A Land Value Tax for Northern Ireland

Centre for Economic Empowerment Research Report: seven

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A Report for NICVA

By Ronan Lyons and Andy Wightman

The economic case for a land value tax is simple, and almost undeniable. Why, then, do we not have one already? Why, indeed, is the possibility of such a tax barely part of the mainstream political debate, with proponents considered marginal and unconventional?

Mirrlees Review, Tax by Design

FOREWORD

In 2008 Northern Ireland experienced a severe property crash. The extreme rise in house prices which preceded the crash was, at the time, broadly welcomed as a sign of growing prosperity. But it is now clear that while some vested interests benefited, the property bubble caused significant social and economic damage.

The prospect of speculative gains diverted investment away from productive outlets and into inflating property prices. Soaring house prices led households to take on onerous mortgages, debts which will long stifle spending and investment. And when the bubble burst, construction collapsed, meaning many people faced unemployment.

Avoiding a re-emergence of a real estate bubble should be an economic priority for government. This report, the seventh in our research series, proposes a solution. It explains how a Land Value Tax could operate in Northern Ireland to prevent speculation on land - a major cause of real estate bubbles. Significantly, because it involves reforming the rates system, this is a solution within the power of Northern Ireland's Assembly and District Councils.

House prices in Northern Ireland are on the rise again. As before, this has been widely welcomed as an indication of economic progress. It is important to ensure that any price rises are a sustainable result of real economic growth, rather than speculation. In this context, this report is crucial reading.

Seamus McAleavey

NICVA Chief Executive

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EXECUTIVE SUMMARY

1 Background

Northern Ireland has recently experienced perhaps the most severe property market crash in the developed world. The real estate bubble led to excessive mortgage debt, depressed consumer spending, distorted investment, and constrained economic growth. Speculation on the future value of land is a major cause of such bubbles.

2 Land Value Tax Explained

Real estate is comprised of two components: land and the improvements (typically buildings) on the land. It is primarily the owners of land who make improvements and, by extension, generate its value. But land itself is a gift of nature. Its value is derived from its proximity to amenities created by others. Land Value Tax (LVT) is a levy charged on land, rather than the improvements. It recovers the socially created value of land and speculative gains on land prices, which drives real estate bubbles.

The corollary of LVT is that improvements made by owners are subject to minimal or zero taxation. Revenue from LVT might even provide a surplus which could be used to offset or abolish other, less desirable forms of taxation, such as business rates. In this way, LVT can help shift incentives from less to more productive activities.

3 Land Taxation in Northern Ireland

The current rating system in Northern Ireland came into force in April 2007. Rates are levied on the value of the whole property with no distinction made between the land value and the improvements. In addition, rates are levied on the basis of a domestic valuation of 1 January 2005. House prices have changed considerably since then. It is clear that the current rating system has had little impact on house prices or behaviour and is merely a means of collecting some taxation revenue.

4 Proposals for LVT in Northern Ireland

In order to introduce a system of LVT, valuations would have to be disaggregated into the land component and the building component. This would involve adapting the current system rather than introducing a new system. LVT also requires comprehensive information on land ownership. The main task here would be to identify the owners of the 19% of homes that are currently in the private rented sector. The recently established Landlord Registration Scheme should help with this. In addition, a means of assessing the highest and best use of land is required as this is the basis upon which LVT is levied. This requires a more robust and transparent system of land use planning than is currently in place.

70% of land in Northern Ireland is agricultural. Agricultural land has been exempt from rating since 1929, creating a greater burden on other properties. Agricultural land should be incrementally brought into the net of a well-designed property tax system.

People who have low incomes and modest homes should continue to receive rates relief, as currently applied. A deferment scheme could be set up for people with low incomes but with expensive properties, whereby rates could be rolled over and paid when the property is sold.

5 Impact Assessment

Modelling of the potential yield impact of LVT suggests that it would redistribute the burden of property tax away from the west and towards the south-east of Northern Ireland. There is also a strong positive correlation between LVT and deprivation. In other words, LVT is a progressive tax.

6 Conclusions and Recommendations

For practical and political reasons, it is not recommended that a system of LVT be introduced immediately. However, Northern Ireland is in a good position to adapt the existing rating system by providing more regular valuations of land and by initiating split valuations of site value and of improvements. Once this is achieved, realistic pilot studies can be carried out to assess the impacts of LVT.

In the longer term, LVT could be introduced and used not only to prevent another real estate bubble but also, if more taxation powers are devolved, to reduce the incidence of other, less economically desirable taxes.

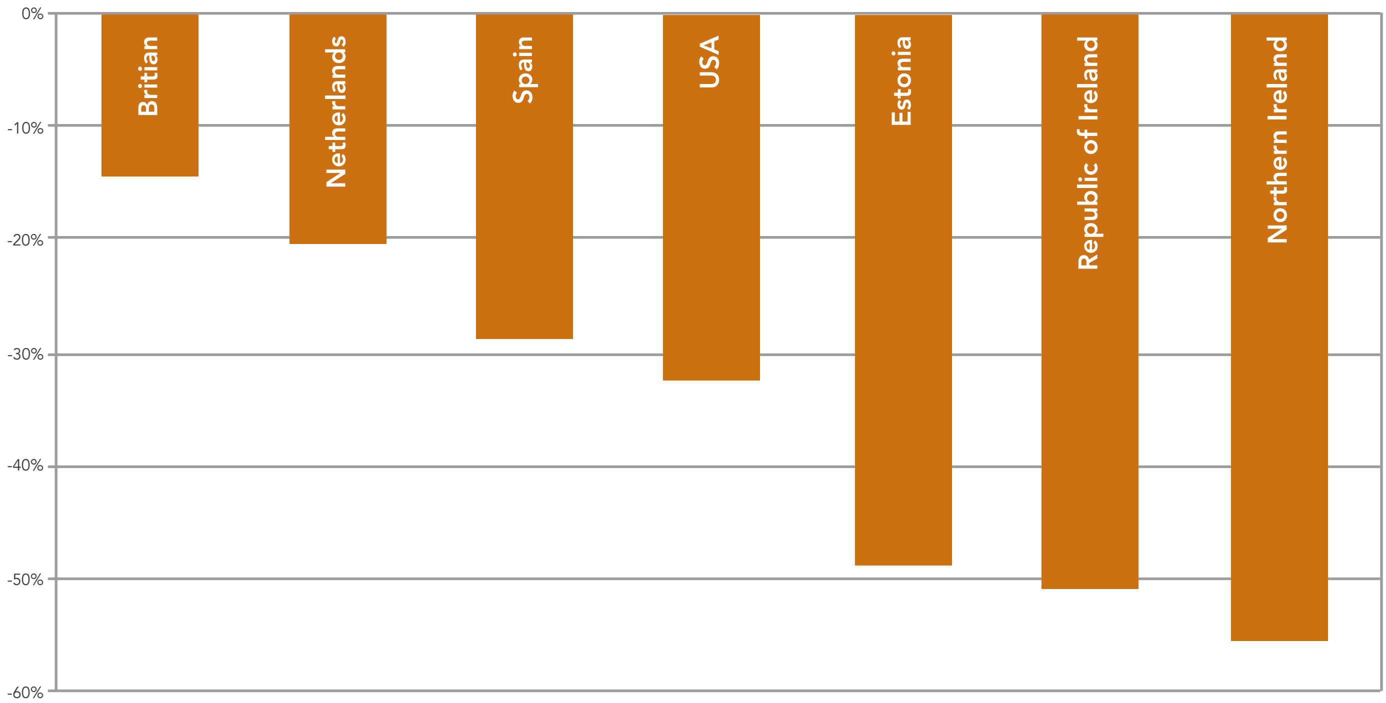
1. BACKGROUND: THE LAND ECONOMY OF NORTHERN IRELAND

1.1 Land Prices in Northern Ireland

Northern Ireland has recently experienced a severe property market bubble[1] and crash. The average house price rose from less than £100,000 in 2003 to £230,000 in 2007, with year-on-year increases of more than 30% in both 2006 and 2007.[2] Since 2007, house prices in Northern Ireland have fallen by 56%.[3]

Figure 1 shows the fall in house prices for a range of countries that experienced a housing bubble before 2007. The fall in Northern Ireland exceeds those experienced in Estonia and the Republic of Ireland, typically regarded as the most severe housing crashes in the developed world.[4]

Figure 1. Fall in house prices from 2007 (to lowest point)



The severity of Northern Ireland's real estate crisis can also be seen in statistics on house price volatility. Figure 2 shows how volatile house prices have been over the preceding five years, for various regions within the UK and Ireland, from the early 1970s. While there have been periods with volatile prices in each region, such as in the late 1980s and early 1990s in England and Wales, by far the most extreme volatility has been seen recently in Northern Ireland, where house price inflation changed from +56% year-on-year in early 2007 to -23% year-on-year by mid-2009.

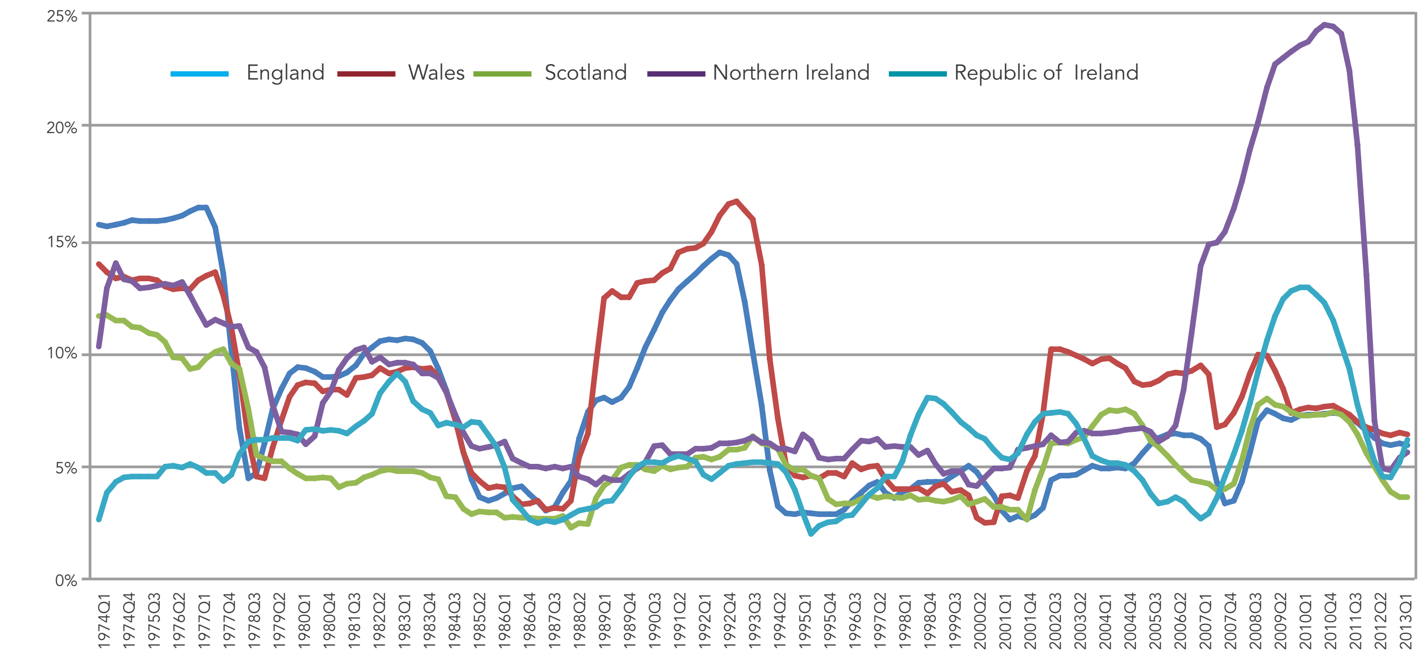
[1] A bubble is a situation in which asset prices rise well above their real underlying value.

[2] Source: ONS House Price Index statistical bulletin.

[3] Northern Ireland Housing Executive (2013) *Northern Ireland Housing Market Review & Perspectives 2013-2016.*

[4] Source: BIS Property price statistics and LPS.

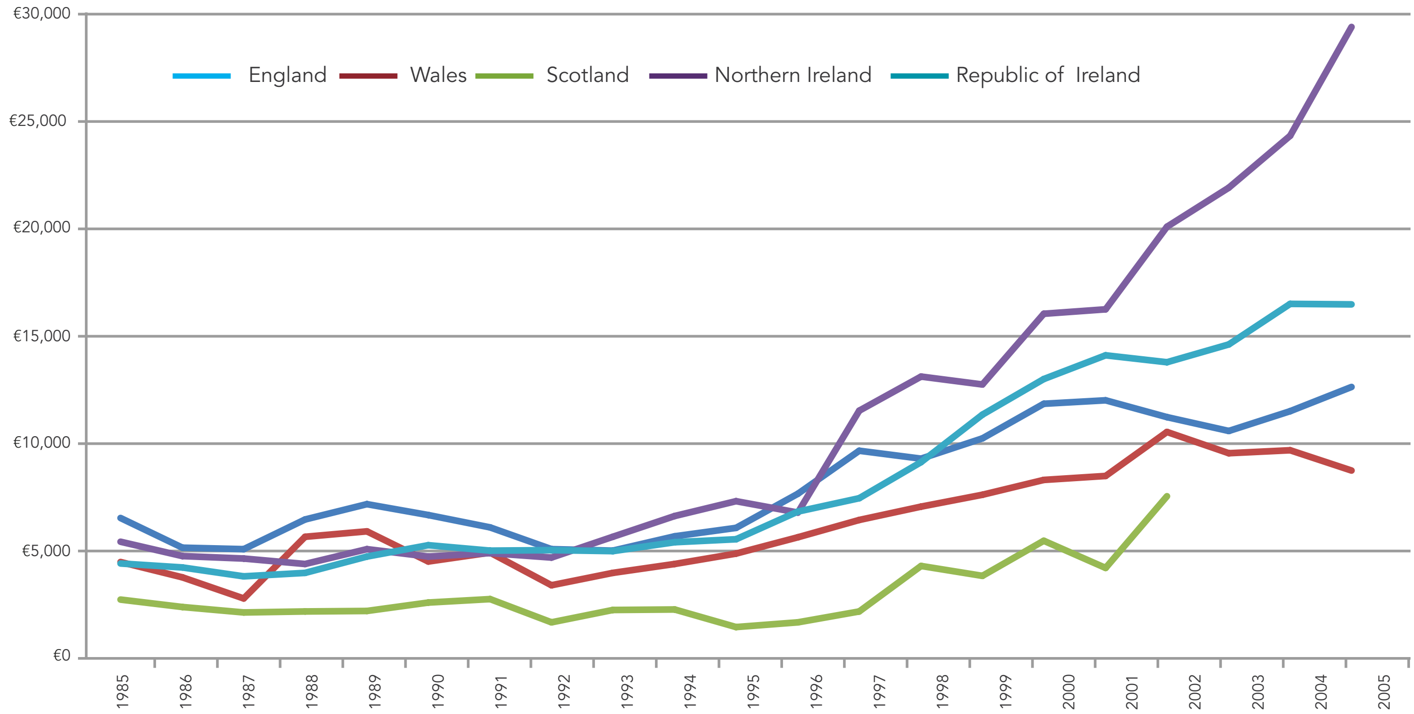
Figure 2. Volatility in House Prices by Economy (5-year Standard Deviation)



Source: Authors' Analysis of ONS and LPS Data

It is not just domestic property that has experienced significant inflation. An EU survey of the price of agricultural land reveals the same trend (see Fig. 3). The price per hectare rose from less than €9,000 in 1998 to more than €16,000 in 2005, while rents were largely static. As a result the ratio of agricultural rents to prices fell from 4% in 1996 to below 1% in 2005.

Figure 3. Price of agricultural land (€ per hectare), 1985-2005



Source: Eurostat Agricultural Statistics

1.2 Economic Impacts

There are a range of costs associated with the high and volatile cost of land. High prices mean that the taxpayer pays more for the land on which social housing is built. Excessive housing costs can limit people's mobility, and interact with a lack of jobs to create unemployment black-spots.

Another cost is additional debt. From 2002 to 2011, a total of £18.03 billion was advanced in mortgage loans in Northern Ireland. Had house price inflation been kept at 5%, a total of £3.9 billion debt would not now be on household balance sheets and if kept to 2%, a total of £5.6 billion personal debt would have been avoided.[5] This sum represents not only a burden to households today, but also a long term liability which consumes earnings that could otherwise have been saved, spent or invested in the real economy.

According to figures from mortgage administration company HML, 41% of borrowers in Northern Ireland who have taken out mortgages since 2005 owed more than their house was worth during the last quarter of 2013. This is the highest rate of the 12 UK regions and amounts to 68,024 homeowners in Northern Ireland.[6] This debt represents a substantial call on future earnings of the residents of Northern Ireland. The consequences are depressed demand, constrained credit availability and lower investment. According to the Northern Ireland Economic Advisory Group, "the property debt overhang has constrained the demand for and supply of credit and appears to have prevented potential business investment taking place."[7] Similarly, in its June 2013 Economic Outlook, Davy Research observed that:

> *"Northern Ireland is an economy still struggling to shake off the legacy of a housing bubble and spillovers from the recessions in the UK and Republic of Ireland. A sharp housing market correction and a collapsing construction sector have weighed on output … Personal insolvencies continue to rise, suggesting that the overhang of household debt and the legacy of the property market bust are weighing on domestic demand."*[8]

Land matters in all of this. As Professor David Newberry observes, good use of land is essential to economic growth:

> *"Land has a value that depends on both its productivity (most obviously for agriculture) and as an input into delivering the services supplied by buildings and infrastructure. Its value in the case of buildings can be considerably enhanced by restricting the supply of land with permission to build, with the result that buildings and the land on which they stand command a higher price than if land were valued at its alternative use…*
>
> *"The quadrupling [of land prices over the last quarter of a century] has greatly increased the cost of houses, and whereas the land component was about 10% of the total [prior to 1983], it is now often 50% of the total cost. As a result… 60% of the UK's £6.5 trillion wealth is tied up in property [and if] half of that is the value of the land underneath houses, then it amounts to 2.5 times Gross Domestic Product (GDP).*
>
> *"Standard growth theory postulates that GDP is generated by combining productive capital with human capital… Investment in productive and human capital generates increase in GDP and, with improvements in technology (and possibly of institutions, or social capital more generally), is the source of growth.*
>
> *"[If] wealth is held in unproductive capital (specifically, the excess value of land caused by artificial scarcity), then productive capital will be less than it might otherwise be, and hence so will the level of GDP. In that sense, creating and increasing the artificial scarcity value of land is potentially damaging to an economy's growth and income level."*[9]

5 Author's calculations from DSD (2013) *NI Housing Statistics 2011-13* Table 5.8.

6 HML, 1 March 2014 www.hml.co.uk/latest-thinking/2014/03/bbc-negative-equity-report/

7 Economic Advisory Group (2013) *Annual Report 2012-13* page 16.

8 Davy Research (25/06/2013) *Northern Ireland Economy.* Available at: https://www.davy.ie/research/public/article.htm?id=niecon20130625_24062013.htm [accessed 30/04/2014].

9 Quotes from a short paper by Professor David Newberry presented to Valuing Land Workshop (12/11/2008).

1.3 Policy Responses

The reform of banking and financial services are conventionally considered to play an important role in avoiding undesirable bubbles.[10] Part of the solution will involve what is termed 'macro-prudential policy', involving for example maximum loan-to-value ratios, lending policies and, given the high degree of correlation between property markets in Northern Ireland and the Republic of Ireland, tools to manage flows of capital between the two economies.

But these tools do little to tackle the underlying cause of real estate bubbles, namely speculation on the future value of land. Indeed in a recent study for the Bank for International Settlements, the authors surveyed 57 economies and found that, "none of the policies designed to affect either the supply of or the demand for credit has a discernible impact on house prices."[11]

In any event, banking, regulatory reform and monetary and credit policies are increasingly the responsibility of national governments, international agreements (Basel II etc.) and the private financial sector. Such tools are not available to devolved administrations or to local Councils. Through housing taxes, governments at these levels can, however, influence the land and property markets. In the same study, the authors found that, "among the policies considered, a change in housing-related taxes is the only policy tool with a discernible impact on house price appreciation."[12]

The Northern Ireland government has undertaken a number of measures in response to the housing crash. A Housing Repossessions Taskforce is investigating the issue of negative equity and repossessions, while a Housing Supply Forum is exploring means to improve housing supply.[13] While important, this will not necessarily stabilise house prices. The Republic of Ireland expanded housing supply fast but still experienced a dramatic housing bubble.

In 2012 the Department of Social Development launched its Housing Strategy.[14] It sets out four main roles for the Government in relation to housing. One of these aims is to create the right conditions for a stable and sustainable housing market that supports economic growth and prosperity. Of the 33 actions laid out in its Action Plan, however, very few relate to this fundamental role for government.

It is the aim of this report to fill that gap with a practical solution that both provides government with sustainable revenues and delivers social outcomes. In particular, the report considers what role LVT can play in not only encouraging stability in the land market, but also exercising a positive influence on the wider economy. The next chapter explains what LVT is, and the advantages it would bring.

[10] It is worth noting the origins of asset inflation in the UK were a combination of deregulation of financial markets and other factors.

[11] Kuttner and Shim (2013) *Can Non-interest Rate Policies Stabilise Housing Markets? Evidence from a Panel of 57 Economies.* BIS Working Paper No. 433.

[12] Ibid. Professor Ken Gibb of the University of Glasgow discusses this study on his blog article, *New International Evidence on Policies to Stabilize Housing Markets.* Available at: http://kengibb.wordpress.com/2013/11/19/new-international-evidence-on-policies-to-stabilize-housing-markets/ [accessed 30/04/2014]

[13] Northern Ireland Executive (30/01/2014) *New Housing Supply Forum will Play a Key Role in the Delivery of Housing: McCausland* http://www.northernireland.gov.uk/index/media-centre/news-departments/news-dsd/news-dsd-january-2014/news-dsd-300114-new-housing-supply.htm [accessed 30/04/2014] and (05/02/2014) *New Housing Repossessions Taskforce will Explore the True Extent of House Repossessions in Northern Ireland: McCausland.* http://www.northernireland.gov.uk/index/media-centre/news-departments/news-dsd/news-dsd-february-2014/news-dsd-050214-new-housing-repossessions.html [accessed 30/04/2014].

[14] DSD (2012) *Facing the Future: Northern Ireland Housing Strategy 2012-17.*

2. LAND VALUE TAX EXPLAINED

2.1 What is LVT?

Real estate comprises two components: land and the improvements (typically buildings) upon the land. LVT is a levy charged on the land, rather than the improvements. It has the following distinctive characteristics:

- LVT is payable at a defined rate on the unimproved value of the land only. In other words, it is assessed on the locational value or site value only and no account is taken of the value of any improvements.
- LVT is assessed on the basis of the rental value of the site (land).
- LVT is paid by the owners of the land/property and not the tenant.
- LVT is assessed on all types of land.
- LVT is based upon regular revaluations of land value.

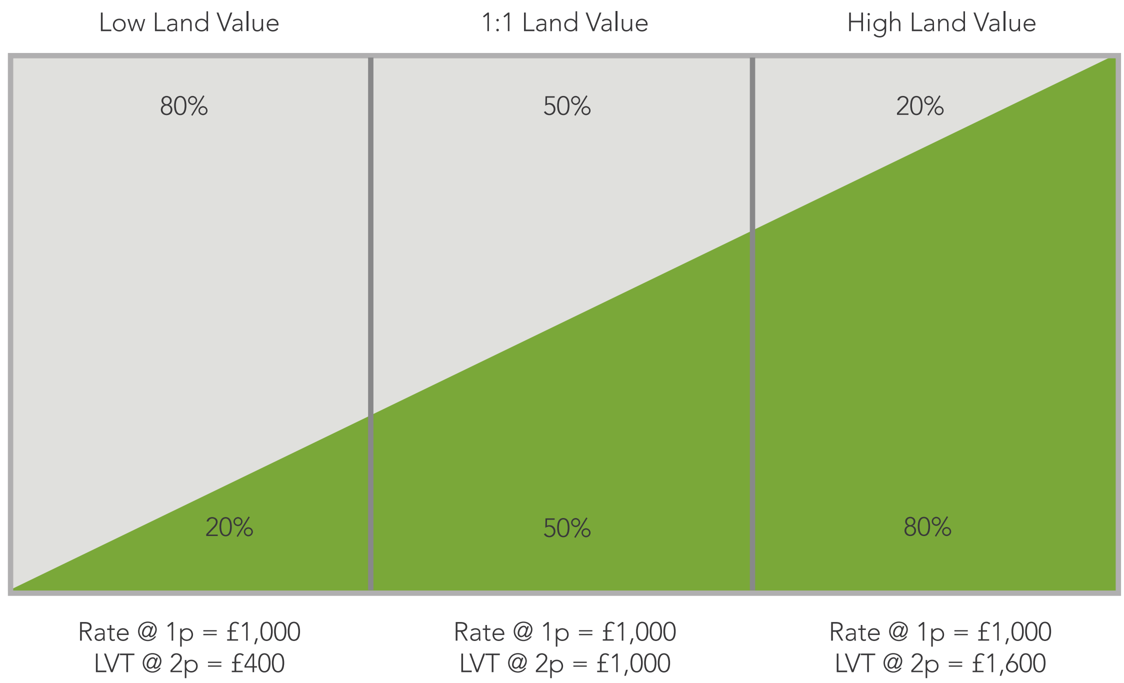
Figure 4 provides a graphical illustration of the key differences between LVT and the current rating systems. Green represents the land or site and the grey represents the improvements.

Figure 4. Land Value Taxation Compared to Current Rating System[15]

[15] Note that for some rental properties in Northern Ireland, rates are paid by the owner. See http://www.dfpni.gov.uk/lps/

Figure 5 illustrates the implications of taxing land only, rather than taxing land and buildings together, as is typically the case. It shows three schematic houses, each worth £100,000. Under the existing rating system and assuming a rate of 1p in the pound, each property pays £1000 in rates annually. However, each property is in a different location. One is in an area of low land values where land represents 20% of the total value of a house. One is in an average location with each component is worth 50% and one is in an area of high land values with land representing 80% of the value of the house.

Figure 5. LVT Due where Land Values Comprise 20%, 50% or 80% of Total Value



Under LVT, the same aggregate revenue would be raised from levying a charge solely on the land. The consequence of this is a redistribution of the burden of taxation from the low value site to the high value site. But what would be the advantages of this approach?

2.2 The Case for Land Value Tax

Captures Economic Rent

The distinction between land and the improvements made on land is an important one. In principle, it is primarily the owners of land who make improvements and, by extension, generate its value. But the land itself is a gift of nature. Its value is derived not from the actions of its owners, but from its proximity to amenities created by others. A tax on land, that is an LVT, aims to recover this socially-created value on behalf of the wider community. It is thus purely a tax on the locational value and is in fact best thought of not as a tax at all but as economic rent - the return to wider society for having created the value that the location enjoys. As Nobel economics laureate, William Vickrey observed:

> *"[P]roperty tax is, economically speaking, a combination of one of the worst taxes – the part that is assessed on real estate improvements ... and one of the best taxes – the tax on land or site value ... A tax on land, properly assessed independently of the use made of the lot, is virtually free of ... 'excess burden', while the tax on improvements imposes serious burdens on construction."*[16]

Under most conventional systems of property tax, this economic rent, or the rental value attributable to the value of a particular site, is capitalised into property prices. As house prices rise, the increase in value represents an increase in the value of the land, not of the house (which over the course of time depreciates in value). These capitalised values are then traded when houses are bought and sold.

Where borrowing is secured against residential property, these capitalised values appear on bank balance sheets as assets. In a housing bubble, as happened in Northern Ireland, these asset values rise fast and stay on the balance sheet once the bubble has burst - leading to excessive indebtedness and negative equity.

Introducing a system of LVT converts these capital values into liabilities - to be paid to public authorities by the owner. But because these capital values are currently held by owners themselves or form part of the secured assets of banks, LVT cannot be introduced overnight and a period of transition must be established to allow the land market to adjust, existing owners to de-leverage and new price expectations to be set.

Once in place, LVT levied at 100% of the rental value of land eliminates all speculative gains in land as the value is entirely socialised. Landowners pay in full for the economic advantage that accrues from occupying relatively valuable sites. LVT thus encourages productive use of land, investment in sites and discourages land speculation and land hoarding or banking. The former activity is productive, creates employment and generates tax revenue. The latter is unproductive, generates blight, creates no employment and no tax revenues. As the Mirrlees Review, the most thorough analysis of the UK tax system in over 30 years, stated:

> *"The economic case for taxing land itself is very strong and there is a long history of arguments in favour of it. Taxing land ownership is equivalent to taxing an economic rent - to do so does not discourage any desirable activity. Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax. With the same amount of land available, people would not be willing to pay any more for it than before, so (the present value of) a land value tax (LVT) would be reflected one-for-one in a lower price of land: the classic example of tax capitalisation."*[17]

Reduction of Less Desirable Taxes

The corollary of LVT is that investments that owners make in improvements are subject to minimal or zero taxation. This allows the burden of taxation to be shifted from more productive to less productive activities. For example levying rates on buildings at the same rate as on land provides a disincentive to improve the quality of domestic dwellings. This disincentive also applies to most other improvements and development. Currently, if improvements are made to a dwelling which increases its value, this has to be notified to Land & Property Services and a higher rate will be levied from the following tax year. Northern Ireland has, for example, 44% of households in fuel poverty, the highest in the UK and the figure is rising.[18] One way of reducing fuel poverty is to improve existing housing stock and to build and renovate existing stock to a much higher standard of energy efficiency.

[16] Vickrey (1999) 'Simplification, Progression, and a Level Playing Field' in Wenzer (ed) *Land-Value Taxation: The Equitable and Efficient Source of Public Finance.*

[17] Mirrlees Review (2011) *Tax by Design* page 371.

[18] DSD (2011) *Warmer Healthier Homes: A New Fuel Poverty Strategy for Northern Ireland.* A household is in fuel poverty "if, in order to maintain an acceptable level of temperature throughout the home, the occupants would have to spend more than 10% of their income on all household fuel use."

LVT also allows for other, less desirable, forms of real estate taxation to be abolished or reduced. So, for example, LVT could, once it raises more than the existing budgets of local governments, be used to reduce the take from taxes such as stamp duty land tax and income tax. Indeed the Mirrlees Review recommended the introduction of LVT and the abolition of Stamp Duty (Figure 6). [19]

Figure 6. Summary of Property-related Mirrlees tax Reforms

Current Tax	*Replacement*
Council Tax	Housing Services Tax levied as a simple, flat % of the rental value of each dwelling
Non-domestic rates	Land value tax
Stamp duty land tax	Abolish and replace revenue with above

LVT revenue could also be used to offset non-domestic (business) rates. For example, the Institute of Fiscal Studies observed that:

> *"[T]he economic rationale for levying business rates at all is not clear: taxing the use of property – as opposed to other inputs – by businesses is an inefficient distortion towards businesses using less valuable premises to operate."*[20]

Over the whole basket of taxes, LVT can operate within an overall framework of revenue neutrality but operate so as to replace the burden of taxation currently borne by other taxes. A householder therefore may pay significantly more in property tax but will be paying significantly less in income tax thus providing a better incentive for the overall economy - to work rather than capitalise the economic rent of land which is then not available for productive investment in the economy.

The opportunity to redesign the system of land and property taxation along these lines should be welcomed. Most existing forms of land and property taxation are simply a means of raising public revenue using land and property values as a proxy for wealth (and thus ability to pay). Property taxes are popular as a form of local tax because they are based on immoveable assets whose value is easily assessed. But they are often not well-designed. In 2010, the OECD reviewed how tax systems could be better designed to promote economic growth. In relation to property taxes, it concluded:

> *"A revenue neutral growth-oriented tax reform would shift part of the revenue base from income taxes to less distortive taxes. Taxes on residential property are likely to be best for growth, also because they could contribute to the usage of underdeveloped land and because most OECD countries provide various tax preferences for owner-occupied housing (such as deductibility of interest on house loans and exemptions from capital gains tax), which result in a misallocation of capital towards housing, away from other investments. In this situation, the pre-tax rate of return on housing investment is below the pre-tax rate of return on investment elsewhere in the economy. This implies that increasing recurrent taxes on immovable property will shift some investment out of housing into higher return investments and so increase the rate of growth."*[21]

A country can even have a high incidence of property taxes but if they are poorly designed they will not achieve a great deal in terms of policy objectives. The UK is a case in point. It already has the highest level of property taxes (4.1%) of all OECD countries as a percentage of GDP. [22] Yet the Mirrlees Review concluded that the system for taxing land and property in the UK is poorly designed and contributes to, among other things, an inefficient housing market and distorted savings and investment decisions:

> *"In the UK poor tax design contributes to an inefficient housing market, distortionary taxation of financial services, excessive reliance on debt finance, employment levels lower than they need be and distorted and inefficient savings and investment decisions."*[23]

[19] The reforms are applicable to the UK with the exception of council tax which is applicable to GB only. Mirrlees noted that the domestic rates in Northern Ireland are similar to the GB Housing Services Tax.

[20] Adam, Emmerson and Kenley (2007), *A Survey of UK Local Government Finance.*

[21] OECD (2010) *Tax Policy Reform and Economic Growth* page 21.

[22] OECD (17/01/2014) *Taxation: Key Tables from OECD* Table 7. http://www.oecd-ilibrary.org/taxation/taxes-on-property_20758510-table7 [web, accessed 30/04/2014]

[23] Mirrlees Review (14/09/2014) *Press Release*, available at www.ifs.org.uk/pr/mirrlees_sept11.pdf

Stabilises Land Market

A recent study for the International Monetary Fund found a causal relationship between recurrent property taxes and house prices and the evidence, in their view, "suggests that higher rates of property taxation can help limit housing booms as well as short-run volatility around an upward trend in prices."[24] However given that UK property taxes are already relatively high, there is little merit in considering any further increases in property tax as a means of stabilising house price volatility.[25] The key issue is the design, rather than the overall level of property taxation.

A principal driver behind housing bubbles in the UK and Ireland has been easy credit allied with the expectation that prices will continue to rise (at least in the foreseeable future). And it is this latter expectation that well-designed property taxes can do something to restrain. A recurrent property tax that is proportional to the value of land and property (LVT) will, over time, act as a stabiliser for land prices. This is because rising prices of, for example, housing, does not reflect a rise in value of the house itself (which tends over time to depreciate) but a rise in the value of the site (the land) upon which the house sits.

Ultimately, with a 100% tax on the rental value of land (typically about 5% of its capital value), there can be no anticipation of house price rises other than those arising as a consequence of improving the physical elements of the property (improving insulation, enlarging the property etc.). Rather than being capitalised into the value of the whole property, the rise in value is captured on an annual basis by the rental equivalent.

Recurrent property taxes therefore have the potential to stabilise land markets but it is a potential that is seldom realised for three reasons;

- Property taxation in the UK is not designed as a fiscal tool to achieve clearly stated policy outcomes. It is merely a convenient means of raising some local finance. Because the bills tend to be very visible, it is an unpopular tax and politicians are heavily influenced by the political impact of any change.
- Any recurrent system of land taxation can only begin to deliver its potential if the tax is levied on values that are current (typically less than a year old). This is well illustrated by the experience in Northern Ireland where the new domestic rating system is still based on valuations at 1 January 2005. Between then and today prices rose dramatically before crashing back down today to 91% of where they were then. A recurrent system of property taxation could do nothing to stabilise prices because there was and is no system of annual valuation.
- If a recurrent tax reflects current values then the total tax take will fluctuate and, in a growing economy (should) grow steadily over time. But most systems of property taxation are currently designed to raise a fixed amount of public revenue to match the budgets of local government. So, for example, if house prices double, then the rate poundage will be cut by 50%. Overall, the tax take stays the same but people buying houses are extending their borrowing by twice as much. The property tax and any stabiliser effect are disconnected due to the revenue-neutral fiscal framework.

This third point is an important consideration in the particular context of Northern Ireland study. Any possible introduction of LVT is to be considered within the frameworks of the existing devolved powers. In terms of taxation these are limited almost exclusively to property taxes. A good property tax should be allowed to operate so as to deliver its full potential and thus there will be times when such a tax raises more revenue than is necessary for the public spending it is designed to finance. In the current situation, this excess is foregone in favour of retaining a broadly fixed total tax take.

[24] Crowe et al (2011) *How to Deal with Real Estate Booms: Lessons from Country Experiences.* IMF Working Paper WP/11/91.

[25] Policy Exchange (2013) *Taxing Issues? Reducing Housing Demand or Increasing Housing Supply.*

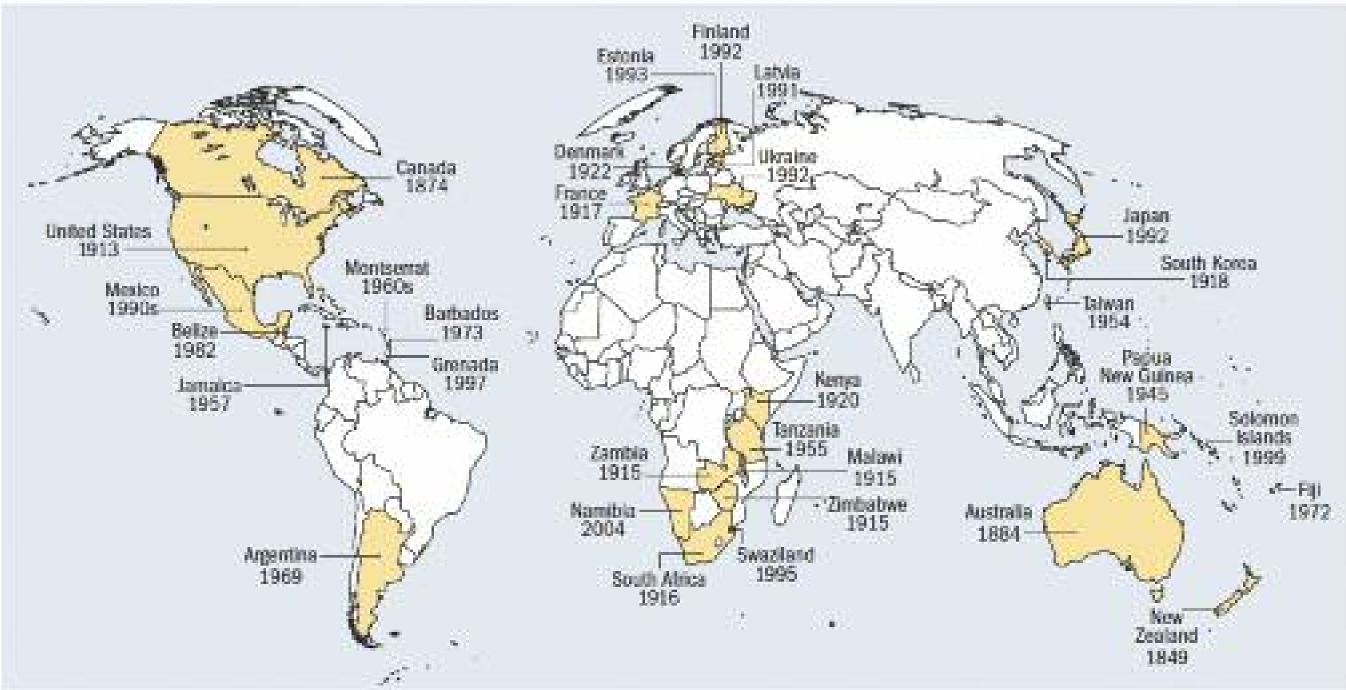
2.3 International Experience of LVT

While no country has operated a pure system of LVT, tax systems in a number of jurisdictions have distinguished between land and improvements. Dyer and England, in a very accessible overview, observed that,

> *"After surveying the experiences of taxing jurisdictions around the world, we conclude that land value taxation is more than an intriguing and attractive idea. It is a form of taxation that has actually worked since the nineteenth century at national, state, and local levels of government. Taxation of land values began with its 1849 adoption in New Zealand, and today it is practiced in countries as diverse as Estonia, Fiji, and the United States. Proposals to tax land values more heavily than improvement values can find support in both historical experience and economic theory."*[26]

As Figure 7 illustrates, land value taxation is currently in operation in a number of countries including Australia, New Zealand, Denmark, Estonia and parts of the USA. The most advanced system of LVT is in Australia, where it is in use across all tiers of government. It is universal in Queensland and New South Wales and predominant in Western Australia. In 2010-11 state and local government raised over AUS$ 33 billion from property-based taxes, accounting for 47.3% of all state and local government tax revenue. Australia has almost a century of experience with land taxes within an English common law tradition.

Figure 7. Countries with LVT Experience and Year of Adoption



Source: Dyer & England (2010) Assessing the Theory and Practice of Land Value Taxation

In New Zealand, property taxes have formed the basis of local government revenue since European colonisation in 1840, and the Valuation of Land Act 1896 which defined the concepts of improved and unimproved values of land. Over 50% of local government revenue is raised from property taxes, with the majority of local authorities using LVT.

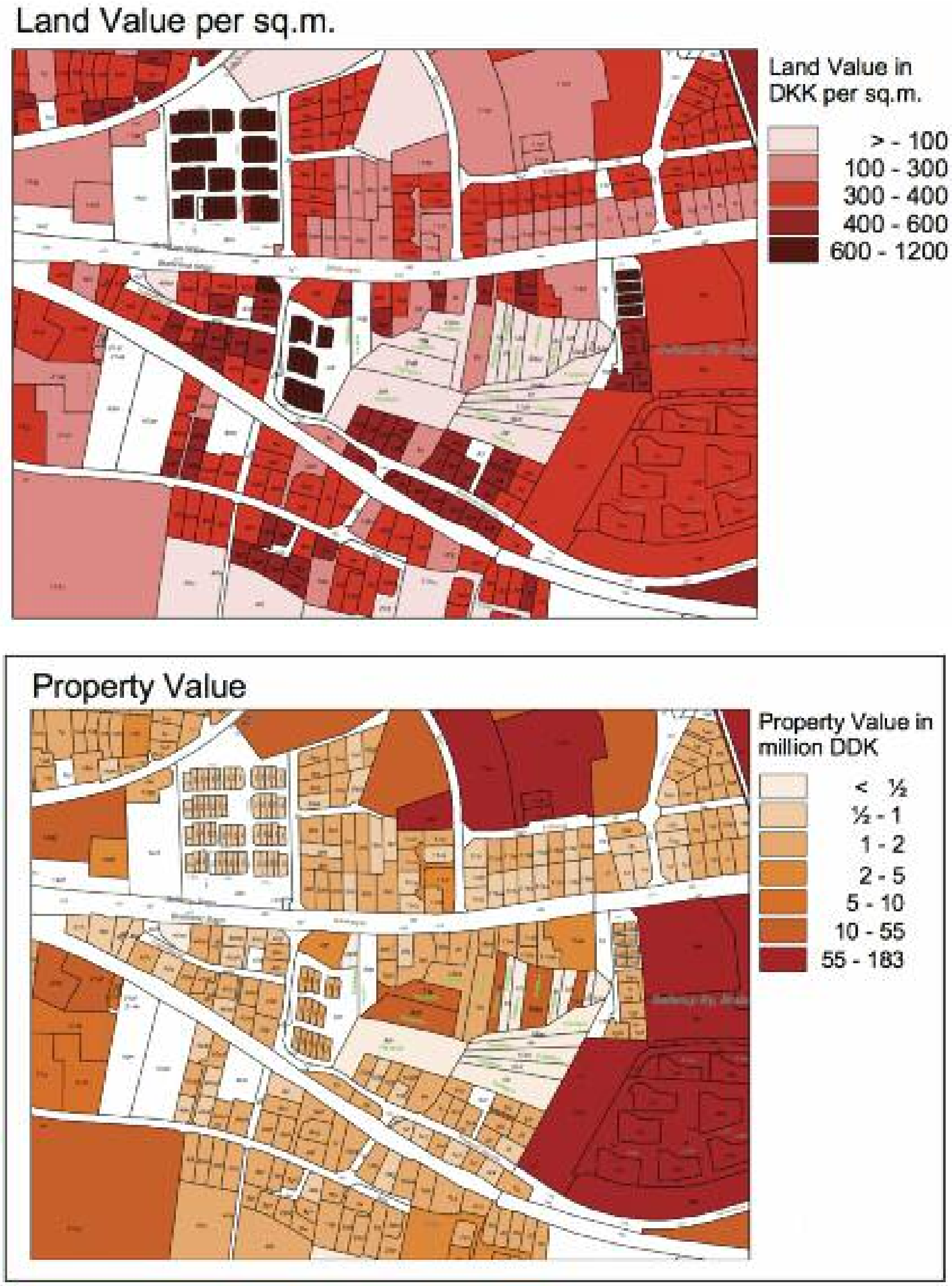
Denmark implements LVT at the county and municipality levels of government, raising about 7% of local government revenue. The county rate is fixed at 1% while the municipalities set a separate rate of between 0.6% and 2.4%, with the two largest cities allowed to levy up to 3.9%. In an interesting twist, Danes are also subject to the land tax on land and property owned abroad. Denmark has a modern and integrated system of land information incorporating cadastral land ownership data,[27] land values and property values.[28] Of particular interest in the context of this study is that Denmark values land separately from the improvements (see Figure 8 for an illustration).

[26] Dyer and England (2010) *Assessing the Theory and Practice of Land Value Taxation*.

[27] Cadastral land ownership data is information (in spatial form) showing the ownership of discrete parcels of land.

[28] See various publications published under The Danish Way at: https://mit.ida.dk/sites/ddl/Documents/Forms/AllItems.aspx. For the paper on valuation and taxation see https://mit.ida.dk/sites/ddl/Documents/08_valuation_and_taxation.pdf.

Figure 8. Land and Property values by site (Danish National Cadstre extract)



Source: Wolters & Enemark 2002 Property Valuation & Taxation in Denmark. The Danish Way No. 8

The most recent proposal to introduce a system of LVT is currently being implemented in the US state of Connecticut where legislation was passed in June 2013 to establish a pilot programme of LVT in up to three municipalities. This could be a model for Northern Ireland to follow. But before looking at how LVT might operate in Northern Ireland, it is useful to review the existing approach to land taxation.

3. LAND TAXATION IN NORTHERN IRELAND

3.1 Origins

Land and property taxation has a long history. It is based on the fact that those who historically owned land were the wealthiest members of society. These households were in receipt of substantial rental income from land and related sources such as property and minerals and thus best placed to contribute to the costs of providing local services including parochial relief and roads.

The levying of a rate in Ireland dates from 1635 when the County Cess was introduced in addition to the tithes. In 1826 legislation was introduced to levy rates on the rental value of land. A Commissioner of Valuation was appointed for each county and the unit of valuation became the townland. In 1836, Sir Richard Griffith was appointed a Commissioner for the whole of Ireland.

The Poor Relief (Ireland) Act 1838 and the Tenement Valuation Act 1846 developed the system further but the modern system of rating is derived from the Tenement Valuation Act of 1852 which combined the two previous assessments (poor relief and rates) and Griffith's valuation of 1848-1864 provided the basis for assessment of the net annual value and an annual rate on land and property payable by the occupier. Land was valued annually until 1930. Thereafter, further revaluations were only carried out across Northern Ireland at much longer intervals (1935, 1956, 1976, 1997, 2003 and 2007).

From the outset, certain hereditaments (a taxable unit of property) were exempted. They were to be valued, but entered in the exempt part of the valuation roll. The 1838 Poor Relief (Ireland) Act s.63 for example exempted churches, burial grounds and property used for charitable purposes and public purposes. Importantly, agricultural land was exempted under the Valuation Acts (Amendment) Act (Northern Ireland) 1932. Until the most recent rates reform in 2007, the rating system was governed by the Rates Act 1977. This provided for an annual rate to be paid on domestic and non-domestic property based upon the rental value of the property.

3.2 The Current Rating System

Currently, Northern Ireland has two rating systems - a regional rate and district council rates. In 2011-12 the regional rates raised £606.4 million (55% of the total) and the district rates raised £500 million (45%). Overall, in 2012-13 district councils raised 62% of their income from district rates.[29]

Until recently, the basic legislative framework for rates in Northern Ireland was the Rates (Northern Ireland) Order 1977. By the time the Northern Ireland Assembly was established it was clear there had to be reform, and a review of domestic rating was initiated in 2002 to modernise the system of domestic property taxation which at that time was still based upon a 1976 revaluation, in turn based upon 1960s rental values.

The result of this review is a new rating system based upon capital valuations as at 1 January 2005. The statutory framework is provided by the Rates (Capital Values, etc.) (Northern Ireland) Order 2006, introduced during the suspension of devolution. Following restoration of devolution in May 2007, the new system was reviewed by the Northern Ireland Executive and further changes have been made. These include the lone pensioner allowance, the lowering of the maximum capital value to £400,000, environmental incentives, the rating of empty homes and a rates deferment scheme for owner occupier pensioners. The 2007 review also discussed proposals for a derelict land tax to discourage excessive land banking whereby developers hold on to land with the aim of making capital gains. This was not taken forward.

Unlike domestic property, non-domestic rates are levied on the rental value of the property (currently as at the last valuation conducted in 2001). Recent reforms include the re-establishment of rates on manufacturing property, a 50% levy on empty property and a revaluation currently underway which is due to be the basis of assessments from 2015.

[29] Northern Ireland Audit Office, *2013*. The Exercise by Local Government Auditors of their Functions in the Year to 31 March 2013 (Figure 1)

Figure 9 summarises the total value of rateable property in Northern Ireland, the annual yield, the number of units and the district and regional rates for 2013-14.

Figure 9. Rateable Values and Properties 2013-14

	2013-14 Rateable value (£m)	Approx Annual Yield (£m)	Number of Hereditaments	Regional Rate	District Rate
Non-domestic (rental value)	1,403	533	80,000	38.02p	18.28p - 31.62p
Domestic (capital value)	91,410	558	700,000	0.3882p	0.2198 - 0.41173p

Source: 2013 Local Government Audit and NI Executive Budget 2011-15

The current system of domestic rating came into force in April 2007 and current rates are levied based on a domestic valuation of 1 January 2005, two years before the housing market crashed. House prices today are approximately back at the level they were in 2005 but have risen and dropped considerably between then and today. It is clear that domestic rating as currently framed has little impact on house prices or behaviour and is merely a convenient means of collecting some taxation revenue.

The stated intention of the direct rule government in 2005 was to have revaluations every five years with the next revaluation therefore due in 2012.[30] These plans have been abandoned and there are no plans to carry out a revaluation during the life of the current assembly which lasts until May 2016. The earliest one might expect a revaluation would be two years into the next assembly term in 2018 by which time the valuations will be thirteen years out of date, a period almost three times as long as originally decided.

As with all forms of property taxation, regular revaluations are an important part of the integrity of the system. If the commitment is blown off course, it can become increasingly difficult politically to undertake a revaluation as the numbers of winners and losers increases over time. A good example of this is the Council Tax regime in Great Britain, where the valuations are still as they were in 1991.

Other features of the current system include:

Empty Properties: Empty property is now subject to rating. The removal of 100% relief for empty domestic property is ostensibly designed to act as an incentive to bring empty homes into use. However, it can have the opposite effect of encouraging dereliction. This is not thought to be widespread but is a good illustration of the perverse incentives that can arise when taxes are levied on property as well as land. Property can be adapted and even destroyed. Land and sites cannot be altered.

Capital Values: Domestic rates are levied on the capital value of dwellings. If alterations are made that increase the value of the property, these should be reported to Land & Property Services and the valuation will be increased for the following tax year. The current rating system thus acts as a disincentive to carry out certain investments and improvements. A rate levied on the land value on the other hand avoids such perverse incentives.

Capping Valuations: The current cap on domestic valuations of £400,000 does nothing to curb price inflation. It merely transfers the burden onto other ratepayers and provides no inhibition to price inflation. The cost of the cap was £4.7 million in 2008 costing the average domestic ratepayer an additional £7 on their annual bill.[31]

[30] See www.dfpni.gov.uk/rating-review/domesticreport-2.pdf paragraph 11.

[31] DFP (2008) *Review of Domestic Rating: Reduction of Maximum Capital Value: Public consultation document.* http://www.dfpni.gov.uk/rating-review/index/reduction_of_maximum_capital_value_consultation_paper.pdf

Derelict Land: In the course of the Rating Review, the possibility of a derelict land tax was discussed. Regrettably, the decision was taken not to proceed with this proposal. Not only is derelict and vacant land a blight, it also represents public revenue foregone which has to be borne by other owners, who develop and maintain useful improvements on their land. As the Mirrlees Review noted,

> *"Another effect of business rates in practice arises from the treatment of unused or undeveloped land, on which business rates are levied at reduced or zero rates. This provides a clear and perverse incentive to use land inefficiently. Indeed, this has led to a rash of garish press headlines about property-owners demolishing property in order to avoid business rates. This puts the issue in rather stark perspective. If property is subject to tax and land is not, then, if the property is not being used, a tax incentive for demolition is created. If empty or unused property is taxed at a lower rate than property being used, then a tax disincentive to use it is created. An LVT avoids these problems. Taxing non-domestic property is inefficient, and should not be part of the tax system."*[32]

3.3 Previous Consideration of LVT

Under the current system in Northern Ireland then, rates are levied on the value of the whole property with no distinction made between the site value and the improvements. LVT was considered as part of the 2007 review of domestic rating in Northern Ireland. The review noted that LVT was a "well established concept" but highlighted doubts over the robustness of the planning system, uncertainties over land valuation and sensitivities over the inclusion of farmland in the assessment.[33] As a consequence, it was decided to pursue the matter no further although it did note one exception to that - the taxing of derelict land which it proposed was "worth pursuing".[34]

The Finance and Personnel Committee's report on the Review, published on 7 November 2007, concluded that "the research and analysis of land value taxation is at too early a stage to make even an initial assessment of the potential merits of this option as a replacement or supplement to the property-based system of local taxation."[35] The more recent Mirrlees Review, however, recognised the potential of LVT and concluded that (at least in relation to non-domestic property) "the case for a thorough official effort to design a workable system seems to us to be overwhelming".[36] This next chapter explains how LVT could work in Northern Ireland, and addresses some of the concerns raised by the 2007 Review.

32 Mirrlees Review (2011) *Tax by Design* page 376.

33 These and other issues were discussed by a number of witnesses giving evidence to the Finance and Personnel Committee of the Northern Ireland Assembly on 26 Sep, 10 Oct and 17 Oct 2007.

34 DFP (2007) *Outcome of NI Executive's 2007 Review of Domestic Rating System* paragraphs 109-111.

35 Committee for Finance and Personnel (2008) *Report of the Committee's Response to the 2007 Executive Review of the Domestic Rating System. Second Report.*

36 Mirrlees Review (2011) *Tax by Design* page 377.

4. PROPOSALS FOR LVT IN NORTHERN IRELAND

4.1 Disaggregated Valuations

In order to introduce a system of LVT, valuations would have to be carried out of the unimproved land component of all property. Thus, the value of a house worth £150,000 would have to be disaggregated into the land component (perhaps £50,000) and the building component (say £100,000). Such valuations would then be recorded and appear on the face of rating bills. Once such a split value rating system is in place, consideration can then be given to varying the rate levied on each component. Full LVT would involve a 100% rate on the site value and 0% on the improvements.

Unfortunately there is little market data on the rental value of land and not a great deal more on the capital value of land (from which it is straightforward to derive a rental value by application of a standard discount factor e.g. 5%).[37] However, this is not as significant an issue as is often assumed. In a pilot study conducted by Glasgow City Council in 2009, the practical implications of LVT were considered and professional valuers identified "no insurmountable issues"[38] in valuing sites.

One method is to use hedonic regression of house prices, whereby prices for similar properties are compared across a region with the difference being attributed to variation in the land value. In a complex study of the amenity value of house prices associated with proximity to nature, economists at the LSE managed to value one million homes using the hedonic method as part of a research project worth £50,000 (5p per property valued). Although such an approach would not be appropriate for LVT, it shows what can be done with modest budgets and the right data.[39] Indeed the method is applied in Section 5 of this report.

Land can also be valued using the residual method whereby the land value is derived by deducting standard build costs for various types and period of houses. What is left (the residual) is the land value. Given that many streets consist of uniform house types built at the same time, Computer Aided Mass Appraisal can be deployed to provide a rapid means of establishing land values over large areas. The important factor in any valuation exercise is not so much absolute values but ensuring that relative values are accurate - that a site worth twice as much as another one is valued as such.

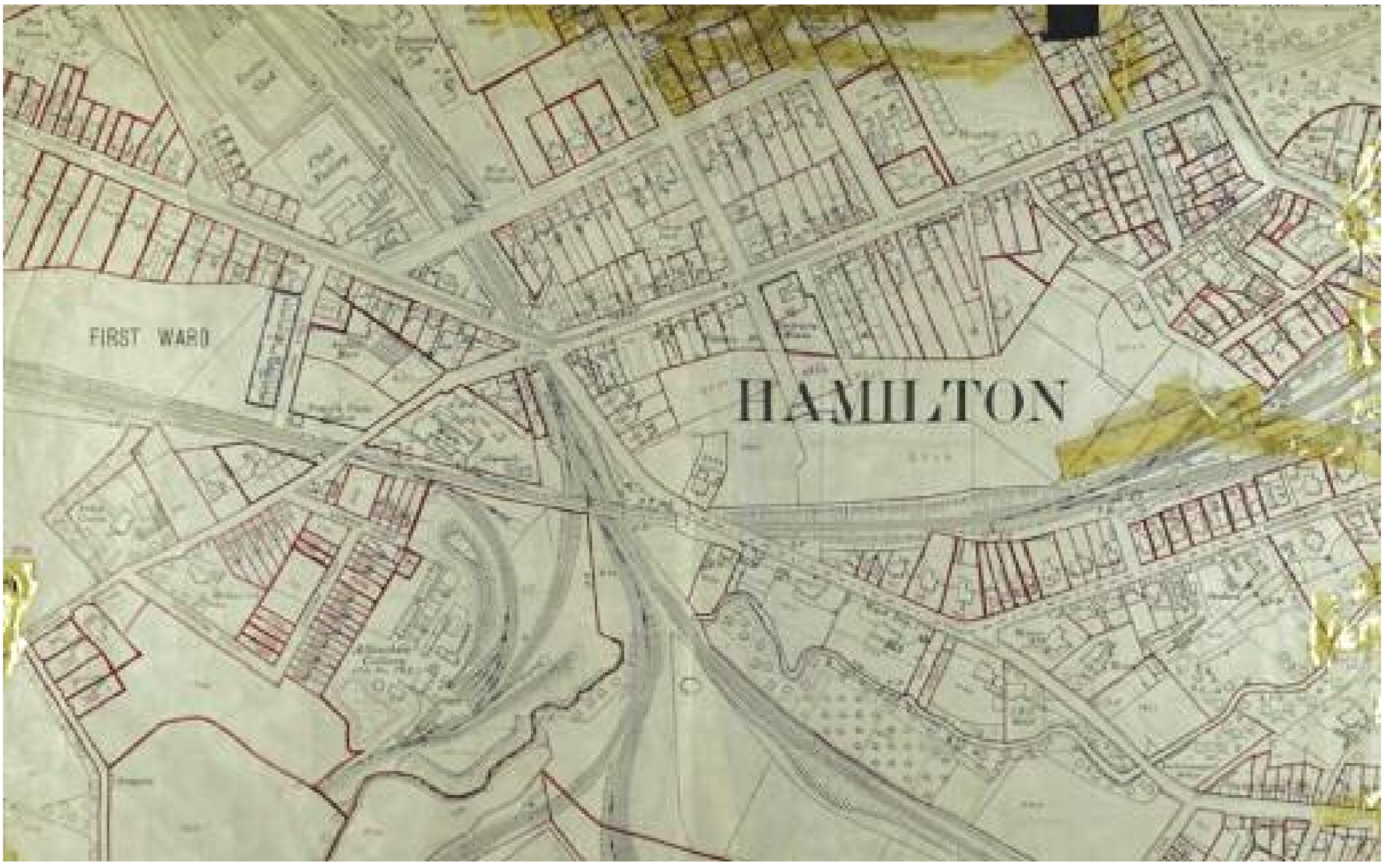
[37] Decapitalisation rates are already applied in the rating system to derive rental values. See DFP (2013) *Consultation Paper. Non-Domestic Rates Revaluation 2015. Decapitalisation Rates: Converting Cost to Rateable Value.*

[38] Glasgow City Council (2009) *Local Taxation Working Group: Overall Findings* paragraph 4.18.

[39] Gibbons et al. (2011) *The Amenity Value of English Nature: A Hedonic Price Approach.* Cost data from personal correspondence with Dr Paul Cheshire.

It is worth noting in this context that the Finance Act 1909-10 introduced by David Lloyd George (the so-called "People's Budget") contained provisions for a land tax to be levied on the uplift in value of land. In preparation for the measure, the Inland Revenue managed to survey the site values and improvements of over 14 million units of property covering 56 million acres of land across Great Britain and Ireland in under four years. This mammoth task was carried out with pen, ink, paper maps and notebooks. One of the resulting map sheets is illustrated in Figure 10.

Figure 10. Sample of Inland Revenue Survey Valuation Map 1910



Unlike the rest of the UK, Northern Ireland already has the basic framework of property ratings, which it is possible to adapt to shift the burden of property taxes onto the site value of land. All domestic and non-domestic properties are subject to regular revaluations and there is a geo-located database of all hereditaments. Rates are already assessed against unique per-property valuations and relief and deferment schemes have been developed. The introduction of LVT would involve adapting this system (to assess split land/improvements valuations) rather than (as would be the case in the rest of the UK) introducing a fundamentally novel system.

4.2 Registry of Landowners

In addition to disaggregated valuations, a system of LVT also needs comprehensive information on land ownership. This is because LVT is levied on owners and not tenants. Under Northern Ireland's system of leasehold tenure, the owner is technically the freeholder. But in many cases the leaseholder enjoys 99.9% of the beneficial ownership where property is held on ultra-long leases (say, for example, more than 175 years) and where, in economic terms, they are, in effect owners.

The Northern Ireland Land Registry is responsible for maintaining records of landownership. Registry staff were unable to confirm the extent of land that is covered by the Land Register or what percentage of titles are recorded. However, since approximately 66% of homes are owner-occupied, ownership information is already held by the valuation and rating authority.[40] The priority task is to identify the owners of the 19% or so of homes that are rented in the private sector (the recent Landlord Registration Scheme will assist in this).[41] A further priority is to incorporate this information within an integrated computerised land information system.

4.3 Highest and Best Use

LVT is levied on land according to the "highest and best use" approved for the site. As McCluskey observes in his 2007 International Overview paper,

> *"Sites are always valued as if vacant and available to be put to its highest and best use, when market value is to be estimated. In the analysis of highest and best use, valuers must consider not only the suitability of the site for existing or proposed use but also its suitability for alternative uses. They must discover that use which is most probable from the point of view of the typically informed buyer on the market. This is the use that will produce the highest present worth of the site.*
>
> *The current or present use of the property may differ from highest and best use of the site. The existing use will continue, however, unless and until land value in its highest and best use exceeds the total value of the property in its existing use. Therefore, the present use of an improved property is presumed to be its highest and best use unless it can be demonstrated that change is imminent through the impact of market demand or legal (land use control) forces."* [42]

Determining the highest and best use requires a sound land use planning framework. To accurately assess the value of land alone, it is necessary to establish the use to which the land is being put. However, for the vast majority of the most valuable land, the highest and best use will be its current use for agriculture, housing or commerce for example. Again, the mapping of land use and attribution of permitted use to all the land in Northern Ireland is practicable. For example in England, the UK Communities and Local Government Department produced the land use map illustrated in Figure 11 and the private company Geoinformation Group[43] produced the National Land Use Map illustrated in Figure 12.

[40] Note that the Northern Ireland Cadastral Parcels data is available to users entitled to it under the Northern Ireland Mapping Agreement. The extent of registered land should be straightforward to calculate but was not available to the authors.

[41] This scheme was introduced in the Landlord Registration Scheme Regulations (Northern Ireland) 2014.

[42] McCluskey, Lim & Davis (2007) *Land Value Taxation:* An International Overview.

[43] See www.geoinformationgroup.co.uk

Figure 11. Extract from Generalised Land Use Database for England 2005

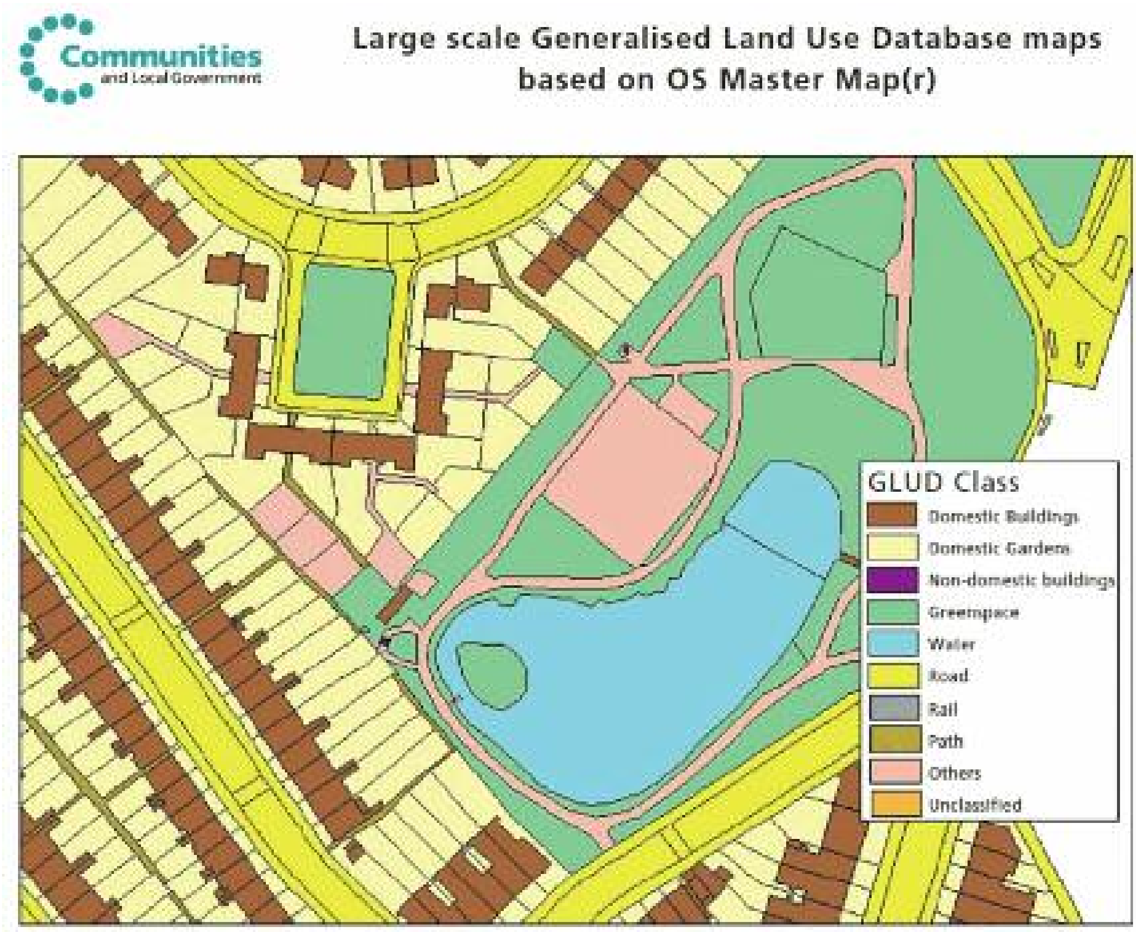


Figure 12. Sample of National Land Use Map

There would therefore need to be substantial improvements in land registration and in the land use planning system to provide accurate and transparent information on the ownership of land and what it is permitted to be used for. This may take some time, although it is clearly desirable whether or not LVT is taken forward. Land value mapping, robust planning and transparent land ownership interests will improve decision making across the public and private sectors.

4.4 Agricultural Land

Farmland accounts for around 70% of the land area of Northern Ireland.[44] Agricultural land has been exempt from rating since 1929. The immediate consequence at the time was that councils received compensation from central government for the lost revenue. Like other types of de-rated land, agricultural exemptions increases the capital value of land and places a greater burden on other rated property. It is clear, however, that the rating of agricultural land is a sensitive topic as are issues of wider tax policy as highlighted by the recent McClean Concare case.[45] The Ulster Farmers Union remains opposed to the rating of agricultural land and to LVT in particular.[46]

The Mirrlees Review recommended that agricultural land should be brought within the net of a well-designed property tax system (as indeed should all land that is currently de-rated). As highlighted in Section 1.1, agricultural land values have risen far more than in other parts of the UK and Ireland. A modest annual levy on the land value would moderate such inflation and, over time, return agricultural land values to nearer their economic value to farming. In such circumstances, the unimproved annual rental value will likely be fairly low. However, as with any land brought within the scope of property taxes for the first time, this could only be done incrementally. Of course, policy-makers can choose to retain the exemption but it would be useful if the costs and rationale for such a decision were made clear.

4.5 People Less Able to Pay

When any new property taxes are introduced or existing ones modified, there will be those who, for a variety of reasons find it difficult to afford to pay. Two groups feature most prominently in such circumstances. One is those whose income is either too low or non-existent and who live in modest dwellings. For these people, a system of rates relief applied according to income is the most appropriate solution and this already applies in Northern Ireland.[47] Under LVT this could continue in much the same form as currently applied.

The second group is those also of modest means but who live in larger and more expensive properties. For these people (typically a pensioner living alone in a large property) the most appropriate solution is a system of deferment whereby rates liability is rolled over and paid when the property is ultimately sold. Such a scheme was introduced in Northern Ireland in April 2010 following the domestic rates review but by 2012 only 21 pensioners had deferred any payment of rates.[48] The scheme was wound up but a similar scheme could easily be re-activated were it to be appropriate to do so.

Consideration should also be given to landowners affected by sudden changes in valuations. Landowners whose land is not zoned for development (typically farmers) may find some of their land dramatically rising in value as a consequence of a planning decision. It is a fundamental principle of LVT that it seeks to capture the rental value of land at its highest and best use. Owners who decide to withhold land from that use pay the price of doing so. However, not all land that is approved for more valuable uses will, in fact be developed. Even where it is owned, it might be some time before development occurs. In the meantime, the existing owner may not have the means to pay the levy. In these circumstances it would be appropriate to extend a deferment scheme to the owners of such land until such time as the value is realised as a capital gain.

44 DARD (2012) *The Agricultural Census in Northern Ireland* Table 4.2.

45 See Private Members' Business 'McClean Concare Case' 28 September 2009 for an insight into the sensitivity of tax liabilities on farmland. Available at: http://archive.niassembly.gov.uk/record/reports2009/090928.pdf

46 See in particular the UFU response to the 2007 rating review, available at: www.dfpni.gov.uk/rating-review/ulster_farming_union.pdf

47 See www.nidirect.gov.uk/housing-benefit-rate-relief

48 *The Rates (Deferment) Regulations (Northern Ireland) 2010.*

4.6 Transitional Arrangements

When the domestic rating system was reformed in 2007 from one based on rental values to one based on capital values, there were winners and losers. Some households saw their bills go up and some saw a reduction.[49]
A transition scheme was introduced to provide relief over three years to those whose bills had increased by more than 33% over and above what their bill would otherwise have been under the previous rental based system. It was awarded over three years, from April 2007 to 31 March 2010, on the basis that in the first year the relief was awarded on the full amount over the 33% threshold, in the second year two thirds and in the third year one third. The full rates became payable in April 2010.

Similarly, any move to a system of LVT would create winners and losers and a transition scheme on similar principles would be necessary. Rather than provide relief to only the most significant losers, a fairer scheme would be to have a five year phased approach whereby existing liabilities under the existing rating system are phased out by 20% per year and LVT liabilities are phased in by 20% per year.

A transitional system is particularly vital for LVT since it captures the full rental value of land and, when implemented at 100% effectively eliminates the capital value of sites and thus ends any prospects of capital gains on the locational value. LVT could, however, be introduced in full for any acquisition of new property after the date of introduction. See Box 1 for an illustration of the impact this would have on land prices.

Box 1. LVT compared to existing taxes – an example from the current market

In November 2013, a site at 19 Talbot Park in Derry was advertised for sale. At the time of its sale, it was vacant and no rates were due. The domestic valuation of the houses at number 17 and 21 is £380,000.

Under the present tax regime, a buyer will pay £200,000 for the plot (its guide price), construct a house at a cost of £180,000 and then have a house worth £380,000, the same as the neighbouring houses. The domestic district rate for 2013-14 is 0.4183p and the regional rate is 0.3882p. The total of 0.8055p means that the current rates bill is therefore £3060.90.

Alternatively, the buyer could purchase the site and then do nothing but wait for it to rise in value. Under the present regime, no rates would be due, thereby creating a disincentive to use valuable land productively. However, under a Land Value Tax levied at 100% of the rental value of the land, the buyer faces an annual bill of £10,000 per year (assuming that the rental value is 5% of its purchase price). After 10 years, the land will have cost the buyer £100,000.

Paying a one off sum of £200,000 and anticipating a tax free capital gain on the land is one thing. Paying £200,000 and exposing oneself to a £10,000 charge year on year is quite another. The result will be that the price of the site will drop to a level a buyer is willing to pay. If this is, for example, £4000 (a little more than current domestic rates), then the price of the site will drop to £80,000 (5% rental value = £4000).

The LVT will be paid regardless of whether the house is built (thus acting as an incentive not to leave the site vacant). Once the site is developed, the ongoing annual levy will continue to be £4000. The maximum development permitted on the site is, of course, determined by the planning authority.

By reducing the value of the site, the total house price is reduced from £380,000 to £260,000, the buyer can invest proportionately more in the building if they choose and there is a significant disincentive to leave the site vacant in the hope of speculative gains. The winners are the homeowner (who has had to borrow less) and the local economy that benefits from greater investment in house construction. The losers include those who would otherwise hoard land for speculative purposes. Banks may lose out if they choose to lend the homeowner less to develop their site than would otherwise have been the case, as they would therefore earn less interest on the mortgage.

[49] See McCluskey et al. (2007) 'Residential Property Tax Reform in Northern Ireland: Impact Analysis and Spatial Redistribution'. *Journal of Property Tax Assessment and Administration* Vol. 4(3) pp. 59-70.

4.7 Use of Surpluses

LVT addresses a major (and pernicious) source of changes in land values – expectations about future values, in particular speculation. But land values also reflect fundamentals, including greater population densities and higher per capita incomes, both of which will increase demand for real estate and thus for land. This is a benign source of growth in land values and, as it reflects a growing economy, is affordable for taxpayers. The implication is that, as an economy grows, land values will generally rise in line with this growth.

Consequently, the yield from LVT will also rise, potentially above the level required by the Northern Ireland Executive or district councils to meet spending commitments. The surplus could be linked with deductions in other taxes such as income tax. So, for example, if the marginal percentage point of income tax raised £100 million of revenue, then a surplus in LVT yield of £100 million would be linked to a reduction of in the income tax rate by one percentage point.

Within the existing powers of the Northern Ireland Act 1998, such a linkage is not currently possible. However, in future, greater powers may well be devolved. Stamp duty and income tax both scored highly in a recent report on the devolution of additional fiscal powers to the Northern Ireland Assembly.[50] One issue with any further devolution of tax powers is that any reduction in the tax level cannot be compensated by the centre through an increase in the block grant (the Azores Judgement).[51] However this does not apply to circumstances where property tax revenue is used within Northern Ireland to replace income tax foregone as a result of reducing the rate.

4.8 Local Government

Local government will, in 2015, consist of 11 new councils with additional powers and greater accountability.[52] The current share of expenditure that is raised by local government district rates is 62% with a further 29% raised through fees and charges. Thus, district councils in Northern Ireland raise 91% of their total revenue through rates, fees and charges that they are responsible for setting. In the context of the rest of the UK, where there are council tax freezes and central controls on non-domestic rates, this is an extraordinary level of fiscal autonomy which should be valued and sustained into the future.

The question therefore arises as to the balance between locally-raised revenue and transfer payments from the Northern Ireland Executive. When new powers and responsibilities are transferred in 2015, this share of revenue from rates (62%) will drop unless the relative amount raised by the district rate is maintained by transferring some of the regional rate to the new authorities. It would thus appear imperative to review the balance of revenue-raising powers between local government and the Northern Ireland Executive.

The new system of local government also provides an opportunity to consider how the property tax system could be developed to assist new councils in the delivery of their new powers. As a recent circular from the DOE stated, "regrouping a number of key functions such as planning, urban regeneration, local economic development and local tourism, will give councils some powerful tools with which to shape their areas and communities."[53] Flexibility in how different types of land are rated can provide useful incentives for local government to take forward these new powers.

[50] PWC (2013) *Fiscal Powers: Review of the Fiscal Powers of the Northern Ireland Assembly* Table 9.

[51] See ibid page 44.

[52] See www.doeni.gov.uk/local_government_reform for further details.

[53] DoE (Feb 2013) *Local Government Reform. Back to Basics … What are the Benefits?*

4.9 Land Value Literacy

As Dyer and England observe in their very readable and useful primer on the topic of LVT, new taxes can be tricky to implement:

> *"There is an adage that 'an old tax is a good tax'. Any revenue-neutral switch to a new tax regime has both winners and losers, giving those who might be losers a political interest in the status quo. Any tax reform starts from current practice rather than a blank slate. Even if analysis favours the land value tax over the property tax, political support for a change will be affected by individuals or groups who expect their taxes to go up or down."*[54]

Northern Ireland has already had recent experience of the challenges in relation to reforms of the existing rating system. LVT would be a further challenge particularly as it represents more than simply a system of property taxation but a means by which to exert substantial influence on the behaviour of landowners in relation to how and what they use their land for.

The immediate implementation of a system of LVT in Northern Ireland may not therefore be politically feasible. Nonetheless, it should be established as a long-term goal. Two steps that would aid this process include the introduction of split valuation as part of ratings, and the completion and publication of a landownership cadastre as part of a transparent public land information system. In this way, the level of "land value literacy" would be substantially enhanced and the potential benefits of LVT better enumerated and appreciated. However, it is possible to make some projections on the impact of LVT in Northern Ireland. This is the subject of the next chapter.

[54] Dyer and England (2010) *Assessing the Theory and Practice of Land Value Taxation.*

5. IMPACT ASSESSMENT

5.1 Land Values

In order to assess the impact and potential of LVT in Northern Ireland in detail, land values need to be assessed across Northern Ireland and across all land types. As indicated in Section 4.2, such a dataset does not yet exist. However, existing information can be used as a proxy, to show the likely nature and impact of LVT in Northern Ireland. To do this, the domestic valuation roll for Northern Ireland was analysed. It contains 776,767 valuations and information on capital value, location, property type and size (in square metres); an example is given in Figure 13.

Figure 13. Sample entry from Domestic Valuation List

Valuation List Entry

12 Dunclug Gardens
Dunclug
Ballymena BT43 6NN

Help With This Page

LPS Property Reference: 479978

Address details

Sub-building Name :	
Building Name :	
Building Number :	12
Primary Street :	Dunclug Gardens
Primary Locality :	
Townland :	Dunclug
Town :	Ballymena
Post Town :	Ballymena
County :	ANTRIM
Postcode :	BT43 6NN
UPRN :	185451531

Property Details

Description :	House Outbuilding Garden
Capital Value Non-Exempt :	£54,000.00
Capital Value Exempt :	£0.00
Property Size :	97.00 Square Metres
Central Heating :	Yes
Garage :	No

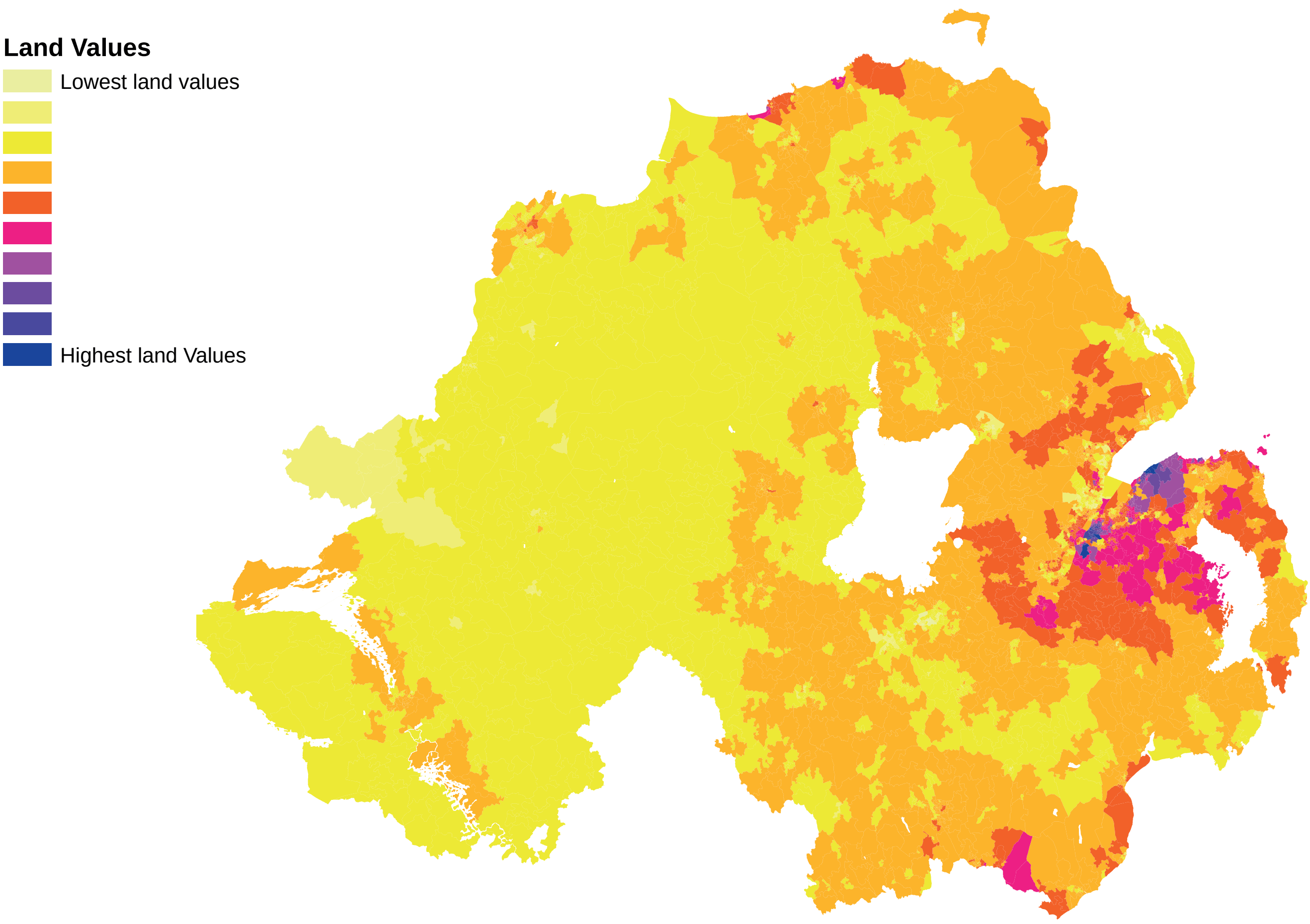
If the value of a certain type of property can be calculated across Northern Ireland, then the implied value of land is easily retrievable. To do this, hedonic regression is adopted. This methodology breaks down the capital value of each dwelling into three main components: its type, its size and its location (which captures land values). It is possible with the results of this analysis to construct the value of the same dwelling in each neighbourhood.

Specifically, in this instance, for each dwelling, information is available on the property's capital value, its type (house/flat, central heating/none, garage/none), and its floor area in square metres. By controlling for different property types (in particular houses versus flats, but also whether or not the property has central heating or a garage), it is possible to come up with the like-for-like capital value of a house of a particular size across Northern Ireland.[55]

Northern Ireland's 4,537 Census-based Small Output Areas were chosen as the unit of analysis for this exercise. This level of granularity in the analysis is important, as the average value of, say, a 100sqm property for a Local Authority ward (of which there are 582) will be an average of the various neighbourhoods within that ward, which could vary dramatically. To illustrate how this dataset can be used to highlight how land values vary across Northern Ireland, the average capital value of a 100sqm house in each of Northern Ireland's Small Output Areas is shown in Figure 14. Given that the cost of construction will not vary significantly across Northern Ireland, this map in effect shows variations in the value of the underlying land.

As is clear from Figure 14, the value of a similar property varies dramatically across Northern Ireland, with the average 100sqm house having a value of less than £50,000 in some areas but more than £300,000 in others. These differences derive from the different value of a plot of land near urban centres, which offer amenities including employment and retail services, compared to a plot of land in rural Northern Ireland, without access to such amenities.

Figure 14. Contours of land value across Small Output Areas in Northern Ireland, 2005 (as measured through average values of 100 sq.m. properties)

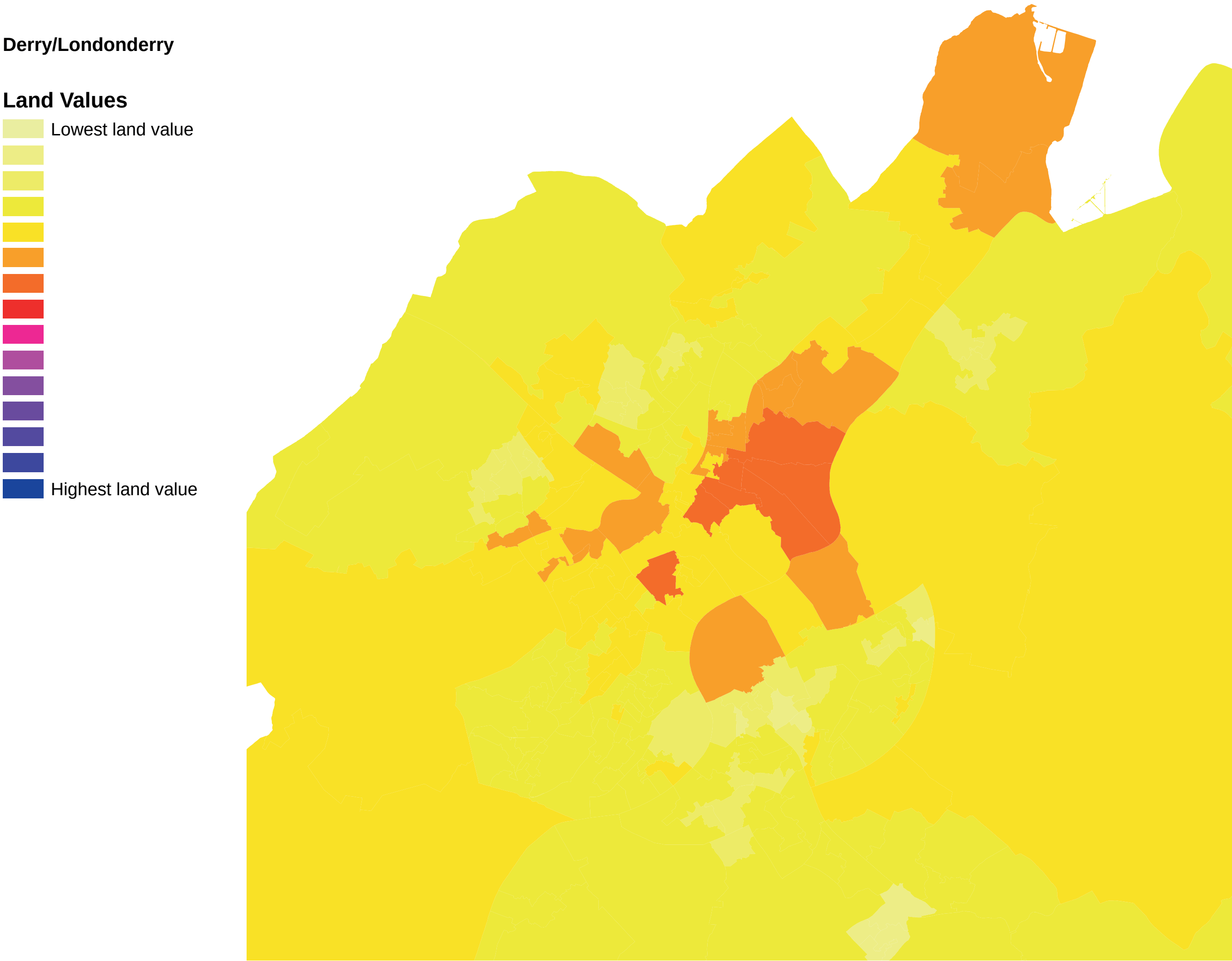


55 To ensure results for particular areas were not skewed by particular property types, e.g. joint residential-commercial dwellings, some exclusions were made, reducing the dataset analysed to 733,504.

Figure 14 highlights the importance of cities, and Figures 15 and 16 show the contours of land values within Belfast and Derry/Londonderry. Particularly in Belfast city, there is huge variation in land values. The differences highlighted in both these maps should be taken as a lower bound, as those who live in areas with cheaper land will typically have larger plots to compensate for their lack of amenities. Thus the like-for-like analysis will be improved by information on site size, available either through inspection as part of a revaluation and/or through digitized deeds.

Figure 15. Contours of Land Value in Belfast

Figure 16. Contours of Land Value in Derry/Londonderry



5.2 Distributional Impact

Given that land values vary across Northern Ireland, the impact of moving to a system of LVT will broadly mean that the more valuable sites attract a higher levy and the lower value sites a lower levy. Figure 17 provides an estimate of how the burden of LVT would differ from the current structure.[56] For simplicity, the tax has been set at revenue neutral levels, i.e. the total revenue from the new tax is the same as from the current tax, but the same rate is assumed to apply across all local authorities. Red areas indicate that the per-dwelling tax burden would fall on average (the darker the red, the greater the fall), while blue areas are those where the per-dwelling tax burden would rise (the darker the blue, the greater the rise).

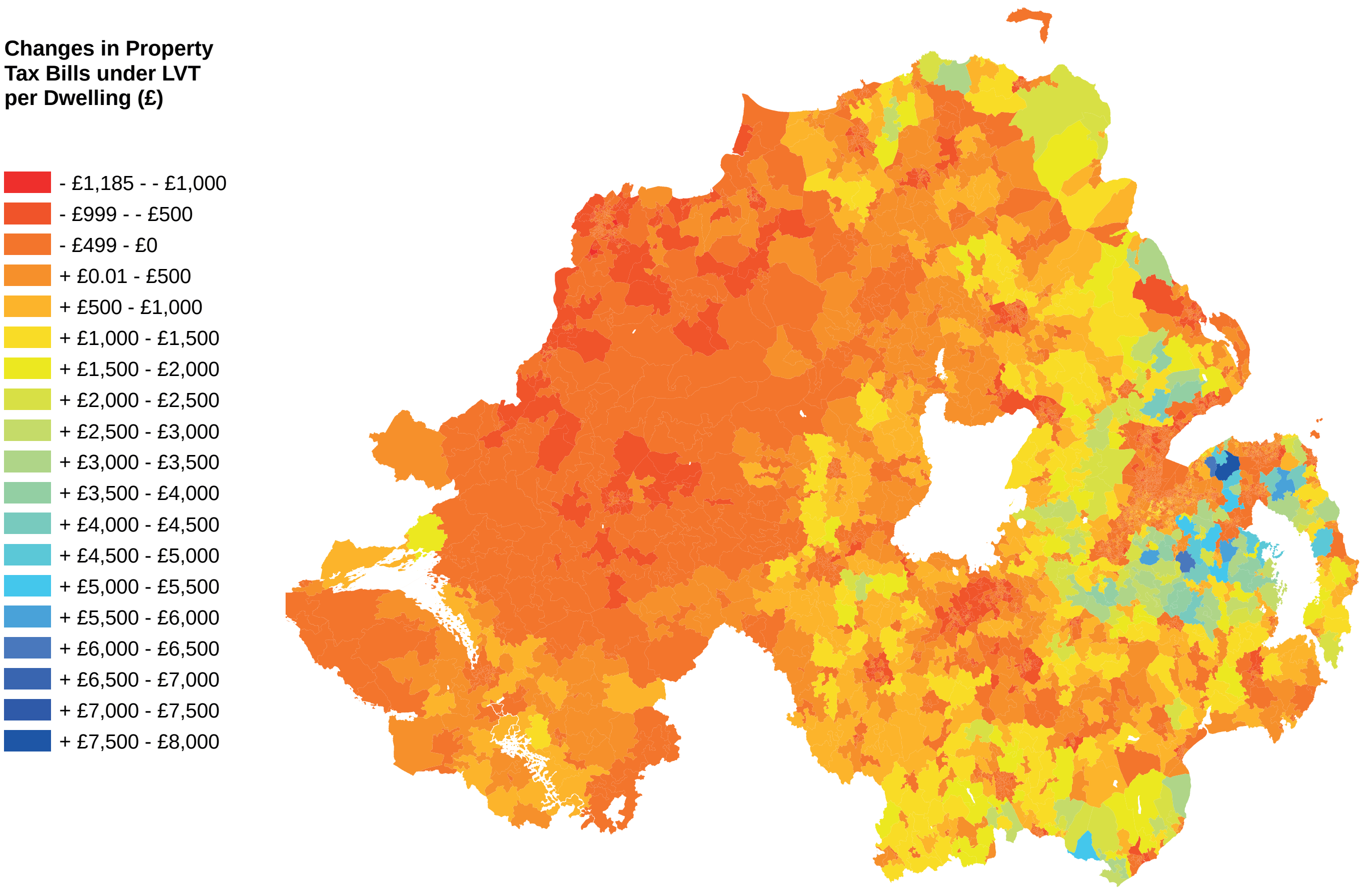
This framework enabled a preliminary calculation of the approximate value of land in each Census Small Output Area, from which it was possible to calculate the burden under a revenue-neutral land value tax, i.e. generating the same current yield as Domestic Rates. The total value of residential land, under this simplified scenario, wasestimated at just over £31bn.[57] Under these assumptions, two-thirds of households would pay a reduced rates bill and approximately 50,000 dwellings would face an increase of more than £1000.

[56] As information on site size was not known for each dwelling, simplifying assumptions were used to generate this map. In particular, it was assumed that on average the site size for each flat or apartment was 1% of an acre, and that for houses, this varied from 10% of an acre (in towns and cities) to 1 acre (other non-agricultural houses) to 5 acres (houses classified as agricultural). In addition, a minimum per-acre value of £10,000 was imposed for land zoned residential. Clearly, changes to these assumptions would generate different results.

[57] For reference, the implied revenue-neutral rate of land value tax was 1.95% (of the capital value, i.e. just below 40% of the rental value, if a 5% capitalization rate applies).

As Figure 17 shows, the principal effect of LVT would be to redistribute the burden of property tax away from areas with low amenities, principally in the west of Northern Ireland, and towards those areas with high-value amenities, in particular to the south-east of Belfast. It is likely that the exact detail of this map could change, once site size is available at dwelling-level. Nonetheless, the broad contours are indicative of the redistribution of the tax burden away from less wealthy areas that would occur under a LVT.

Figure 17. Estimated Change in Household Property Tax Bills under LVT (£ per dwelling)



To give an insight into site values at a more local level, existing information used for rates, in particular size, was combined with information derived from maps on the extent of site size.[58] Four streets were chosen at random, reflecting a relatively high value area in Malone Upper, Belfast, a standard neighbourhood in Culmore, Derry, and neighbourhoods in large (Saul, Downpatrick) and small (Racarbry, Armagh) towns outside the main urban centres.

Each street has typically 50 dwellings, allowing a preliminary investigation of the relationship between site size and dwelling value, accounting for other factors such as dwelling size. The results of this analysis are shown in Figure 18. It includes both the current tax burden for the median property value on each street as well as an estimated burden for LVT raising no additional revenue from the four properties analysed here. As can be seen, for these four properties, LVT would result in a lower burden for three, with the incidence of the tax rising only for the highest value property.

[58] The tool used was http://www.findlotsize.com/, which allows the user to estimate site size based on a visual inspection of the property's boundaries on aerial maps.

Figure 18. Preliminary analysis of land values and tax burdens [59]

	Street in Malone Lower, Belfast	Street in Culmore, Londonderry	Street in Saul, Downpatrick	Street in Racarby, Armagh
Median	£550,000	£155,000	£110,000	£57,000
Current Rate	0.006976	0.008055	0.007395	0.008003
Current Tax	£2,790 (with cap) £3,837 (without cap)	£1,249	£813	£456
Estimated value of residential land (per acre)	£423,218	£16,496	£63,788	£28,601
Median site/plot size on street	950	585	445	140
Simple revenue-neutral LVT (no cap)	£5,754	£138	£406	£57

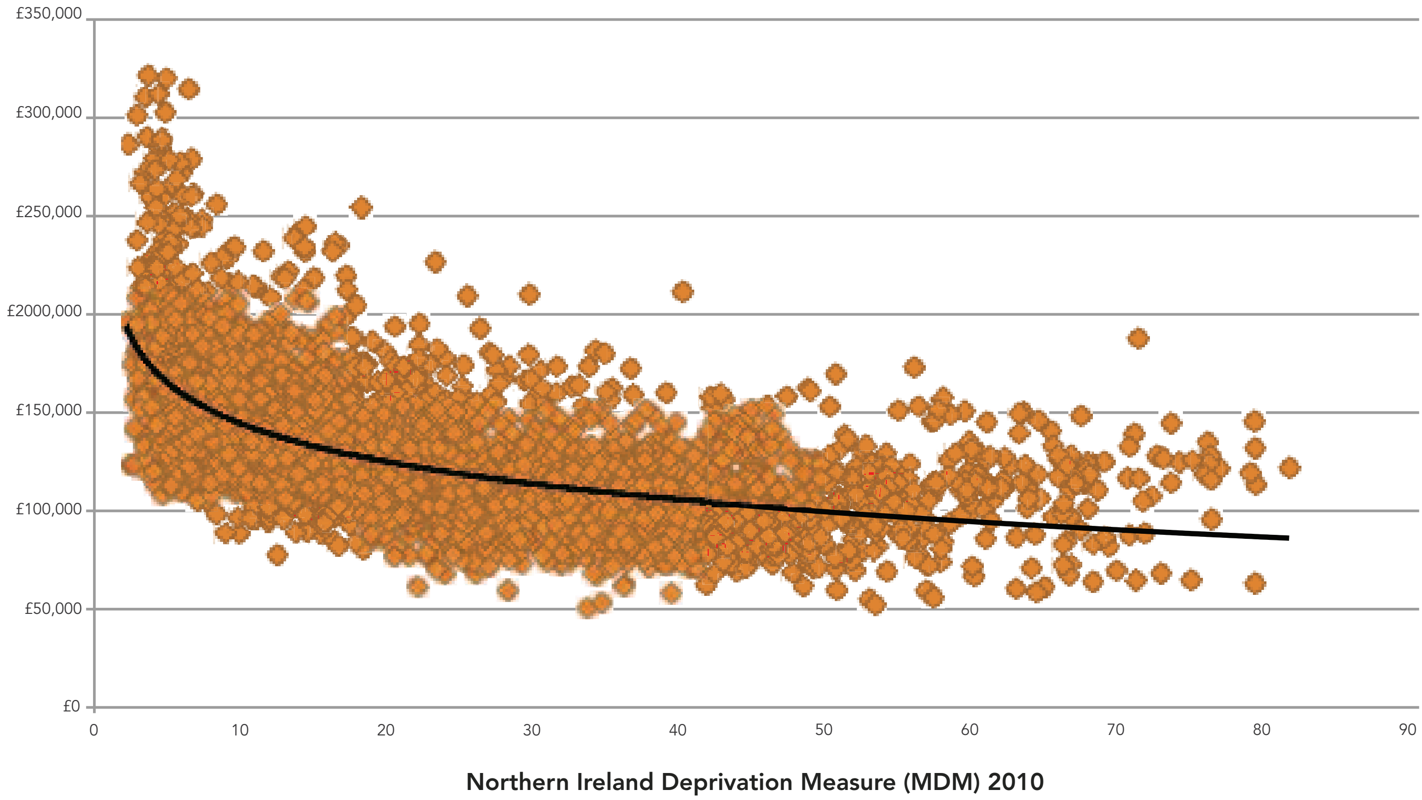
This exercise shows how straightforward it is technically to calculate site size when the information is available to analysts. The two principal 'omitted variables' for assessing property value are building age and site size. According to LPS records, building age is collected but not shown. Thus, there is only one additional piece of information required for a transition to land value tax, i.e. site size.

As outlined earlier in Section 2.3, it is worth remembering that precisely this type of information is generated by administrations in other small economies, both in Europe and elsewhere, highlighting the feasibility of LVT.

5.3 Deprivation

The distribution of land values illustrated in Figure 14 reflects the capitalised site value build up over time. The value of residential land reflects the demand for particular locations in the urban environment and it might be expected that the material wealth of the population in turn is reflected in residential land values. To test this relationship, the data in Figure 14 was correlated with the 5,022 Output Areas from the Northern Ireland Multiple Deprivation Measure (NIMDM) 2010. The results are illustrated in Figure 18. The correlation coefficient is 38.3% indicating a strong positive relationship between land values and broader measures of deprivation. In other words, LVT is a progressive tax.

Figure 18. Correlation of Land Values with NIMDM



[59] These estimates of land values are based purely on variations within the street, rather than a comparison across streets and therefore the precision of estimates depends on the extent to which site sizes differ between houses on that street. In addition, it is assumed for simplicity (and due to data constraints) that there is a linear relationship between site size and site value. When a dataset of site sizes becomes available on a larger scale, this assumption can be relaxed and more refined analysis of the value of sites will be possible.

6. CONCLUSIONS AND RECOMMENDATIONS

6.1 Conclusions

One of the primary roles for Northern Ireland's government, according to its Housing Strategy, is to create the right conditions for a stable and sustainable housing market that supports economic growth and prosperity. LVT represents a feasible and effective way of delivering this objective.

Indeed in many respects, Northern Ireland is uniquely positioned to implement LVT. Unlike other economies within the UK and Ireland, Northern Ireland already has a functioning system of market-value property taxation. It would be a relatively straightforward adjustment of the existing system to split this valuation into the land (unimproved) component and lower rates on the buildings (improved) component.

The long-run goal should be switching the burden of rates away from buildings and on to land. This would encourage scarce valuable land in urban areas to be used well, rather than left derelict. It would also deter land hoarding and speculation that may be socially and economically harmful. In time, this could yield a system based entirely on LVT, rather than on buildings, shifting the tax burden further away from the productive sectors of the economy.

Nonetheless, challenges remain that prevent the immediate adoption of LVT in Northern Ireland. Indeed, precisely because of its effect, the LVT system poses challenges to existing cultural expectations of land, housing, planning and the politics of property. These challenges need to be understood and agreed by citizens, policy makers and politicians.

There are also powerful vested interests in land and property who understand the key shift that LVT represents - ie: the end (over time) of a business model based on private land value capture (land speculation in more pejorative terms).

In addition, the domestic rating system has been relatively recently overhauled, with significant effort. There is no doubt that the current system, based on updated capital values, is a substantial improvement on the previous system, based upon rental values. But even now it is evident that one critical component of a good property tax system – regular revaluations – has slipped and it may be 15-20 years before another one is carried out.

In the course of that recent review, LVT was examined and whilst there was general agreement on its benefits, it was believed to represent too much of a leap in the dark. Moreover, the easiest course of action was to modernise and adapt the existing rating system and compelling reasons would be needed to consider a fundamental shift away from the status quo. Two factors mean that the context has changed since then, however. The first is the publication of the Mirrlees Review, which has changed the landscape and long-term agenda across the UK on this topic.[60] The second, specific to Northern Ireland, is the severity of its property market bubble and crash over the last decade.

6.2 Recommendations

For practical and political reasons, we do not recommend that Northern Ireland introduces a system of LVT in the immediate future. However, if implemented, the recommendations made in this report, would allow an LVT system to be introduced when it is considered appropriate to do so.

The policy recommendations below are split into short-term and long-term. The short-term recommendations are those that could reasonably be implemented by the end of the next term of the Northern Ireland Assembly in 2021. The longer-term recommendations are those which should be considered from 2021 onwards. There are three principle reasons for this split.

- The first is that the recent review of domestic rating is now complete and has only been in operation for five years. This review was a very considerable achievement and there is little political appetite for any further major reform in the near future.
- The second reason is to allow the new local authorities to 'bed in' during their first term from 2015-2019. These authorities will have far greater powers than the existing district councils. Importantly, they also provide the new authorities with the kinds of powers that would allow policies to be implemented that incorporate variations in property taxes designed to act as incentives, funding sources or trade-offs. In other words, taxation powers can be exercised in a more flexible and co-ordinated manner designed to achieve policy goals.
- The third reason is in recognition of the fact that the Northern Ireland Assembly is still maturing as an institution. Not only does this process take time but the current powers of the Assembly are restricted. The fuller benefits of LVT can only be realised with greater powers (see Section 4.7). Only after 2021 might we envisage significantly greater powers being devolved to the Assembly.

[60] This heightened interest is illustrated by House of Commons (2013) Land Value Taxation (HoC Library Standard Note SN06558), which provides a good summary of recent debates on the topic in the UK.

The recommendations have been made following three guidelines:

1. Recommendations are made that seek to highlight, better understand and communicate the land value component that is inherent within the existing system by means of administrative reforms that are practical and achievable.
2. Recommendations are made for ways in which the land value component can, if considered appropriate, be unlocked to deliver a partial or comprehensive system of LVT.
3. Longer term aspirations are highlighted that are contingent on further powers being devolved to the Northern Ireland Assembly.

These recommendations, unless stated, refer to both domestic and non-domestic rates.

Short-Term Recommendations

1. The development of a methodology of attributing land value to all land in Northern Ireland, principally through establishing site size as an additional attribute for domestic and non-domestic valuation rolls, and the implementation of comprehensive land valuation by 1 January 2016.
2. The publication, following a review of land registration, of a comprehensive and freely available online register and map of land ownership and valuations in Northern Ireland.
3. The publication from 2016 of the split between land and improvements on individual rating bills, both domestic and non-domestic.
4. A commitment to conducting annual revaluations for all land in NI from 2016; this may be based on an index-linked review of property prices, taking into account the split between land and buildings.
5. The design and implementation of a pilot LVT programme by one local authority.
6. Legislation to levy non-domestic rates on the land value of all derelict and vacant land and to scrap the £400,000 cap, which represents an arbitrary lowering of the tax burden for Northern Ireland's wealthiest property owners.

Long-Term Recommendations

7. The development of proposals for further devolution of powers to the Assembly, including income tax and stamp duty, following the experience of the Scotland Act 2012.
8. The provision of statutory powers to the new local authorities to vary the proportion of the district rate to be levied on the land value and on the improvements.
9. The provision of statutory powers to local authorities to reduce the rate of any future taxes levied by the Assembly (such as income tax) for their residents, where fully funded by increases in the yield from district rates levied on land values.
10. Further analysis of the role of LVT, once appropriate datasets are available, in capturing the full economic rent of all land in Northern Ireland that can be used to reduce the incidence of other taxes, such as income taxes.
11. The development of a modern, transparent land information system; the Danish system may serve as a model.
12. The implementation of a system of LVT over a transition period of five years to replace the existing rating system and to include all land that is currently de-rated.