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TOWN PLANNING FINANCE,
TAXATION AND LAND VALUES

By RALPH TURVEY

Introduction.

The arguments in favour of making some attempt to secure to the community a part of increases in the value of land seem to spring from two main sources. Firstly, there is the Henry George line of thought which basically rests upon the moral judgement that unearned accretions to the wealth of landowners should not be left in their hands. Secondly, there is the perpetual search of public authorities for new sources of revenue, a search which becomes particularly urgent when large-scale and costly urban improvements are contemplated. A town council which is planning, say, a new street system is thus particularly likely to examine the possibility of securing a portion of any resulting increase in values so that the burden of the scheme upon its normal sources of finance may be kept down.

The reports on compulsory acquisition legislation *(expropriationslagstiftning)*[1] and on the compulsory acquisition of areas for comprehensive development *(zonexpropriation)*[2] together with the appointment of a committee on land values *(Markvärdeutredningen)* suggest that these related questions are now the subject of interest in Sweden. The two reports just cited illustrate the admirable readiness of Swedes to examine the experience of foreign countries in considering their own problems, and no doubt the new committee will follow the example of its predecessors.

Now so far as England is concerned, many mistakes have been made which Sweden would do well to avoid, and some study of this experience should therefore be useful. But such study is apt to be mis-

[1] S.O.U. 1948: 4.
[2] S.O.U. 1952: 25.

leading if it is based only upon legal documents and legislation. The text of a law gives no indication of whether or not the law works well; nor do the official pronouncements which preceded its enactment. Writings by lawyers usually deal only with purely legal problems, while the people who really know what is going on—those professionally concerned with transactions in real property—rarely set down their knowledge in print. Thus even those who have some background knowledge of the relevant legislation and institutions must inevitably encounter great difficulty in endeavouring to interpret the experience of a foreign country. This being the case, the following observations on British experience and references to various sources may be of some interest.

As a preliminary, it must be pointed out that British landlord and tenant law is peculiarly complicated in one respect. This is the institution of the building lease or ground lease, usually 99 years in length. Under such a lease the lessee agrees to erect a building on the site and has the effective ownership of the property until it "reverts" to the lessor 99 years later without any compensation being payable by him to the lessee. The latter pays a "ground rent" (and also, on some occasions, an initial capital sum). It is evident that economically speaking this is much like buying the land and taking an irredeemable mortgage from the seller, since what will happen in 99 years is almost sufficiently remote to be discounted to zero.

The result of this system is of course that property ownership can be very complicated. For example: A may hold a house on a weekly tenancy from B who, in 1939, took a 21-year lease from C who inherited the ground lease of the house together with that of several others from his father, who bought the houses and took over the ground lease from D, who took the ground lease from E and built them in 1909. Thus E (or his successor) owns the right to receive the ground rent from C until 2008 when he will have the reversion of the houses. C owns the right to receive a rent from B until 1960 when he will get possession of the house and be able to use or re-let it for another 48 years. And so on. If A is protected under the rent control acts he will be able to stay on as long as he wants.

This simplified *(sic)* example suffices to show that property owner-

ship is complex. So, therefore, is the valuation of property and taxation of property in Britain.

There is a second preliminary point which needs to be made. The value of a building on a site can be estimated, and so can the value the site would have if there were no building upon it. But the value of the building by itself cannot be estimated. The reason is the simple one that whereas a building on a site or a vacant site can be sold or rented, a building alone cannot (unless it can be moved). Of course the value of the building alone can be *defined* as the difference between the other two values, but this is a residual not an independent estimate. In other words, the value of a property cannot be meaningfully divided between the value of the building and the value of the site. It follows that if the value of the whole property has risen by, say, £1,000 since 1946 it is nonsense to ask how much of this £1,000 represents an increase in the value of the site and how much an increase in the value of the building. Neglect of this simple but ineluctable truth can cause legislation to produce the most absurd anomalies and difficulties.

Taxation of Site Values.

1. In 1952, a committee reported on the possibility of wholly or partly substituting the rating of site values for the present rating system. At present rates are levied in proportion to the annual rental value of building and site together, houses being assessed at 1939 rental levels and industrial premises at one-quarter of their annual value. (This is an extremely simplified statement.) The majority were against site value rating, but their report paid considerable attention to the system of development charges (since abolished, see below) and to other current legislation and is thus in part inapplicable to the problems of other countries. Chapter II, "Historical Summary", however, provides a useful survey of previous proposals.[3]

One of the arguments put forward by the minority in favour of the rating of site values is that it would stimulate building. This proposi-

[3] *The Rating of Site Values.* Her Majesty's Stationery Office, 1952.

tion can easily be demonstrated,[4] but the necessity for any such stimulus in an age of inflation is open to question. A second argument is more dubious; the proposition that the practicability of the rating of site values in Britain is demonstrated by its success in other countries. The experience of various Commonwealth countries and of Denmark is adduced in support of this proposition.

The first objection to this is that the complexities of the building lease system create difficulties unknown in most of these other countries. A second possible objection is that the success, for example, of *grundskyld* in Denmark has not been fully demonstrated. It is, of course, true that objection to the system has not been sufficiently strong to foment a revolution, but this is rather negative evidence. What is needed is some detailed research into the valuations to ascertain their accuracy. The matter has received some slight attention in the Danish report on the 100 % taxation of site values *(fuld grundskyld)*,[5] however, and it may be worth while to make some observations upon their views. They provide a table showing "Purchase sum higher than valuation sum, %" for unbuilt-on properties, with the figures for 1950 ranging from 22.4 % to 64 %. Presumably the former figure, which relates to Copenhagen amt, means that the aggregate sales value of the properties concerned which were sold in 1950 exceeded their aggregate assessed values by 22.4 %. If so, it follows that some properties must have sold for more than this percentage in excess of their assessed value and others for less. The dispersion must thus have been very considerable and would appear to justify no great complacency on the part of the authorities. But the majority, who appear to believe that there is no serious problem in valuing assets which are taxed at 100 % (!), perhaps deserve less attention than Aksel Jensen. In his minority report[6] he shows a clear understanding of the fundamental point enunciated in the Introduction above and argues that the assessed values vary widely relatively to market values. It is, of course, the dispersion and not the absolute level of assessed

[4] See the chapter on this subject in my forthcoming book on the theoretical analysis of land values and related topics.

[5] *Betænkning vedrørende fuld grundskyld.* Copenhagen 1954, pp. 75–6.

[6] *Op. cit.*, pp. 190–2.

values relatively to market values which matters. If all assessments were, say, 86 % of market values both unfairness and peculiar effects on the allocation of resources would be avoided. In the case of an increment tax, however, the percentage must not rise between successive valuations. Suppose, for example, that there is an 80 % tax on increments. Then if, to take an extreme case, a property initially worth £1,000 rose to a value of £2,000, while the assessment as a percentage of the true value rose from 50 % to 90 %, the tax would exceed the increment. It is this possibility, indicating lack of confidence in the assessments, which provides the reason why increment taxes are generally at a rate considerably less than 100 %.

2. In 1931 the Budget included a land value tax, but the necessary valuations were suspended in the following year. The proponents of land value taxation imply that this reflected moral turpitude on the part of the Government, but technical valuation difficulties appear to have furnished a major reason for the suspension. An examination of these difficulties would be instructive, but I know of none.

3. In the budget of 1910 some duties on land values were introduced. They included a tax on increments of site value ("Increment Value Duty" and "Reversion Duty"), a tax on the site value of unbuilt-on land in excess of its agricultural value ("Undeveloped Land Duty") and a tax on mineral rights. These taxes were partly suspended in 1914 and were repealed after the war. Leaving aside the separate tax on mineral rights, they afford an admirable example of how not to tax land values. Fortunately for anyone who wishes to study this example, a mass of valuable information is available in various expert memoranda on the working of the duties submitted to a House of Commons committee.[7] The following summary statement is taken from the authoritative memorandum of evidence submitted by a Commissioner of Inland Revenue.

> The general difficulties which have been encountered by the Board [of Inland Revenue] in connection with the work of valuation may be summarised as follows:—
>
> (a) The necessity of assessing and collecting the Land Values Duties

[7] *Report from the Select Committee on Land Values.* Cmd. 556, His Majesty's Stationery Office, 1920.

(two of which were based upon the values to be fixed in the general valuation) simultaneously with the process of making the valuation, thus diverting the time and energies of the staff from the work of valuation to work in connection with the duties.

(b) The unusual nature of the values which have to be ascertained under the Statute, values of a completely new character, with which neither expert valuers nor the public were familiar.

(c) The prolonged and organised opposition which was offered by the public and inevitably led to legal and technical points of all kinds being raised against the valuations, even when these would, if sustained, be of but doubtful benefit to the taxpayer.

Further, there were difficulties of a technical character which experience has shown to be innate in the provisions of the Act itself. These tended to create delay and prevent an early completion of the work (e.g., the determination of the unit of valuation, minus site value, deductions in respect of value attributable to land appropriated for roads, etc.).

A few of the absurdities which resulted from the definitions of value given in the Act will show that the system would not have worked without very substantial revision even in the absence of organized opposition. (1) In some cases Site Value was assessed at a negative figure. (2) Farm land had to be valued as though it were divested not only of buildings but also of every growing thing, including grass and weeds. (3) Increment value duty could be charged when there had been no increase in the value of the site but the purchaser had bought the property at a price exceeding a current estimate of its market value.

Anomalies of this sort basically resulted from the fact that those responsible for the detailed drafting of the Act understood little of valuation and assumed that any competent valuer could make a reasonably accurate valuation of practically anything. Consequently valuations were required of things which are never the subject of transactions and of properties in a condition hypothetically different from their actual condition. An example of the resulting legalistic nonsense is furnished by the following two definitions in section 25 of the Act:

> ... the gross value of land means the amount which the fee simple of the land, if sold at the time in the open market by a willing seller in its then condition, free from incumbrances, and from any burden, charge or restriction (other than rates or taxes) might be expected to realise. ...

> ... The total value of land means the gross value after deducting the amount by which the gross value would be diminished if the land were sold subject to any fixed charges and to any public rights of way or any public rights of user, and to any rights of common and to any easements affecting the land, and to any covenant or agreement restricting the use of the land. ...

This is rather like saying that in order to obtain the total value of a painting by Dufy one must first ascertain the value it would have if it had been painted by Picasso (the gross value) and then subtract the amount by which the value is different because it was Dufy and not Picasso who painted the picture!

If a tax on increments in site values is imposed, two possibilities are open regarding the occasion of the tax. On the one hand it may be levied at each periodical general revaluation in respect of the increase since the previous valuation. On the other hand, it may be levied only when the gain is realised by the owner. This second alternative was followed in the present case, and duty was levied (*a*) on the sale of land, (*b*) on the grant of a lease of over fourteen years' duration, (*c*) on death and (*d*) at a lower rate on the reversion of a building lease. In either alternative the problem must be faced of how to deal with "fictitious" increments in value caused by general inflation or by a fall in interest rates. In 1910, however, after the splendid stability of Victorian times, these matters were unimportant.

The case for levying the tax when a gain is realised instead of levying it periodically seems a sound one, for it avoids the imposition of liquidity difficulties upon owners. Suppose, for example, that between 1950 and 1955 the capital value of a property has risen and that it is occupied by a tenant who has a 21-year lease granted in 1945. The landlord will reap no gain until 1967, so to tax him in 1955 may put him into considerable financial difficulties since he will not receive any of the gain for another twelve years.

Now it may be said in reply that this problem would be avoided if the property were valued not as in an imaginary condition (vacant, without a tenant) but in its actual condition (subject to a lease till 1967). In this case the rise in capital value would be less. What this boils down to is the proposition that the tax should be assessed on

what the landlord actually owns instead of what he would own if there were no tenant, and this certainly seems fair. But if it be accepted, it has far-reaching implications. It means that if a man owns a property he should be taxed according to its whole value and not just its site value. After all, the value of a property (a building on a site) and the site value (the value it would have if the building were demolished) could conceivably move in opposite directions: if the former rose and the latter fell, a tax on the increment in the former might well be thought inequitable. And if both values rose, but site value increased by a greater amount, the argument in the preceding paragraph holds, since the increase in site value will not be realised until the economic life of the building is ended.

The conclusion which we have reached is based on considerations of fairness—on a value judgement. If this be accepted it means that an increment tax should be levied when gains are actually realised, rather than periodically on assessed increases in site value.

With a tax on the level of values, as distinct from increments in values, there is a case for taxing site values rather than the whole values of properties in order not to discourage new building and improvements (though the importance of this has been questioned above). It may be suggested that the same point applies to an increment value tax as well. Now even when a tax is on site value, this problem of avoiding the taxation of improvements arises, since levelling, drainage, the provision of access roads and similar operations can raise site value. Some method therefore has to be sought by which increments in site value caused by improvements of this sort can escape taxation. There are two alternatives. The first is to assess the site value as though the improvements had never been made. This, however, is an idea which, despite its appeal to the legal profession, raises great difficulties. A valuer can estimate the value which a farm in a prosperous agricultural area would have if it were wild virgin land only by subtracting an estimate of the cost of clearing, draining, etc. from its value in its present state. Such a valuation would be contentious and might often produce the absurd result of a negative value of the site. It would therefore be inferior to the second alternative, which is to subtract from the value of the site in its present state for a certain

period of years the actual cost of improvements actually undertaken. Now this could equally well be done in respect of all improvements and not merely site improvements. The assessable value of a property could be the value of that property as a whole less $1 + y$ times the cost of all improvements, including building, undertaken by the owner or by his predecessors within the last x years. If x were specified for each type of improvement as its usual amortization period, and y were specified as a (generously) normal rate of profit on improvements, a tax on increments in property values would not act as a tax on improvements.

It may be that this could not be made to work in practice without some disincentive effect. But if this be so, the same must be true of a tax on increments in site value. Thus the considerations just mentioned do not upset the conclusion reached above that, so far as an increment tax is concerned, whole property values are a better base for taxation than site values. The greater arbitrariness which inevitably attends the estimation of site values serves only to strengthen this conclusion.

The Compensation-Betterment Problem.

Town and country planning in a broad sense—including use zoning, street improvements, the redevelopment of obsolete areas, etc.—may impose losses on property owners in two ways. Firstly, some properties may be expropriated; secondly, the value of properties may be adversely affected as, for example, when building is prohibited in a certain area. On the other hand, planning activities may benefit property owners as, for example, when the construction of a new street raises property values. Thus owners on whom losses are imposed may demand a right to compensation, while the community may assert a right to a share of benefits. The problem of when compensation should be paid, how it should be assessed and when and how the community should take a share of increases in property values constitutes the compensation-betterment problem.

In 1947 the Town and County Planning Act introduced a new system of planning and along with it a new compensation-betterment scheme.

A feature of the latter was the institution of development charges *(exploateringsavgifter)*. These were payable when the grant of planning permission increased the value of a property and thus did *not* constitute a general tax on increments in value, since they were not levied upon increases in value which involved no changes in land use.

Development charges were abolished after a few years. Once again, many of the difficulties which led to this decision may be traced to the fact that what seems reasonable to the legal mind may bear too little relationship to the facts of the property market to escape arbitrariness. However I shall not examine the matter here, since I have done so in a readily accessible form elsewhere.[8] Nor shall I describe the amended compensation-betterment system introduced in 1954.[9]

The experience obtained since 1947 gives rise to one general reflection which may be worth noting here. If (1) the compensation provisions are such that those property owners whose property is acquired or who are subjected to restrictions on the use of their property are made substantially worse off as a result, and if (2) it is impossible to forecast with complete certainty which properties will be so affected, the functioning of the property market will be adversely affected.[1] Both these conditions are at present fulfilled with those proposals for new roads which are not yet decided in all details but merely indicate their general location and direction. There is therefore a large number of properties which may be affected, and since the compensation payable when acquisition takes place is frequently regarded as less than sufficient to compensate the owners for their loss, the result is that all the properties along the proposed route fall in value very considerably. The uncertainty thus inhibits any rebuilding and the area is more or less sterilized in its present state, perhaps for years, until the full details are worked out and made public.

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[8] See "Development charges and the compensation–betterment problem" in *The Economic Journal*, June 1953, together with Mr. Munby's criticism (*ibid.*, March 1954) and my reply (June 1954).

[9] See my paper "Compensation and Town Planning: The 1954 Act" in *The London and Cambridge Economic Bulletin*, September 1955, published in *The Times Review of Industry* of that month.

[1] This point is made by Lindström in his additional note to the report of the Markutredning, S.O.U. 1948: 4.

Recoupment.

The term "betterment" has come to have a wider and wider meaning over time. In the narrow sense used here it refers to increases in the value of neighbouring property brought about by a particular improvement, such as the construction of a new street. In a wider sense it covers all increases in the value of property caused by planning activity and regulation. Sometimes it is used to mean not the rise in value itself, but the levy of a charge upon it.

One method of recovering betterment is recoupment *(ekonomisk zonexpropriation)*. This involves the purchase of more land than is technically necessary for the construction of an improvement and the subsequent sale or lease of the surplus once the improvement is completed. Under this system the owners of the property taken for recoupment are prevented from securing its betterment; they lose their property and receive compensation. The net gain to the planning authority equals:

the resale value of the bettered property;
+ the enhancement in the resale value of remnant land due to its being united with the land taken for improvement;[2]
— the compensation paid for the land acquired for recoupment.

This net gain, by reducing the net cost of the improvement, will redound to the benefit of the taxpayers whose taxes finance the improvement. How much they gain and how fair the system is to those owners whose properties are taken for recoupment clearly depends, *inter alia,* upon how the compensation awarded to the latter is assessed.

There is another case, besides the aim of recoupment, for acquiring more land than is needed for the improvement itself. This is the facilitation of the redevelopment of the surrounding area *(teknisk zonexpropriation)*. If the public authorities buy out or evict all tenants as

[2] Even if no land is taken specifically for recoupment purposes, some remnants may be surplus since the whole of a property will often have to be acquired even when only part of it is required for the improvement. These remnants will be enhanced in value by amalgamation with back land for reasons discussed below.

well as the landlords, redevelopment can start at once, while if the properties in question are left in private hands their owners will have to wait for existing leases to run out. Furthermore, if all the land becames concentrated into one ownership it can be redivided into plots of the optimum size and shape: for example the sites of several small houses can be amalgamated to form the site for a block of offices. The problem of the remnants can be solved too, by incorporating them into other sites. If this is not done the remnants, by impeding access to the new improvement, may obstruct development. The remnants will often be too small or oddly shaped to be properly redeveloped alone; there is therefore a danger that unless all the land is acquired inferior buildings may be erected on the remnants, depreciating the value of neighbouring property.

All these considerations show that there will be good reasons for the acquisition of land not physically required for the improvement in some cases, namely where this will facilitate redevelopment. But these are just the cases where recoupment is likely to pay off. Thus the aims of securing betterment and of redevelopment are not really separable.

Recoupment is a financial success if the algebraic sum of the three items listed above is positive. Unfortunately, the only figure available in many cases has been the gross total of proceeds from the sale of surplus land, and this has led some authors into the fallacy of regarding the magnitude of this total as indicating the success of the recoupment. The relevant figures appear to be available only for some nineteenth century London street improvements, and show that on the whole recoupment was a failure! In view of the cogency of the arguments in its favour this is rather surprising, and the reader may therefore be interested to refer to an investigation of the matter.[3]

Betterment Charges.

An attempt to recover betterment by levying a direct charge upon the owners of properties subject to betterment was made by the Lon-

[3] See Turvey, "Recoupment as an aid in financing nineteenth century street improvements in London" in *The Review of Economic Studies*, Vol. XXI (1), no. 54.

don County Council in the case of a number of street improvements commenced between 1895 and 1902. An argument used by the London County Council in favour of this procedure when it sought the necessary legislation was that recoupment had failed.

The betterment charge was 3 % per annum of half the enhancement in value of the properties lying within a betterment area demarcated by the Act of Parliament which empowered the Council to undertake the improvement. The enhancement was calculated as the difference between an initial valuation and a second valuation made within a few years of the completion of the improvement. Apart from the fact that the capital value of the charge was only 50 % of the betterment, property owners were safeguarded by two devices, between which they could choose. On the one hand they could appeal against the amount of charge assessed on their properties and bring the matter to arbitration. On the other hand they could require the Council to purchase their properties at the initial valuation and the Council could then choose between making the purchase or abandoning its claim to a betterment charge on those properties.

In three of the improvements where a charge was levied on betterment,[4] the total enhancement of value was assessed at £112,826. The London County Council had originally assessed it at a larger sum, but were required to purchase some properties on which the enhancement originally assessed had been approximately £25,000. In all except one of these cases they preferred to drop the charge, however. Thus the capital value of the betterment charges levied came to only £56,413, which compared very poorly with valuation costs borne by the Council of £16,997. This experience discouraged the Council, and after 1902 they no longer considered it worth-while to obtain the necessary legal powers to levy a betterment charge.

Valuations, since they inevitably involve some element of hunch and guesswork, necessarily have a margin of error. The possible error in the difference between two valuations is therefore very considerable, yet there is no other way of assessing the betterment caused by an improvement. Thus to avoid overburdening the owners of bettered

[4] Tower Bridge Southern approach; Tottenham Court Road at St. Giles Circus; Kingsway–Aldwych. In the latter case land was also purchased for recoupment.

property, betterment cannot be charged at 100 % and various provisions such as those described above must be introduced by way of safeguard. The possibilities of raising money by this method are therefore severely limited.

Finally, it is worth-while noting that betterment was assessed in respect of properties in their existing state, and not in respect of site values. But if this be preferable in the case of a betterment charge, surely it is also preferable, as argued above, in the case of a national tax on increments in value.

Conclusion.

The general conclusion to be drawn from this survey is that British experience affords few schemes worthy of imitation. In particular, it appears that any scheme which is constructed without regard to the working of the property market and the technicalities of valuation is unlikely to work well; legal elegance is a poor criterion by which to assess proposals.
