

Can the ‘unearned increment’ in land values be harnessed to supply affordable housing?

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(Paper presented at UN Habitat Warsaw Conference, 2009)

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INNOVATIVE LAND and PROPERTY TAXATION

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ANNEXES

SUMMARIES OF THREE PAPERS PRESENTED AT THE WARSAW CONFERENCE, 2009

CAN THE 'UNEARNED INCREMENT' IN LAND VALUES BE HARNESSSED TO SUPPLY AFFORDABLE HOUSING?

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Affordable housing is increasingly becoming a 'gaping hole'. Alterman emphasised the growing problem of exclusion and lack of housing affordability, which is persistent not only in developing countries but also very visible in developed economies, such as the United States. It is thus thought that the 'unearned increment', the rise in land values, could be used to finance affordable housing and other public services and infrastructure. Alterman stresses the importance of the rationales for capturing value, ultimately leading to a specific set of policies depending on the institutional environment. Various direct and indirect value capture mechanisms are analysed. Even though the idea of land value capture is not new, few countries have adopted it in its pure form; since its original conception by Henry George, the idea of land value taxation has morphed into various degrees and forms of the original concept. Experimentation with different instruments is still at its embryonic stage. Alterman analyzes the U.K, represented as the world's laboratory with regard to taxation policies.

AFFORDABLE HOUSING: THE "GAPING HOLE"

Affordable housing resources have decreased substantially in recent years; Alterman linked this to:

- The retreat of governments and reduction of public finance.
- Reluctance of citizens to pay higher taxes.

- Privatisation or semi-privatisation of existing social public housing stocks.
- Regulation which has caused an erosion of the existing affordable housing stocks.
- Regeneration of cities with the omission of affordable housing.
- Exclusionary zoning and gated communities.

There is an ensuing need to research instruments other than direct taxes to finance or incentivise affordable housing. Such instruments are generally associated with planning regulation and land policy.

THE 'UNEARNED INCREMENT': DIRECT AND INDIRECT VALUE CAPTURE MECHANISMS

The issue of dealing with changes in land values caused by planning and zoning is problematic. The question is to whom should the added increment go to and how heavily it should be taxed. In the case of a value decrease, should landowners be compensated? These issues remain in policy planning today. There are two types of value capture mechanisms- direct and indirect. The concepts are often confused; however, they need to be understood as two different entities as they arise from different rationales.

Rationales for value capture

Direct value capture mechanisms refer to an increase in the value of land of private

owners through actions undertaken by public authorities or by the general community. The rationale for capture is thus the fact that the increase in value was not caused personally by an individual and hence should be shared with a broader community. That type of mechanism has generally been slow to catch on.

Indirect value capture mechanisms are used increasingly by various countries and local governments. They result from different legal and policy environments which generally make the use of direct value capture mechanisms problematic. The rationales for these capture mechanisms also tend to differ from the traditional rationales. Alterman described those alternative rationales as concentrated on the anticipated impacts of development. These might include the need to help recover development costs that would otherwise be imposed on public budget; however the local authority should not exact mitigation from the developer in the case of windfalls, as this

BOX A.1 DIRECT VALUE CAPTURE MECHANISMS

Betterment (in contrast to compensation, aggravation): the rise in land values caused directly by a planning or public works decision. Used in UK and former colonies.

Unearned increment: any rise in land values, whether due to public decisions or to the general economy; stressing the fact that the rise is not due to landowners' own initiatives and efforts. Used internationally. Plus-value: or value increase - as above, but a more ideologically neutral term. Used internationally.

Windfalls (in contrast to wipe-outs): Coined in the USA.

Givings (in contrast to "takings"): an esoteric take of the reverse US concept.

Source: Alterman 2009

BOX A.2 INDIRECT VALUE CAPTURE CONCEPT AND INSTRUMENTS

Developer obligations (exactions (USA), planning obligations, planning gain (UK), participation (France) cost recovery (Netherlands) : variety of mechanisms used by planning authorities to transfer some or all of the burden of supplying public services, amenities, or environmental mitigation obligations, from the public authority to the developer.

Infrastructure levy: the oldest type of obligations based on betterment rationale; limited to cost of construction

Impact fees or linkage: Preset levels and rules of developer obligations.

Developer agreements: Discretionary obligations negotiated case by case at various levels and for a variety of purposes.

Incentive zoning: (USA) Pre-set two-tier system as an incentive for developers to provide a specific public good e.g. Affordable Housing.

Transfer of Development Rights: based on the ability to transfer the plus value of one development to another so as to compensate those who's planning and development rights have been reduced. However, not usually suited for affordable housing.

Source: Alterman 2009

would constitute a direct capture mechanism. These capture mechanisms are usually more complex and less well defined. Alterman referred to these as ‘developer obligations’.

Additional rationales for the capture of the ‘unearned increment’ listed by Alterman include:

- Reduction of the (political) temptation to misuse planning decisions to enrich individuals.
- Reduction of land speculation by reducing its gains.
- Increasing the trust in government’s planning decisions.
- Reduction of a growing public objection to new development (affordable housing in particular).
- Provision of a financial resource to compensate those whose property values decline due to planning.

CAPTURE MECHANISMS IN PRACTICE

The difficulty in designing and implementing direct unearned increment instruments arises from multiple dimensions that need to be considered. Firstly, the undertaking needs to be anchored legally. Additionally, the taxable cause that created the rise needs to be defined as well as its incidence point. Furthermore the method of payment and the plus value rate need to be agreed upon. This brings the problem of who received the proceeds, and how this revenue is used.

Alterman conducted a twelve country review of direct value-plus capture via the use of betterment taxes. It was found that the concept of betterment taxes still rests in theory rather than practice. The study revealed that the mechanism has only been fully operative in Israel, where the betterment level is high. Spain was pointed out as a country with a partial low-rate quasi-betterment tax. In Poland the betterment tax is newly introduced

and at the moment it is inoperative as it needs further revision. In general, capital gains tax was mentioned as a common way of capturing the unearned increment, existing in the UK, the US and the Netherlands. The researcher also noted a distinctive rise in the use of indirect mechanisms, such as impact fees, linkage, development agreements and incentive zoning.

The UK can be regarded as a world laboratory with regard to experimentation with value capture instruments. A plethora of different modes have been tested, however, they were often removed or changed with the advent of a new government. The rates for recoupment have varied greatly, reaching as high as 100% in the Post War 1947 Act; however they never continued for long enough to enable good evaluation of their benefits. Since 1980, there has been a resounding ‘no’ to direct betterment capture in the UK. The chronological account of the betterment capture mechanisms illustrates how a system wrought with political and ideological complication can lead to an ultimate failure of this type of tax application.

TENTATIVE LESSONS, CONCLUSIONS AND RELEVANCE TO AFFORDABLE HOUSING

The analysis of the cross-country study provides some tentative lessons and conclusions, which can be used directly in relation to affordable housing. First and foremost, sustainable political support is essential in order to implement the capture mechanism, especially for its long lifespan. Implementation of a direct mechanism is difficult as it requires national legislation, which is a politically charged issue, especially if the debate has high public exposure. Additionally, a purely direct tax has high administrative costs. With regard to the use of proceeds from captured value, affordable housing is only one of the competing needs. Affordable housing is a contentious issue; part of the problem is that affordable housing

is disliked due to its negative connotation and thus more difficult to obtain sustained political support as opposed to other public services. The lack of flexibility of the current national laws makes it more difficult to cater to the changing needs of affordable housing.

Due to their more flexible nature, indirect instruments can perhaps offer an alternative means of financing affordable housing; their level can be adjusted according to needs. They can indirectly retrieve the plus-value. Nevertheless, the introduction of such

instruments is not straightforward; it requires a high level of skill from local government professionals. In order to make it sustainable, a level of trust in the government and low levels of corruption are necessary.

Concluding, targeting affordable housing is more challenging than targeting traditional public services. The instruments that have been reviewed point to the need of periodic evaluation in order to suit the political and social environment. This is true of both developing and developed nations.