The Economics of House Prices

THE value of a property is made up of the value of the building and the value of the site on which it stands. The cost of identical buildings is the same wherever they are erected (subject to very minor variations, which can be ignored). The difference in price asked for the same type of house is therefore due to the difference in land value, which is a reflection of the advantages attaching to certain areas and certain sites. A three-bedroomed house costing £3,000 to build might sell on a site in the North for £3,200, on a similar site in the South-East for £4,000, and on a site close to London for £5,000 or more. The building is the same; it is the values of the sites that are different.

Under the *present rating system* the rateable value is the annual letting value of land and buildings together as a unit. Under *site-value rating* the rateable value is the annual letting value of the site alone, that is, excluding the value of the building erected on it. The pilot survey at Whitstable* has indicated that domestic ratepayers as a group would benefit substantially from the introduction of site-value rating. A large part of the burden now borne by them would be shifted to the owners of underdeveloped and vacant land who now pay little or no rates at all. The Whitstable survey also showed that this benefit would remain even if certain classes of ratepayers were exempt (as at present).

Reduction in the Price of Land

Prospective house-owners would benefit from site-value rating also because it would reduce the selling price of land.

Useable land has both an annual value, the yearly rental for which it could be leased, and a capital value, the amount for which it could be sold. If the prevailing rate of interest is five per cent per annum, the annual value will tend to be five per cent of the capital value because that is the amount the owner could expect to earn on his capital if invested elsewhere; or to put it the other way round, the *capital value* will be twenty times annual value.

Under site-value rating a disparity arises between what a tenant actually pays and what the owner finally receives. For instance, a rate of 10s. in the £ applied to a site with an annual value of £100 would provide £50 for the local authority, leaving a net annual income of £50 to the owner. It is to this annual income that capital

TABLE A

Annual Value of Site	Site-Value Rate		Net Annual Value of Site	Capital Value of Site
	Poundage	Payable		
£100	Nil	Nil	£100	£2,000
£100	5s.	£25	£75	£1,500
£100	10s.	£50	£50	£1,000
£100	15s.	£75	£25	£500
£100	£1	£100	Nil	Nil

**Rating of Site Value* — Report on a pilot survey at Whitstable — Rating and Valuation Association, 29 Belgrave Square, London, S.W.1.

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value is related; whereas before the introduction of site-value rating the site would sell for 20 x £100 = £2,000, afterwards it would sell for 20 x £50 = £1,000. The income to be derived by a ground landlord would be halved, and consequently the value to a buyer would be halved also.

Assuming a gross annual value of £100 and an interest rate of 5 per cent, Table A shows the effect on the capital value of a piece of land of a site-value rate levied at various poundages.

These results would not come about if landlords were able to recoup themselves by increasing rents, which they cannot.* The amount that a tenant is prepared to pay for any particular site depends upon the advantages which that site possesses in comparison with other sites. If the advantages of living in a town rather than on the outskirts of a village are considered by potential tenants to be worth £500 per annum, then competition among those potential tenants will enable a landlord to ask and obtain such a rent, but if he tries to charge more his tenants will go elsewhere.

*See Professor Paul A. Samuelson, *Economics — An Introductory Analysis,* p. 598.

TAB

	Price of Building	Price of Land	Overall Price of Property	Amount of Deposit	A M
(1)	£3,400	£1,600	£5,000	£500	
(2)	£3,000	£1,000	£4,000	£400	
(3)	£2,600	£400	£3,000	£300	

TAB

	Price of Building	Price of Land	Overall Price of Property	Amount of Deposit	A M
(1)	£3,400	£800	£4,200	£420	
(2)	£3,000	£500	£3,500	£350	
(3)	£2,600	£200	£2,800	£280	

TAB

	Present Rating System			Site
	Mortgage Repayments	Rates Payable	Total Outgoings	Mortgage Repayment
(1)	£353	£45	£398	£297
(2)	£283	£35	£318	£247
(3)	£212	£25	£237	£198

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HOUSE OWNERS OF A CHANGE TO
SITE-VALUE RATING

By A. J. Carter

The introduction of site-value rating will not alter this situation; the tenant will be prepared to pay no more for any *particular* site than before. The competitive mechanism by which rents are determined is not altered by a change of the rating system, and therefore landlords and other owners who are enjoying the full value of their sites must bear the site-value rate themselves.

Three Examples Under Different Rating Systems

The range of prices both for buildings and for sites is very wide. There are expensive houses on expensive sites and on cheap sites, and there are cheap houses on expensive sites and on cheap sites. Three examples will be taken here to cover this range. They are: (1) a good-quality house on a valuable site; (2) a house of not quite such good quality on a less valuable site; and (3) a smaller house on a cheap site. The houses will be assumed to cost £3,400, £3,000 and £2,600 respectively, and the sites £1,600, £1,000, and £400 respectively.

It has been assumed that the deposit required on all three houses is ten per cent of the purchase price, and that the balance of ninety per cent can be obtained on mortgage, subject to the amount of the loan being no more than three times the annual wage or salary of the applicant. The mortgages are assumed to run for twenty-five years at an interest rate of six per cent; figures for annual repayments are shown to the nearest pound.

The existing rateable values have been taken as £90, £70, and £50 respectively, and the rate poundage as 10s. (For simplicity, the site-value rate poundage will be assumed to be the same as the present rate poundage. The Whitstable survey indicates that it could be slightly higher, so to make the comparison a fair one the existing rateable values have been deliberately pitched low.) Table B sums up this information.

From Table A it can be seen that a site-value rate levied at 10s. in the £ would reduce the selling price of a £2,000 site to £1,000. Similarly, it would reduce the price of a £1,600 site to £800, a £1,000 site to £500, and a £400 site to £200.

When rating is on site values, the equivalent figures to those given in Table B are shown in Table C. Not only are the amounts to be paid in rates lower, but the reduction in the prices of the sites and so in the overall purchase prices leads to smaller deposits and substantially smaller mortgages. Consequently, the salaries that prospective buyers must earn to qualify for the mortgages are less, and the repayments themselves are lower.

On the basis of the information in Tables B and C, Table D compares the total annual outgoings (mortgage repayments plus rates) before and after the introduction of site-value rating. It also shows the total saving over the full twenty-five year period of the mortgage. It should be borne in mind that for valuable sites the reduction in price, and therefore in mortgage repayments, will be much more significant than the reduction in rates, while for cheaper sites the reduction in price and repayments will be fairly small but the reduction in rates more substantial.

Leasehold and Freehold Compared

When leasehold property is offered, the price is lower than for a freehold, the difference being paid in the form of an annual ground rent on the leasehold property. Table E shows various combinations of prices and ground rents taking as an example a £3,400 building on a £1,600 site. The ground rents have been calculated at five per cent of the residual values, i.e. the same basis as in Table A.

It should be noted that it is usual for some initial payment to be made for the land — the position is rarely, if ever, as in (e). Probably the most likely combination of initial payment and ground rent would be that in (c). The corresponding figures for a £3,000 building on a £1,000 site, and a £2,600 building on a £400 site, are shown in Table F.

With a leasehold property the buyer benefits initially from the lower purchase price but this is offset over the years by the annual ground rent. The ground rent

E B

nt of tgage	Salary Required	Annual Repayments	Present Rating System	
			Rateable Value	Rates Payable
500	£1,500	£353	£90	£45
600	£1,200	£283	£70	£35
700	£900	£212	£50	£25

E C

nt of tgage	Salary Required	Annual Repayments	Site-Value Rating System	
			Rateable Value	Rates Payable
780	£1,260	£297	£80	£40
50	£1,050	£247	£50	£25
520	£840	£198	£20	£10

D

lue Rating System		Saving From Introduction of Site-Value Rating	
Rates Payable	Total Outgoings	Annual	Over 25 years
£40	£337	£61	£1,525
£25	£272	£46	£1,150
£10	£208	£29	£725

TABLE E

		Price of Building	Initial Payment for Land	Overall Price of Property	Residual Value of Land	Ground Rent per annum
(1)	(a) Freehold	£3,400	£1,600	£5,000	Nil	Nil
	(b) Leasehold	£3,400	£1,200	£4,600	£400	£20
	(c) Leasehold	£3,400	£800	£4,200	£800	£40
	(d) Leasehold	£3,400	£400	£3,800	£1,200	£60
	(e) Leasehold	£3,400	Nil	£3,400	£1,600	£80

TABLE F

		Price of Building	Initial Payment for Land	Overall Price of Property	Residual Value of Land	Ground Rent per annum
(2)	(c) Leasehold	£3,000	£500	£3,500	£500	£25
(3)	(c) Leasehold	£2,600	£200	£2,800	£200	£10

TABLE G

		Price of Building	Price of Land	Overall Price of Property	Ground Rent	Rateable Value	Rates Payable
(1)	Leasehold (present rating system)	£3,400	£800	£4,200	£40	£90	£45
	Freehold (site-value rating system)	£3,400	£800	£4,200	Nil	£80	£40
(2)	Leasehold (present rating system)	£3,000	£500	£3,500	£25	£70	£35
	Freehold (site-value rating system)	£3,000	£500	£3,500	Nil	£50	£25
(3)	Leasehold (present rating system)	£2,600	£200	£2,800	£10	£50	£25
	Freehold (site-value rating system)	£2,600	£200	£2,800	Nil	£20	£10

continues to be paid until the expiry of the lease, when the land, together with everything on it, reverts to the ground landlord.

The *leasehold* prices of the three examples under the *present* rating system are of the same order as the *freehold* prices under *site-value* rating. A direct comparison can therefore be made as in Table G.

Under site-value rating the price is reduced to the leasehold level but the property remains freehold. There is no ground rent and no reversion at the end of the lease. The amount saved in each case is the amount at present paid in rates.

Effect of Site-Value Rating

The principal effects of site-value rating on prospective house purchasers may now be summarised by comparing a freehold house under site-value rating with (a) a freehold house under the present system, and (b) a leasehold house under the present system.

In (a), site-value rating (i) reduces the rateable value and the rates payable, (ii) reduces the selling price of the land and therefore the overall price of the property, (iii) in consequence reduces both the amount of the deposit and the amount of the mortgage, and (iv) as a result of reducing the amount of the mortgage reduces both the salary required to qualify for it and the repayments.

In (b), site-value rating (i) reduces the rateable value and the rates payable, (ii) enables the property to be offered freehold for the same price, and (iii) eliminates payment of the ground rent.

Solicitors' fees are based largely on the price of the property and would therefore be reduced as the price of the property was reduced. Compulsory registration of titles, a prerequisite to site-value rating, would further reduce fees for properties not yet registered.

With the reduction in the price of land the prices of all properties, existing as well as new, would fall, but householders wishing to move would not lose, for although the value of their own properties would have decreased

(Continued on page 179)

PREJUDICE OR INCOMPETENCE?

(*Continued from page* 171)

authority expenditure providing a field of disagreement" presumes that land would be valued according to local authority expenditure! Such a suggestion is complete nonsense.

Logic vs. Fantasy

The report is full of false trails such as the argument that site-value rating would not release land at the "proper time" (whenever that is) or in the "right order" (whatever that is) and the argument that site-value rating would both decrease *and* cause land speculation and that speculators would save up their rate liabilities and impose them on a future buyer. Truly the bottom of the barrel has been scraped for red herrings in the attempt to discredit site-value rating.

In its summing up the Working Party declares: "in our view the introduction of site-value rating would lead to a much greater hardship over a wide field" this without a shred of evidence to support it.

We disagree with all their conclusions (save one) and although we admit our own bias in this matter, we can do so in the field of logic, not fantasy. The one conclusion we accept is the one which contradicts the Working Party's own previous statement; it is as follows: "Site-value rating would entirely exempt from contribution to local rates certain sections of the community, i.e. the occupiers of rented properties." Since it is inherent in the system of site-value rating that the rate falls upon the site owner, this conclusion is not very startling, but it contradicts the Working Party's claim that the site-value rate can be passed on to the tenant. It cannot have it both ways.

The R.I.C.S. by its report stands guilty of either of two charges and it may take its pick. Either it was firmly prejudiced from the start and determined to damn site-value rating, whatever the damage done to reason and fact, or it is grossly incompetent to study such a serious matter.

RATES AND THE HOMEOWNER

(*Continued from page* 174)

so would the values of the properties they wished to buy. Estate agents' fees (which are payable by the vendor) are a percentage of the selling price and so, like solicitors' fees, would be reduced as a result of rating site values.

These effects would be felt by most householders. There would, however, be a few exceptional cases where the site-value rate was higher than the present rate. These are the cases where the householder owns any of the following: (a) a house that is tiny, old, or decrepit and standing on land capable of better development and therefore rated low at present; (b) a house on a plot of land on which other dwellings could be built; (c) a house on a valuable site in the town centre that could be more effectively used for, say, a shop. One of the advantages of site-value rating is that it would make for the more efficient use of land, and those few householders who do not make full use of their land should not be subsidised, as they are now, by the many who do.

The housing problem has two main aspects: that houses are much too dear, and that not nearly enough of them are being built. Measures like the granting of one hundred per cent mortgages make home buying easier and so stimulate demand, but do not affect supply, with the result that house prices must rise. Under site-value rating owners of sites now vacant or under-used would be induced to offer them for immediate development, and a much larger quantity of land would be available for building. Consequently, the increased demand for houses caused by the lowering of land prices and rates would be accompanied by an increase in the supply of land on which those houses could be built. There would then be an irresistible incentive for the building industry to improve its efficiency and expand its output.

SITE-VALUE RATING ENDORSED

From *The Evesham Journal*, Friday, August 28

We feel that the proposal to rate site values instead of continuing with the present system is, on the whole, as fair and equitable as any scheme so far devised. For it takes the burden from those who find it too heavy and places it on those better able to bear it, at the same time tending to halt rising land values and help the housing situation by bringing more land on to the market. It is a far superior and more workable scheme than that of the Labour Party to nationalise all land ripe for development.

There are many people outside the Liberal Party who can see merit and hope in these proposals. Every thoughtful person knows that something must be done to reform the rates, to tackle the scandal of land prices and to provide land for housing; and many Conservatives will, perhaps reluctantly, give the proposals favourable consideration. Perhaps the Conservative Party might even adopt them wholly or in part. Even the staunch Tory *Daily Telegraph* in a leading article writes: "Since the only eventual answer to the crisis in property values is more land for development . . . anything which promises to achieve this . . . should be seized on . . Here, surely, is an occasion when the Liberal Party should be allowed to perform its function of supplying ideas to those capable of carrying them out." This is certainly complimentary to the Liberal Party; but it would be rather cold comfort for Liberals if they found that their ideas were put successfully into practice and their political opponents got all the credit.