

An INSITE **HELP!** Can't you separate land from building values?

report

TO TAX LAND, you first have to calculate its pure value.

In other words, the assessors have to separate out the land value component from the total value of the property.

Except for raw land, most properties include an element of capital – from modest road improvements and drainage to skyscraper blocks in the middle of Manhattan.

The exercise in separating these values, however, cannot be done.

That's according to some economists from both ends of the political spectrum.

On the right, for example, is Dr. Donald Denman, Professor Emeritus of the Department of Land Economy, University of Cambridge.

On the left, airing his views in a new book by Marxist authors, is Michael Edwards, who claims that such a valuation exercise is "fantasy".¹

If these economists are right, of course, many people are in plenty of trouble.

● Merrill Butler, a southern Californian builder and former president of the National Association of Home Builders, is one of them.

He has devised a way to help people overcome the problem of buying high-price houses.

His "Homeowners Easy Land Lease Program" (HELP) works on the basis that the price of land is deterring people from buying their homes.

HELP makes it possible for someone to buy the house, but lease the land. This means they have to raise a smaller mortgage, and the monthly repayments are lower than under a conventional purchase (see table).

Mr. Butler's scheme is not new: this arrangements – which is an attempt to temper the impact of artificially high land values – has been operated in places as far apart as Hawaii and Maryland for years.

It's second-best, but it works.

The important point, however, is this: the scheme works because the parties to the transaction can agree on the price of that part of the property they were buying (the house) and the value of that part which they were leasing (the land).

● Condominium investors would also be in trouble.

The U.S. Internal Revenue Service allows only depreciation of the building, so the more value the

investor can shift to the house or condominium unit, the bigger the tax deduction.

In Washington, D.C., many real estate brokers argue (on behalf of their clients) that the land value component of property assessments is too high.

But they would, wouldn't they? In the end, however, investor and assessor agree on the separate values, and so strike the best deal all round.

OPPPOSITION to land value taxation is one reason why people claim that pure land values cannot be accurately calculated.

British historian A. J. P. Taylor has recalled one such occasion; the general election of 1910:

"This was an election fought partly, though only partly, on the Liberal idea for the taxation of land values.

"The Tories claimed that the valuation put on the land by the Liberals was much too high and that the taxation they'd have to pay was therefore much too heavy.

"The Liberal candidate, Baron de Forest, the heir of Baron de Hirsch who had built the Orient Line, and himself one of the richest men in Europe... issued a statement that he had deposited his cheque for £3m in the local bank and was prepared the following morning to buy all the land of Southport at the valuation the Liberals had put on it.

"Their complaint that the valuation was too high was not heard again".

● Property investors would also be in trouble if they could not carry out accurate valuations of land.

For buildings wear out, and the capital invested in them is gradually eroded. To maintain revenue, buildings need to be renewed.

According to Norman Bowie, a consultant for Jones Lang Wootton, one of London's biggest real estate firms:

"It is often argued that provision

for depreciation is unnecessary, as replacement occurs only when the site value overhauls that of the land and buildings when valued as a single entity.

"This overlooks the simple fact that the value of the land would have increased in any event so that in reality the value of the capital originally invested in the building is gradually being eroded and finally lost.

"To rebuild (or to refurbish) requires the owner to inject fresh additional capital into the property".²

To make judgments on when to invest new capital into a building, an owner needs to know the relative value of land and buildings... which entails a valuation exercise which some "experts" say cannot be done!

IT SEEMS that the opponents of separate valuations for land and buildings are theoreticians.

Unfortunately, however, they have the ears of the politicians and their civil servants, who can therefore be prejudiced against a two-tier tax system (higher rates on land values than on buildings) on allegedly practical grounds.

For practitioners in the real world, however – from speculators to homeowners, from investors to developers – the valuation exercise is an entirely practical one.

It can be improved, without doubt: the use of computers would speed up the process, and make it more accurate and cheaper to administer.

But for all practical purposes, here and now, there are no sound reasons for claiming that the value of land cannot properly be separated from the value of capital invested on (and in) the land.

1. M. Ball, V. Bentivegna, M. Edwards and M. Folin (editors), *Land Rent, Housing and Urban Planning*, London: Croom Helm, 1985, p.210.
2. Norman Bowie, "Do property investors allow for depreciation?" *Chartered Surveyor* (London), May 1982, p.581.

HOUSE PURCHASE UNDER TWO DIFFERENT PLANS: U.S.\$

	Conventional purchase	HELP deal
Purchase price	80,000	56,000
Borrower's qualifying income	37,000	32,640
10% deposit	8,000	5,600
Monthly payments	882	618
Land rent	—	160

● Assumptions: 90% loan at 14.5% rate of interest. The total monthly payment of \$778 is \$104 less than under the conventional method, which draws more people on lower incomes into the house buying bracket.