Discussion of ‘Housing Taxation in OECD Countries’ and ‘Brick by Brick’ Vol. 2

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SUERF webinar

Real estate markets – outlook, risks, scenarios, policies

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Two brilliant reports, complemented by significant extensions of the data-base

- Lucid, comprehensive, well-researched and evidence- and reference-based.
- *Land and housing are intimately involved in all aspects of economic life:* implementing the recommendations could improve the well-being of citizens and the sustainability of life on Planet Earth.
- Brick by Brick, vol.2 continues Vol. 1's theme viz. it is vital to design *holistic, cross-discipline, cross-ministry policy approaches*.
  - Post-pandemic, cost of living crisis and housing affordability.
  - Decarbonising housing.
  - Housing finance: efficiency, resilience and decarbonisation.
  - How urban policy needs to adapt to the new geography of housing demand.
- The housing taxation volume is a *mine of information*.
  - Trends and challenges in the light of structural shifts: housing affordability, environmental impact.
  - The distribution of housing wealth.
  - Existing tax policies and reform options.

The role of land and long-run consequences of real estate booms: is a little under-played

- Much of the rise in real estate prices reflects rocketing land values.
- The prize-winning study by Müller and Verner (2021) examines the sectoral allocation of credit in 116 countries since 1940.
  - Finds that greater credit to *non-tradable sectors*, including construction and real estate, is *associated with a boom-bust pattern in output*, similar to household credit booms.
- Such lending booms also predict elevated financial crisis risk and productivity slowdowns.
- Other evidence for a negative relationship between rising real estate values and productivity:
  - Doerr (2020) [*US, China, Spain and other EU nations*] and Chakraborty et al. (2018) [*the US*], Hau and Ouyang (2021) [*China*], Basco et al (2022) [*Spain*], and Grjebine et al. (2022) [*European countries*].
- Mechanisms include *boosting growth* of sectors with lower productivity growth, *crowding out credit access* of non-real estate sectors and *increasing crisis risk*.

Shares of land in household fixed non-financial assets

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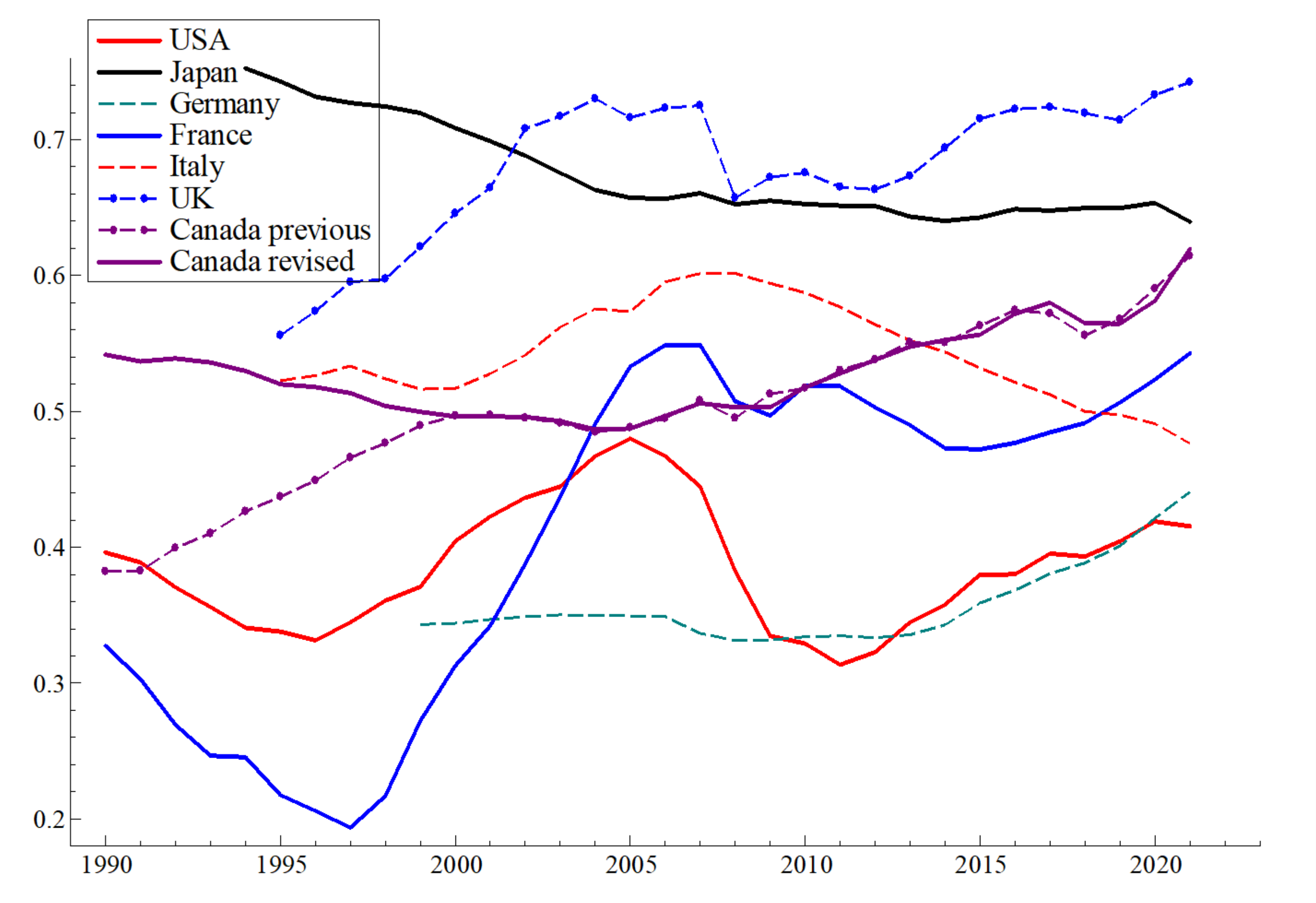

Source: OECD, Balance sheets for non-financial assets owned by households and non-profit institutions serving households, share of land in fixed non-financial assets, revised data for Canada from Statistics Canada.

Both reports confirm that *well-designed recurrent property taxes* could help to:

- Broaden the tax base and raise more tax revenue.
- Reduce inequality between individuals and generations, and social exclusion.
- Reduce greenhouse emissions from buildings – help address the climate crisis.
- Improve land value capture to finance infrastructure and affordable housing.
- Reduce urban sprawl.
- Allocate existing housing stock more efficiently
- Hence, improve housing affordability.
- Improve labour market flexibility, given reduction in transactions taxes.
- Reverse widening regional inequality- promote ‘levelling up’.
- Stabilise the macro economy.

But *could have emphasised more*:

- Shift investment incentives from rent-seeking to productivity enhancing.

- *Land value taxes* have long been regarded as the *most efficient of tax options*.
- But *much of the literature ignores*:
    - Optimal tax literature which highlights need for a consumption tax (Mirrlees, 2011).
    - And the greatest market failure faced by mankind – the life-threatening emission of greenhouse gases.
- Together these imply need for split rate taxes, in which *land and buildings face different tax rates*.
- Market value-based property taxes *discourage green investment*, e.g. in insulation, low carbon energy systems.
- At the very least, this *justifies discount for low carbon emitting buildings* – even if carbon taxes were more widely used.
- In the absence of comprehensive carbon taxes, discounts need to be substantial – effectively, 'green discounts' *are a polite way of taxing high carbon emitting buildings more highly*.

All these objectives met by 'Green Land Value Tax'

- A Green Land Value Tax (GLTV) could resolve conflicts between:
  (i) meeting climate goals; and *(ii) equity and housing affordability.*
  - See design in: Muellbauer (2023, 2024).
  - Climate scientists fear *catastrophic tipping points* in the global climate, IPCC, (2021); IPCC,(2022), IPCC (2023).
  - Importance of decarbonising the housing stock is a major theme of Brick by Brick, vol. 2.
  - Land prices (reflected in house prices) relative to incomes are near all-time records, pricing younger citizens out of home-ownership and affordable rents. Highlighted in both OECD reports.
- The GLVT is effectively a split-rate property tax:
  - consists of a charge on the land *plus* a charge on the building *minus* a discount (depending on energy usage).
- Features:
  - Regular revaluations to discourage speculation and avoid cliff-edge changes.
  - To protect cash-poor but land-rich households, everyone, initially retired households, would have the right to defer the tax.

Designing property tax deferral

- Deferral is a *key element for public acceptance*:
  - Every retired household would have *the right to defer the tax*. Protects *cash-poor but property-rich* households.
  - *Tax authority* registers a proportionate interest at *Land Registry (=* unpaid tax for each year deferred), settled when the property sold or transferred - avoids complex interest charges.
  - A small discount for *cash-payments*.
- Deferral schemes have been *widely offered*:
  - Debt accumulates at compound interest.
  - e.g. US, Canada, Denmark & Ireland (OECD (2022), pp.86-7), but *take-up is remarkably low.*
  - Munnell et al. (2022) suggest eligibility restrictions, ignorance, complexity and concern about high interest rates as possible reasons.
- My 'proportion of equity' deferral proposal is *easy to understand*:
  - Tick a box on the property tax form requesting deferral - without a means test, complex form-filling and compound interest rate calculations.
  - In most OECD countries, in the long-run, house prices have risen more than incomes – which should ensure solid long-run revenue flows.
  - National governments should underwrite deferral schemes to stabilise local revenue streams.
  - Automatic deferral right could eventually be extended to all households.

Widely-accessible deferral transforms the conclusions on regressivity

- "From a distributional perspective, several studies find that recurrent taxes on immovable property are *regressive with respect to income*, but these studies have *limitations*." [OECD (2022) p. 80-81.]
    - Most of these studies *are on cash income* and are *confined to owner-occupiers*.
- *Imputed rent* (part of National Accounts' defn. of consumption and disposable income) is explained in: [OECD (2022) p. 99, box 3.4].
- <u>With deferral</u>, no excuse for focus just on cash income inequality and omitting tenants.
    - E.g. a cash-poor widow owning a home in an expensive location, is well off compared to a tenant with the same cash income but paying rent.
- This matters with *split rate taxation*, where land is taxed more highly than buildings.
- Barbosa & Skipka (2019) analyse granular data for German owner-occupiers:
    - Land ownership more concentrated than property ownership, but land values are slightly less correlated with cash income than overall property values.
    - Among owner-occupiers: a shift from a property tax to a pure LVT would create somewhat more losers than winners in the lower cash-income quintiles.
    - Conclusion is highly implausible for disposable income (i.e. incl. imputed rent).
    - Over half of German households are renters, typically in less spacious homes, so opposite conclusion must hold for households in general.

Valuation issues

- OECD (2022), p.117-118]: discusses experience with split rate taxes, *including valuation problems*.
  - Germany: has just gone through a revaluation splitting land from building values.
  - Australia: "land value taxes are administered by state authorities, which have developed sophisticated mass appraisal techniques that combine historical sales records with Geographic Information Systems (GIS) software and increased assessment accuracy", p. 118.

- Residual method: land value=property value minus rebuilding cost (from insurance) but *can be gamed and often understates land values*.

- *Superior hedonic mass-valuation measures*: apply to granular multi-year house price data to extract land values [Diewert, de Haan & Hendriks, 2021, 2015].
  - Take account of the age of the structure and other indicators.
  - Construction price indices are largely national and not location-specific.
  - Controlling for their movements improves the identification of local land prices by sorting movements in building values from local land values.
  - Moreover, spatial land price gradients are smoother and therefore easier to estimate accurately than often idiosyncratic housing values.

Applying the ideas of the two OECD reports to the UK: a three-part policy package

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1. Enable Land Value Capture

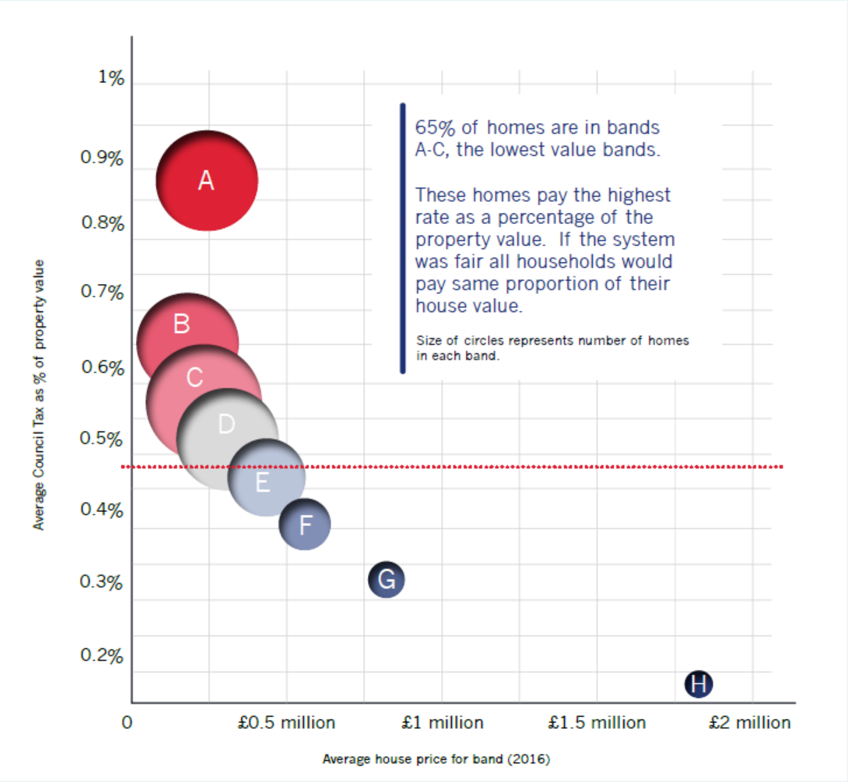
   - *Fairly split the uplift in land values* between the current landowner and the national or local planning authorities – to help meet infrastructure or housing needs.
   - *Capture for the tax-payer* more of the increased land values from planning gain and from public investment.
     - was widely used in New Town development in the 1950s-1970s.
   - *Makes housing more affordable* because land becomes cheaper in new developments.
   - To enable LVC, will *require reform* of the 1961 Land Compensation Act, LVC 2017 and a *shift in fiscal rule* away from gross debt/GDP focus to *public sector net worth/GDP.*

2. Planning reform, e.g. Watling and Breach (2023)

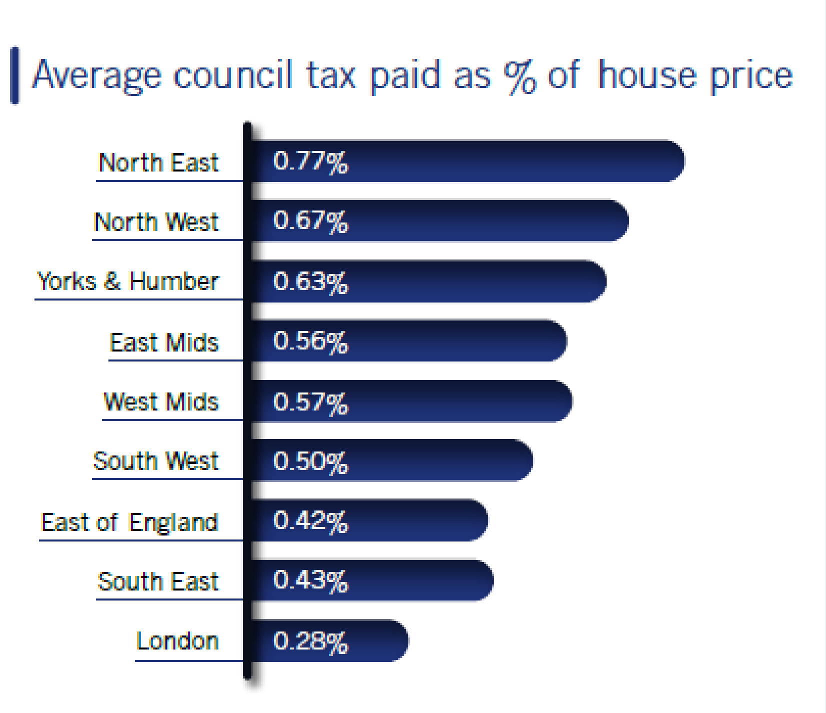
   - *A flexible zoning code*: mixed-use zones for different types of neighbourhood.
   - Guarantee planning permission for *plan- and building reg.-compliant* proposals.
   - Merge Local Plans and Local Transport Plans – *integrate infrastructure and housing*.

3. Replace Council Tax

Individually regressive



Regionally regressive



Other features of UK property tax reform

- Expand coverage of property tax to *agricultural and vacant land*, excluding lower-value land (e.g. below £30k per hectare).
    - Improves both government fiscal capacity and resource allocation.
- Invest in *Land Registry* to extend coverage of land titles.
- Reduce *Stamp Duty* to improve *labour mobility* and *housing market flexibility*.
- Start with *property revaluation*, enabling a move to a *proportional property tax* with *green discounts* and simple *equity-based deferral (*at least for older households).
- All property tax reforms need *phasing in* and campaign of *public education*.
- Even with deferral, adjustment to new tax rates might need to be *phased*.
- *Next revaluation*: split *land values* from *building values*
- Extend split-rate tax structure to *Business Rates* as well as households (but with greater weight on land).