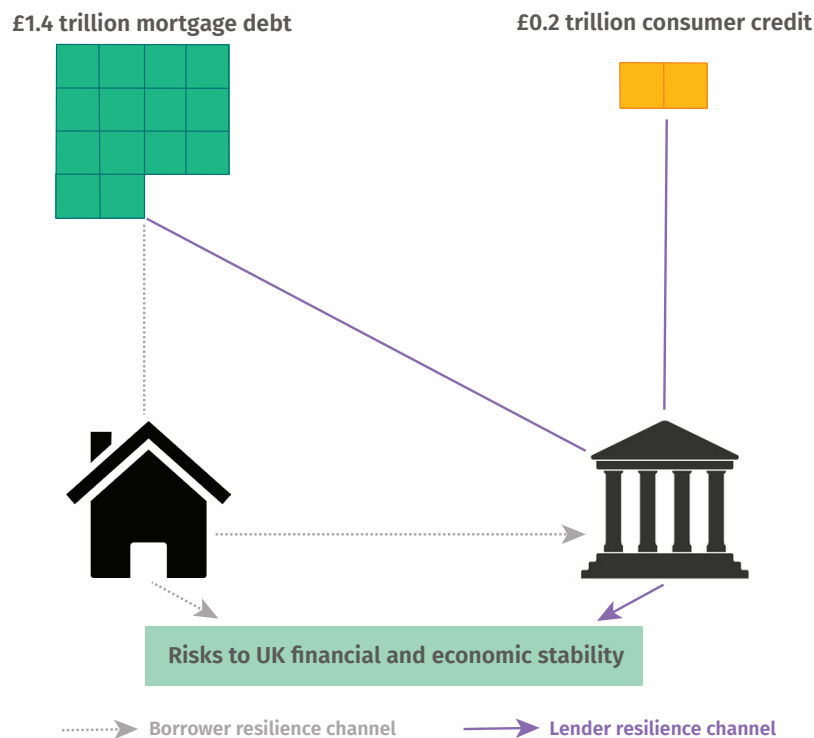
Muellbauer (2018) also points to the poor productivity in the housebuilding industry as a contributor to the UK's poor productivity performance – the speculative housebuilding model having brought about market concentration has also lowered productivity growth. This is due to the fact that UK housebuilders are far more focused on the process of securing land because the capital gains that arise from it is where they secure the majority of their returns. Thus achieving greater productivity in the provision of high quality housing is not a central concern of UK housebuilders (ibid).

### THE ROLE OF LAND AND MACROECONOMIC STABILITY

The Bank of England has consistently warned of the risk to UK financial stability and the UK economy (Bank of England 2018).

**FIGURE 2.5**

**Household debt poses risks to UK financial stability and the UK economy through two main channels**



Source: Reproduced from Bank of England 2018



Muellbauer (2018) argues that overvalued asset prices eventually lead to house price falls. This is particularly relevant in the UK where housing collateral is an important driver of consumption. A house price fall reduces residential investment, has a negative impact on consumer spending, and increases bad loans, lowering the level of capital available to banks and other lenders (ibid).

Credit risk spreads in credit markets and weakens lending. In turn, residential investment falls further, as does household spending – eventually unemployment increases and GDP falls (Muelbauer 2018). Since the majority of bank lending and household liabilities are now made up of mortgage debt, maintaining the asset value of homes is now intrinsically linked with achieving macroeconomic stability (Ryan-Collins et al 2017).

### 3. Regulation and taxation fail to capture ‘economic rents’ arising from land

*“Then, as the millennium was dawning, a miracle happened. The government returned every penny that I had paid in taxes over the previous 40 years. So for four decades I had lived tax free – and I had not dodged the taxman! How was this possible?”*

*“I ‘confessed’ in ‘Taken for a Ride’. Taxpayers generously funded the extension to the Jubilee line, one of London’s Underground lines. Two of the stations were located close to office properties that I own. Those two stations raised the value of my properties by more than all the taxes that I had paid into the public’s coffers over the previous 40 years.”*

*Don Riley in Wheels of Fortune (Harrison 2006)<sup>9</sup>*

There are broadly two types of instruments that can be used by the public sector to capture or capitalise on uplifts in land values: tax or fee-based instruments, and development-based instruments (Suzuki et al 2015). Table 3.1 describes the main forms that these instruments take around the world.

**TABLE 3.1**

**Instruments for capturing land value uplift**

	Instrument	Description
Tax or fee-based	Property and land tax	Tax levied on estimated value of land or land and buildings combined.
	Betterment charges and special assessments	Tax surcharge on estimated benefits created by public investments, requiring property owners who benefit directly from public investments to pay for their costs.
	Tax increment financing (TIF)	TIF is a mechanism for using projected future increases in tax revenues to finance current improvements such as new or improved infrastructure that are expected to generate the uplift in increased tax revenues. It enables a local authority to trade anticipated future tax income for a present benefit through the issuing of bonds (BPF 2008).
Development-based	Land sale or lease	Governments sell or lease developers publicly-owned land or its development rights in return for an up-front payment, leasehold charge, or annual land rent payments through the term of the lease.
	Joint development	A joint partnership between public bodies such as an NHS hospital and the private sector, where the latter support the project financially because they will benefit from the investment or the provision of housing on the site, eg housing for key workers.
	Land readjustment	Landowners pool their land either voluntarily or through a compulsory mechanism, receiving payment for their land in return and a share of the land value uplift.
	Urban redevelopment schemes	Landowners and a developer establish a joint vehicle, assembling pieces of land into a larger site that is then developed.

Source: Reproduced and adapted from Suzuki et al 2015

<sup>9</sup> Quoted in TFL and GLA (2017)

## DEVELOPMENT-BASED MECHANISMS IN ENGLAND

It is widely recognised that current development methods deployed in England are inadequate at capturing uplift in land values (RTPI 2018; TFL and GLA 2018; Highbury Group 2018)

This is, in part, due to the fact that current mechanisms were not designed to maximise land value capture, but to mitigate the immediate impacts of development (RTPI 2018) or to replace public funding following cuts to government spending (Highbury Group 2018).

The main development-based instruments used in England are as follows.

### 1. Section 106 (S106)

S106 of the Town and Country Planning Act (1990) gives local planning authorities (LPAs) the ability to place certain obligation on developers. The main purposes of these mechanisms are to ensure a scheme is compliant with local planning policy and to mitigate negative impacts arising from the development, not to capture land value (RTPI 2018, Highbury Group 2018). S106 does enable some of the uplift value of a development to be captured by the LPA – through requiring the delivery of affordable housing, for example – but it is fundamentally flawed as a land value capture mechanism. It is based on a snapshot, which means it is often set too high or low. As a result, there are high transaction costs with negotiating viability and a lack of consistency which produces uncertainty (RTPI 2018).

### 2. The community infrastructure levy (CIL)

The primary objective of CIL is to raise funds from development value to help pay for public infrastructure. It was introduced in order to simplify planning obligations. The idea was to set an area-wide levy, following a viability assessment of the geography in question, which would ensure greater certainty and less negotiation. While CIL has been successful in some areas, such as London and the South-West of England (RTPI 2018), it is largely perceived to have failed. CIL contains a number of central flaws. First, it is a flat rate tax on space rather than value – making it regressive in application, with more profitable developments paying a lower levy than less profitable ones (TFL and GLA 2017). Second, CIL rates are set across an area as a whole rather than a specific development. This means that they tend to be based on hypothetical developments rather than real ones, and therefore contain a large margin of error, and are biased towards low rates to ensure viability. Third, CIL is not mandatory, and therefore coverage is patchy and the viability assessments are vulnerable to market changes (see below).

### 3. Land assembly and compulsory purchase orders (CPOs)

CPO powers enable local authorities to buy land without the consent of the landowner. CPOs were used extensively in the UK in the development of New Towns<sup>10</sup>, with development corporations purchasing land at close to use value and using the uplift in values that arise from the development to pay for the necessary infrastructure. However, legal developments in the UK have seen what is called ‘hope value’ incorporated into purchase prices. At present, under the 1961 Land Compensation Act, landowners are able to capture the ‘hope value’ of land – the increase in its value that would be likely to occur were it to be given planning permission. The difference in cost to the public authority can be significant, with a distorting impact on the land market (RTPI 2018). Consequently, LPAs are required to buy the land for significantly more than its existing use value (agricultural or brownfield, for example). This undermines the value of CPO as a tool for capturing uplifts in land values (RTPI 2018).

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10 For instance, see <https://www.tcpa.org.uk/Handlers/Download.ashx?IDMF=5bda030e-0b33-42ed-b4d4-0d4728be4ebd>

#### 4. Utilising public land

The public ownership of land removes it from the market entirely and prevents economic rents accruing to private landowners. In many ways, it is the simplest way to ensure that land is used for the public good. The public sector owns a significant proportion of England and Wales' land (900,000 hectares, or 6 per cent of all freehold land). With local authorities and central government departments and bodies under financial constraints, many are selling public land in order to raise money rather than seeking to build affordable homes, for example. For instance, the government has set a target of building 160,000 homes on public sector land by 2020, but is significantly behind target – research by the New Economics Foundation has also shown only one in five of these homes are set to be 'affordable' (Brett 2018).

#### THE VIABILITY TEST

Current methods of land value capture generally attempt to capture uplift from developers, as opposed to landowners, to whom the main uplift accrues. Viability negotiations have been at the root of this problem over the past six years. The viability test is a measure that was introduced into the planning system by the Cameron government to ensure that developments are 'viable'. Developers were able to use these assessments to argue that delivery of Section 106 obligations – such as for affordable housing – will reduce their profits below what is deemed 'competitive' (generally defined to be around 20 per cent). As a consequence, developers were able to overpay for land, knowing that they will be able to negotiate down future planning obligations in order to protect their profit. This loophole resulted in the loss of circa 2,500 affordable homes in just one year in 11 local authority areas alone – this is equivalent to a 79 per cent reduction in affordable housing compared to the levels required by council policies (Grayston 2017). The government revised planning rules in June 2018 in an attempt to close the loophole and prevent developers from using the price paid to a landowner as a justification for negotiating out affordable home requirements.

#### OTHER MEASURES INCREASING LAND VALUES

Since 2010, the government has made successive changes to housing and planning policy which have weakened the various mechanisms to capture land value for the public good. In addition to the viability test, the definition of an 'affordable' home has been watered down, while social rents are now linked to market prices rather than wages (up to 80 per cent of market value or rents) (Baxter and Murphy 2017). Rather than increasing the supply of affordable homes as the government has suggested, it has increased land values as expectations of landowners have risen.

Recent analysis by the Centre for Progressive Capitalism (CPC) has demonstrated how ineffective current development mechanisms are. The CPC (2017) estimates that, in 2014/15, the land value uplift that arose from the awarding of planning permission was £12.4 billion, but the combined receipts of S106 and CIL were less than a quarter of that at £2.7 billion. Moreover, they have estimated that the amount lost could accumulate to £185 billion over the next two decades (ibid).

#### LEARNING FROM ABROAD: GERMANY

In Germany, public authorities play a far more interventionist role in bringing forward land for development. The process 'Umlegung' is a planning mechanism of 'land pooling' or 'land readjustment'. In general, the municipal body is able to assemble the land for a development and then share the uplift in land values with the landowners after the necessary

infrastructure has been paid for. This is often a voluntary arrangement, but it can be compulsory where agreement cannot be reached.

Germany also has what are called ‘urban development measures’ (Städtebauliche Entwicklungsmaßnahme), which are used in situations where the land is under-utilised or not used according to the purposes specified by the municipal authority. Under this system, the municipality designates the land and assembles it for development – prices are frozen after designation preventing speculation and private owners are paid the existing value of the plot. The authority is then able to sell it on following redevelopment at the new, higher, value. In practice, these are measures of last resort and are rarely used – but they act as a powerful incentive for landowners to bring land forward for development.

A similar system also operates in the Netherlands.

Source: Falk 2018

## TAXATION MECHANISMS IN ENGLAND

Taxes on property and land have been around for centuries and remain a significant source of overall taxation revenue (Mirrlees 2011). They have long been favoured by economists. Fixed in supply and hard to hide, land – and the economic rents it earns – can be taxed without distorting behaviour (ibid).

The main taxes on property and land are council tax, the national non-domestic rate (business rates) and stamp duty land tax (SDLT). Current taxes on land and property are widely recognised as relatively poor mechanisms at capturing land values, not least because they are not very responsive to increases in values (TFL and GLA 2017) but also because they are, for the large part, not designed for that purpose.

Council tax is highly regressive and is only loosely related to the value of a property. Moreover, the failure to update the property prices on which it relies (1991 property values) means it is wholly inadequate as a means to capture land value. Business rates, meanwhile, are subject to a significant number of exemptions, and while they are adjusted periodically to reflect increasing values over time, the value growth is ‘neutralised’ at the national level so that overall yield is the same (ibid). SDLT is also widely regarded to be inefficient (Scanlon et al 2017) and the rates charged inadequate to capture rising land values (TFL and GLA 2017).

### 1. Council tax

For the purposes of council tax, properties are placed into one of eight bands (nine in Wales) based on their 1991 values. Each local authority is responsible for setting the rate charged for homes in Band D in their area and all of the other bands are set as a ratio of Band D based on a system of ninths<sup>11</sup> which is set by national government. The tax raised £32.2 billion in 2017–18 (OBR 2018).

Critics cite three central flaws with the design and operation of council tax (see for example Murphy et al 2018; Corlett and Gardiner 2018; Aubrey 2016). First, the council tax liability is based, for properties in England and Scotland, on values from April 1991 (in Wales it is 2003), meaning properties that have gained the most value since that date are under-taxed – a regressive result. Second, council tax is unique among current taxes in being deliberately regressive in its design, as the

11 Band D is equivalent to one, the lowest band is Band A which is six-ninths of Band D, and the highest is Band H which is two times Band D. For example, if a local council sets the Band D council rate at £1,000, Band A would be six-ninths of that value at £666.66, and Band H would be £2,000. The ratio between the lowest band and the highest is capped at a multiple of three, regardless of the value of the properties.

effective tax rate on lower-value properties is higher than that on higher-value properties (Murphy et al 2018, Johnson 2014). Recent research by the Resolution Foundation found that those living in £100,000 homes pay around five times the tax rate of those living in £1 million mansions (Gardiner 2018). Third, there is a distinct spatial unfairness due to the geographical distribution of high value properties (Corlett and Gardiner 2018, Murphy et al 2018).

As a consequence of these design flaws, council tax has failed to capture the unearned windfalls that have accrued to homeowners over nearly three decades. As well as being unjust – there is no reason why capital gains on property should be taxed more lightly than other forms of capital gain – this incentivises the over-consumption of housing because it is undertaxed relative to other assets (ibid).

## **2. The national non-domestic rate (NNDR or business rates)**

The national non-domestic rate (NNDR) or business rates, are levied as a percentage of the estimated rental value – the so called ‘rateable value’ – of non-residential property with valuations held every five years.<sup>12</sup> Business rates are administered locally and, following reforms in 2013, half of the revenues are retained locally. The rest are pooled nationally according to an agreed formula.

It is widely accepted that business rates are not well-designed (Mirrlees et al 2011). As Johnson argues (2014), economists regard business rates as a “combination of one of the worst taxes – a tax on the value of business property – with one of the best – a tax on land values”. Its most fundamental flaw is that it distorts firm behaviour by taxing an input to the productive process of a company (the business property), disadvantaging it vis a vis other forms of physical capital (Mirrlees et al 2011). As argued in the Mirrlees Review (2011), “it is an important principle of the economics of taxation that an efficient tax system should not distort choices firms make about inputs into the production process, and hence that intermediate goods – those used in the production process – should not be taxed”.

As a consequence of business rates, property-intensive businesses are at a disadvantage relative to other businesses in the UK. They are also cited as being at a disadvantage relative to international business competitors – business rates are routinely highlighted as a cause for the lack of competitiveness in the UK steel industry (Boxall 2017; Pickard and Pooler 2016).

The other crucial flaw of business rates is the way unused and undeveloped land is treated. The fact that the charge is either reduced or levied at zero on this type of land creates significant distortions in the incentives to hold and develop land, and encourages its inefficient use. Business rates also discriminate against certain kinds of business – agricultural land is exempt, for example – and this creates additional perverse incentives to use land inefficiently (ibid). Finally, there are inconsistencies between council tax and business rates, the consequence of which is that there is a clear incentive for the use of land for housing at the expense of commercial use (Wingham 2017).

Moreover, and importantly for wealth distribution, business rates fail to adequately capture the economic rents that accrue to landowners from rising land values. This is due to the large number of exemptions as outlined above, the fact that tax revenues are linked to inflation rather than the value of the property, and the fact that it is levied on the property as a whole rather than the space that lies underneath.

## **3. Stamp duty land tax (SDLT)**

Stamp duty is levied on the land transactions of residential properties and is paid by the purchaser. Rates increase depending on the property value, ranging

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12 A new three-year cycle will be introduced following the next valuation in 2022.

from 0 per cent for properties up to £125,000 to 12 per cent on properties over £1.5 million (the higher rate only applies above £1.5 million). Other arrangements exist for various categories of buyers, including relief for first-time buyers, higher rates for those buying additional properties, and those purchasing through a corporate body.

As argued by the IFS and the LSE, among others, SDLT is an example of a ‘bad tax’ (Scanlon et al 2017, Mirrlees 2011). In fact, Stuart Adam has argued that SDLT is a candidate for the “worst-designed tax”. As Mirrlees (2011) argued, there is no good economic argument for taxing homes that are traded more frequently, as SDLT does. Moreover, SDLT actively discourages mutually beneficial transactions, it restricts ownership of residential property by those who value it most (first-time buyers), reduces incentives for people to move home, and it means some people are encouraged to live in an area or size of home they otherwise wouldn’t have chosen (ibid). While the highest rate on any residential property transaction is 15 per cent, the average rate in London for example has been estimated at 3 per cent, a rate not deemed to be significant enough to capture rising values (TFL and GLA 2017).

#### 4. Capital gains tax (CGT)

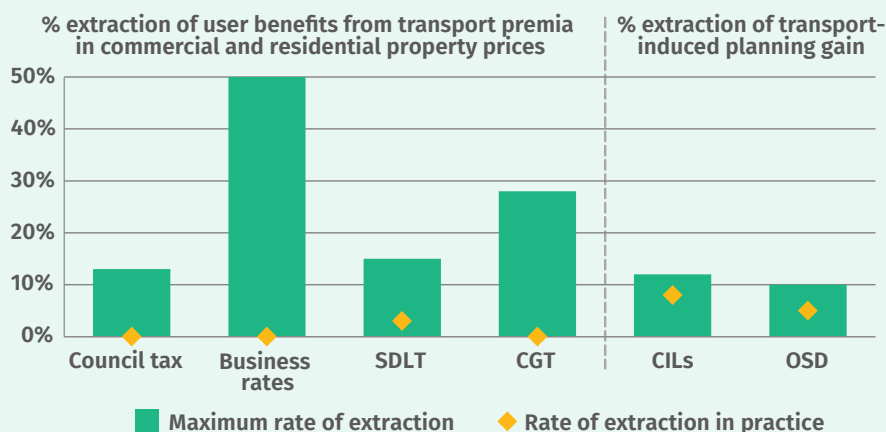
CGT is applied at 28 per cent on the difference between the acquisition cost and the disposal value of residential property, and at 20 per cent for other chargeable assets. However, because it exempts a homeowner’s principal residence, it effectively excludes the vast majority of residential property transactions, while there are a number of reliefs for properties for which it does apply, rendering it a largely ineffective tax at capturing land value (ibid).

#### INEFFECTIVE MECHANISMS AT CAPTURING LAND VALUES

While taxation and development-led mechanisms can be extremely effective at capturing land value uplifts, as has been demonstrated above, the mechanisms currently in effect in the UK are extremely weak at doing so. A joint study of existing instruments by Transport for London and the Greater London Authority (2017) has demonstrated just how ineffective they are in the capital, as shown in figure 3.1. (note these figures are estimates only).

**FIGURE 3.1**

**Current taxation and development do not adequately capture the land value uplift that comes about as a consequence of transport investment**  
*Current rates of extraction of land value uplift by existing instruments*



Source: TFL and GLA 2017



## 4. Recommendations

*“The tax upon land values is, therefore, the most just and equal of all taxes. It is the taking by the community, for the use of the community, of that value which is the creation of the community.”*

Henry George, 1879

### INTRODUCTION

Government – whether at the national, regional or local level – has too few effective tools at its disposal to capture the uplift values that arise from land. We argue that the government should introduce a number of measures to capture land value, curb the rampant speculation in our land market, build more homes, and curtail the impacts of the financialisation of the housing market.

Their approach should focus on three broad groups of measures:

1. development-based measures
2. land and property tax instruments
3. regulating the financial sector.

### DEVELOPMENT-BASED MEASURES

#### Reforming the land market

As we set out above, the current ‘speculative’ model of development in England allows landowners to capture huge uplifts in the land value created by the planning system and public investment in infrastructure. Successive legal decisions have allowed the inclusion of ‘hope value’ in purchase prices. This means that a landowner who is being forced to sell their piece of agricultural land through compulsory purchase to a local authority for the purposes of development can expect a return closer to the developable value rather than its existing use. The difference in these prices can be significant and this process has had a distorting impact on the land market – a primary cause of why land prices have risen so exorbitantly.

**Compulsory purchase laws should be reformed to allow local authorities and public bodies in England to buy land at a fair value that enables the delivery of high quality development.** We propose the reform of compulsory purchase laws, by amending the 1961 Land Compensation Act, which has been recommended by a number of organisations including Shelter (Jeffreys et al 2017), the Royal Town Planning Institute (RTPI 2018) and the Centre for Progressive Capitalism (Aubrey 2017). This is the approach already taken in a number of countries, including Germany and the Netherlands and that was in operation in the UK prior to 1961.

In practice, the expectation would be that compulsory purchase would be used sparingly (though it must be a credible threat), but this change would reduce price expectations and allow the cost of land to fall. The landowner could still expect to receive a return on their investment which provides them with an incentive to bring forward their land.

Objections to this proposal include the argument that such a move would be in contravention of Protocol One of the European Convention on Human Rights. However, the protocol only requires that land be sold at its ‘market value’, and the current legislation in the UK (the 1961 Land Compensation Act) has allowed the



distortion of 'market value' allowing landowners to claim 'hope' value i.e. it allows 'market' value to include the prospective planning permission. Removing this distortion would see 'market' value fall much closer to existing use value.<sup>13</sup>

**Planning authorities in England should be given the powers to 'zone' areas of land for development and freeze its price close to its current use value, as happens in Germany** and argued for by Falk (2018). Landowners would still get a fair return, but any windfall would accrue to the state to pay for infrastructure and affordable housing to benefit the local community. Authorities would have the power to determine what would be built on the land, ensuring that these new developments deliver high quality and sustainable communities. Areas designated through these zones would generally be areas of strategic importance or where the land was underutilised. In most cases, we would expect that land assembly in these 'zones' would occur on a voluntary basis, as their very designation would signal the determination of the LPA to move ahead with development backed by compulsory powers should agreement not be reached. Further reforms to the Land Compensation Act 1961 would be needed to implement this measure.<sup>14</sup>

**It is also proposed that the fire-sale of public land in England to the highest bidder should be ended.** Public land should instead be prioritised for the delivery of genuinely affordable and high quality developments.

The Treasury should clarify its Best Value rules to allow public bodies to manage their assets in the public interest. In most cases, public bodies could retain the freehold of their public land and enter into partnerships with housing associations, community land trusts and custom or self-builders to develop it. There are particular opportunities for public land to be developed by CLTs and not-for-profit organisations that develop and hold in perpetuity affordable homes for a local community.

Since access to land and finance are significant barriers to CLTs (Heywood 2016), **CLTs and other co-operative housing organisations should qualify for lending through the regional divisions of our proposed National Investment Bank (Jacobs et al 2017).**

### **Reforming the housing market**

Reforming the land market will help bring down the cost of building homes and help more young people to build up wealth by owning their own home, while enabling others to rent at affordable rates. However, to aid this process and slow house price inflation, we need to increase the rate at which new homes are built. We also need to ensure that those homes we do build are genuinely affordable.

As we set out above, housing need has never been met without a significant contribution from the public sector. Yet local authorities are restrained from building the homes their local communities need by an arbitrary cap on housebuilding placed on them by central government.

**The cap on local authority borrowing to finance housebuilding in England should be abolished.** To help achieve their potential housebuilding capacity, local authorities must be allowed to borrow. Given that housing investment earns a return in rents paid or sales made, it makes no sense for councils' borrowing to be capped as at present (House of Commons Treasury Committee 2017).

At present, this type of borrowing by local authorities to fund the building of council homes is counted towards the government's measure of debt, and is therefore subject to its fiscal rules under the Public Sector Net Debt (PSND) measure (Perry

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13 For a further explanation of these arguments see <https://progressive-policy.net/2017/10/market-prices-housing-crisis/>

14 For further detail see Falk 2018

2014). However, this measure of debt is unique to the UK, as the international measure of debt is the General Government Gross Debt (GGGD). The GGGD is used across the EU and by bodies such as the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD). The key difference between the two measures is that, while GGGD includes only borrowing from central and local government, PSND also includes the borrowing of public corporations. Council housing, and housing managed by arms-length management organisations (ALMOs) is classified as public corporations. Therefore, under our present measure of debt, lifting the debt cap and the resulting additional borrowing would be covered by the government's fiscal rules. However, by adopting the international rules, this type of borrowing for investment would be excluded and would bring the UK in to line with its international counterparts. **The government should therefore make a specific exemption for borrowing for council housing under PSND, and it should consider the wholesale adoption of the GGGD measure for calculating UK debt, bringing the country in line with the accepted international criteria.**

Alongside measures to increase local authority housebuilding, we also need policies to ensure that the housing being delivered is affordable. **The government should set new guidelines in England for the minimum proportion of new housing developments which must be genuinely affordable.** Local authorities would be able to set their own targets in local plans based on what is viable at a local level, taking into consideration local land values. In the absence of a local target, the national measure would set the ratio - a reasonable split for the national minimum in the absence of a local target could be one-third of all new housing as social housing for rent, one-third genuinely affordable (in perpetuity) for sale, and one-third for sale at market prices.

Our proposals for land reform, combined with these proposals for reform of our housing market, will provide a significant boost to competition in the housing market which has otherwise become over-concentrated.

## REFORMING PROPERTY TAXATION

### **Introduce an annual property tax to replace council tax and eventually stamp duty**

The government should abolish council tax and replace it with a property tax that is proportional to the present-day value of homes. Such a tax would be far more progressive than council tax, and would effectively capture increases in house prices in a way the current system does not.

Unlike a land value tax it would also be a tax on the property. This is appropriate for domestic property because a home is effectively 'consumed' and in economic terms should be liable for a form of VAT (Mirrlees et al 2011). The new tax would therefore act as both a property tax and a tax on consumption.

To bring the system in line with its international counterparts (Whitehead and Blanc 2017), the property tax should be levied on owners rather than occupiers, though it is acknowledged that higher taxes may be passed on to tenants in the form of higher rents. The simultaneous abolition of council tax – which is usually paid by the tenant – would help to ensure that the disposable income of tenant households would not be negatively affected. Nevertheless, it would reduce the visibility of property tax, making it less visible as a charge to the tenant, which is frequently cited as a major cause of council tax's unpopularity (Slack and Bird 2014).

A necessary component of this tax reform would be the introduction of a mechanism to allow the deferral of payment for those households that are cash-poor but asset-rich. Such a mechanism would allow payment on sale or death of the property owner. There would need to be regular revaluation, potentially on an

annual basis as is practised elsewhere (Corlett and Gardiner 2018), to ensure that the tax was reflective of its tax base. Regular revaluation would also ensure that the tax would better capture the increase in house prices that arose from public investment, such as in new transport links (for example, High Speed 2), and vice versa should house prices fall.

Any reform of council tax must take the fact that it is a key revenue stream for local government into consideration. Given the multitude of interests and complications that this provides, it is not possible to consider this in detail here. However, many people still believe there is a strong link between council tax and the services provided for locally, and many see it as a charge for those services rather than a property tax (Murphy et al 2018). There is, therefore, a strong case for retaining that link and there could, for example, be discretion at the local level to vary the levy within certain parameters to allow for different local priorities and needs for public services, as well as variable tax allowances to allow for regional disparities in house prices (Corlett and Gardiner 2018).

Over time, it would be anticipated that the percentage charge should be gradually increased to allow reductions in the level of SDLT, potentially phasing it out altogether.

Research undertaken by the Centre for Progressive Capitalism and the Resolution Foundation suggests that an annual charge of 0.5 per cent of property values would be at least revenue neutral in the case of the former (Aubrey 2016), or raise £1.6 billion more across Great Britain when compared with the current council tax system (Corlett and Gardiner 2018).

There is the option of introducing a threshold below which properties would not have to pay the tax. For example, a 1 per cent tax rate which provided for a £100,000 tax-free allowance per property, would have meant no tax liability for the bottom 14 per cent of properties nationally in 2015/16, and progressive, effective tax rates for properties above the threshold (ibid). If regional allowances were introduced instead of a national allowance – recognising the significant variation in house prices across places – it could raise £3.8 billion in additional revenues (ibid).<sup>15</sup>

The vast majority of households would benefit from the introduction of a proportional property tax – and, for those in the bottom half of the income distribution, their incomes would rise. London and the South East would see fewer winners than other regions, and therefore the regional allowances and the possibility of local discretion would be important (ibid).

### **Introduce a land value tax to replace business rates**

The government should replace business rates with a land value tax (LVT), as others have argued, including the Institute for Fiscal Studies (Mirrlees et al 2011), the Centre for Progressive Capitalism (Aubrey 2016) and the Tony Blair Institute (Adler 2017).

A land value tax is based on two principles. It taxes the value of land, not the property standing on it. And the value of the land is calculated on the basis of its 'optimum use'<sup>16</sup> under existing planning permission, not its current use (Ryan-Collins et al 2017).

These principles confer several advantages over our current business rates system. By taxing undeveloped land on the basis of its use value, it penalises those who hold land without developing it, and incentivises development. Since the value of

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15 The Resolution Foundation, for example, make the lowest 10 per cent of properties in each region tax-free. These range (for 2015/16) from £72,000 in the North East to £160,000 in the South East and £240,000 in London (Corlett and Gardiner 2018).

16 The 'optimum use' of a piece of land would be decided by the local public authority based on its assessment of what a site might best be used for as opposed to its current or actual use.

a property is excluded from the valuation of the land, it does not penalise those businesses that improve their properties, as business rates do today.

Introducing a land value tax would not be simple. It isn't always easy to determine who owns land. Estimating the value of land without the property on it would require new techniques and institutional arrangements. There would also be significant transitional issues in shifting from one form of taxation to another. Nonetheless, land value taxation is already in place in a number of European countries, as well as in parts of the US, Australia and New Zealand, and each has found ways of overcoming the obstacles.

Introducing a land value tax would be the most economically efficient means of taxing commercial land without the distorting effects of business rates. It would support, rather than deter, productive investment; and it would capture some of the unearned windfalls from the ownership of land, and reduce the incentive to speculate on it. It would help rebalance the economy geographically, making disadvantaged regions with lower land values more attractive locations in which to do business.

It would not be anticipated that there should be national exemptions such as for agriculture, but consideration could be given to exempting the first £20,000 value per hectare which would, in effect, exempt most low-value agricultural land (Muellbauer 2005). In addition, local authorities could be empowered to offer certain businesses transitional protections.

To replace business rates on a revenue neutral basis it is estimated that an annual rate of approximately 4 per cent levied on land value would need to be charged (Mirrlees et al 2011). Any implementation should be incremental, for example, an initial charge of around 1 per cent of land value could be levied and rising each year by the same amount, whilst phasing out business rates at the same time (as argued by Mirrlees et al 2011).

Such a tax should continue to fund local government, while the rates of tax would be set nationally (as is the case for business rates), to allow for redistribution between local authorities. In due course, as regions converged, it might be possible to introduce some local variation.

Alongside the introduction of the land value tax, measures should be introduced for the registration and valuation of land for this purpose. The Office for National Statistics (ONS) recently included the separation of land value from the value of the buildings on top of it, also breaking it down into different sectors. However, detailed regional or local estimates are not provided. As part of any process of introducing a land value tax, such estimates would have to be far more detailed, learning from processes elsewhere, where taxes on land value are already in operation. An annual valuation, for example, would ensure values were up to date and would reflect current market conditions. Employed elsewhere, annual valuations have proved successful – in the Netherlands annual revaluations resulted in an 80 per cent reduction in appeals (Aubrey 2016).

## **REGULATING THE FINANCIAL SECTOR**

The rapid expansion of credit since the 1980s, underwritten by property, combined with the structure of the land market has created a toxic combination which has fuelled speculation and resulted in rising land values and overly inflated house prices. Our proposals to tackle the underlying causes in the land market will have an impact, but action also needs to be taken on the supply of credit and the treatment of property as an asset.

**As IPPR has previously proposed (Blakeley 2018; Dolphin 2012), there is a case for overarching reform to macroprudential policy, both to counter systemic risk and limit house price inflation.** The Financial Policy Committee (FPC) of the Bank of England could, for example, be given an explicit house price inflation target, set by government. This would be analogous to the mandate the Monetary Policy Committee (MPC) has to control consumer price inflation.

The aim of such a target would be to set property price expectations (a critical driver of house price inflation), reduce excessive debt, and reduce capital inflows by disincentivising property investment (ibid). Measures the Bank of England could take to implement such a target could include controlling mortgage lending, in the form of limits on loan-to-value and loan-to-income ratios.

## Conclusion

*“Roads are made, streets are made, services are improved, electric light turns night into day, water is brought from reservoirs a hundred miles off in the mountains – and all the while the landlord sits still. Every one of those improvements is effected by the labour and cost of other people and the taxpayers. To not one of those improvements does the land monopolist, as a land monopolist, contribute, and yet by every one of them the value of his land is enhanced. He renders no service to the community, he contributes nothing to the general welfare, he contributes nothing to the process from which his own enrichment is derived.”*

Winston Churchill, 1909<sup>17</sup>

The speculative land and housing markets are damaging the UK's society and its economy. Wealth inequality, a poorly functioning housing market, an economy focused on unproductive investment and macroeconomic instability are all negative consequences of our current treatment of land within the UK economy. Our existing systems for regulating and taxing land, far from acting to curb some of the worst excesses that arise from land speculation, actively encourage it.

The proposals set out in this paper for regulating our land and housing market, and for a more progressive taxation system focused on land, are a first step in ensuring that the unearned ‘economic rents’ which arise from landownership are shared for the public good. Our proposals will reduce speculation in land, lead to a decrease in wealth inequality, and allow for a greater focus on productive economic investment. They will also help to create a better-functioning housing market, capable of delivering the number of homes we need to meet demand, particularly genuinely affordable homes. Together, our proposals will make for a stronger, more just and prosperous economy.

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<sup>17</sup> Quoted by Barker (2003)

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# **The Invisible Land**

## **The hidden force driving the UK's unequal economy and broken housing market**

### ***Discussion Paper***

The IPPR Commission on Economic Justice is a landmark initiative to rethink economic policy for post-Brexit Britain. The Commission brings together leading figures from across society to examine the challenges facing the UK economy and make practical recommendations for reform.

The speculative land and housing markets are damaging the UK's society and its economy. Wealth inequality, a poorly functioning housing market, an economy focused on unproductive investment and macroeconomic instability are all negative consequences of our current treatment of land within the UK economy. Our existing systems for regulating and taxing land, far from acting to curb some of the worst excesses that arise from land speculation, actively encourage it.

In this discussion paper, we set out the drivers of the UK's speculative land market. We characterise the consequences for the UK economy of our failure to properly regulate and tax land. And we put forward practical proposals to help us move to a stronger, more just and prosperous economy.