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Changing the property game

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In stage three the Government may reasonably want to help some mortgage payers and tax some property speculators. How should it do it?

Two of the Government's main worries for stage three spring from the same cause: in an age of inflation anybody who has hold of anything durable like land or a house makes a lot of money, and he therefore has to borrow a lot from the future (not just in high interest rates, but in paying more now for the durable asset than its present worth) in order to join in the game. There is an increasingly strong social case for saying that the Government's fair deal in stage three should hold out some relief to those who lose most from this quirk in the land market (ie, young couples with heavy mortgage commitments on recently-bought houses, who are having to borrow now from the capital gains expected to be made on their houses in their middle age), and there is also increasing political reason to believe that the Government will want to hit at those who gain from it (ie, "property speculators").

The Economist argued three weeks ago that Mr Heath's best response to the "mortgage crisis" would be to sponsor any scheme which would allow borrowers to choose to pay lower interest in the early part of a mortgage for the purchase of a house, and then to pay more as inflation proceeds and the capital value of their house increases. In the Guardian on Tuesday, Nuffield College's Mr Fred Hirsch, formerly of the International Monetary Fund, put forward a scheme which is exactly what Mr Barber should adopt when he talks to building society chiefs next Tuesday.

Mr Hirsch wants a Mortgage Refinance Agency (wickedly called MRA) which would convert to index-linked mortgages, on request, mortgage commitments newly taken out by borrowers from approved building societies. Somebody paying 11 per cent on his present borrowing could then often choose instead to pay 5 per

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cent on it if his mortgage repayment period had a long way to go, but he would have to contract to increase his annual interest payments as the cost of living index rose (ie, as the pound depreciated). Initially the MRA, having to meet the 11 per cent payments to the building societies while getting only the 5 per cent, might seem certain to be in deficit; but it would in effect have an index-linked bond from the customer (secured by the house), and it could probably refinance itself promptly by selling those bonds to pension funds and others eager for this sort of investment (preferably including building societies who could use these securities as backing for index-linked deposits which they could then offer to savers who deposited with them for a fixed minimum term).

A scheme of this sort would just set up a mechanism for the quite viable service of allowing young people (with houses as a security to offer) to borrow from their own middle age, via anybody who is willing to bet that some inflation might continue during the lifetime of today's newly-built houses; and at present there are plenty of investors who would bet that. While MRA could be a private venture if it got proper support, there is in present social-economic-political circumstances everything to be said for the Government establishing some such agency (with any mix of private finance plus public guarantee that it likes) at once. Some of us think we might suggest more attractive methods of index-linking than Mr Hirsch's proposal of the retail price index. Fine, let the Government set up a Hirsch-type MRA to create the market, and then private ventures can introduce these other variants, and help the mortgage payer by competing with MRA which could itself also be flexible. It is bewildering that Conservative politicians should miss such an opportunity, against which there is nothing with any economic commonsense to be said.

Beside this, the anxiety to cut down a few new property millionaires may seem rather niggling. But the authorities are undoubtedly embarrassed at the emergence of some more of this breed while stages one and two have been restricting other people. A relatively new property company, Cavendish Land, is about to be sold to the Legal and General Assurance company for £45m. The transaction will make Cavendish Land's leading light, Mr David Lewis, a millionaire eleven times over. In March, a Hongkong company bought Reunion Properties, and the Reeves family collected some £28m in cash. In January, the post office's new pension fund bought English and Continental Property for £100m: giving its founders, Mr Jack Walker and Mr Raymond Greene, a combined profit of some £20m. All of these are bright and entrepreneurial men who—by bringing land out of wasted use into more sensible uses—have often performed a genuine economic service, but for it they have received remuneration quite out of proportion to the risks run.

The most that the Government can think of is to extend the freeze on business rents, and it is extremely confused and uncertain how to go about that. A continued blanket freeze during a period of rising employment and some continuing inflation awkwardly induces owners to keep new offices vacant, so as to delay the establishment of a benchmark rent as long as possible. Maybe the Government will go for index-linked office rents (which is what property owners are going to try to urge on the housing minister, Mr Paul Channon), but distortions will arise even from that.

The trouble with most schemes for stopping property owners' bonanzas is that at some time or other they do delay development and impede the more productive use of land. At present the country has plenty of planning restrictions to hamper undesirable use of land, but no incentives except occasional bonanzas to bring land into efficient use. Possibly the dissatisfaction with land bonanzas will drive the next Labour government to some policy of the nationalisation of the land. If it does, it is important that it should be through a scheme that will do least to delay development. One method would be to declare that all land would revert to the state at the end of, say, 50 years; since the price of freehold land is equal to the price of long leaseholds there would be no loss to the landowners of this generation; the state would then sell leaseholds to the highest bidder; a free market would decide how land should be used, but the monopoly profits would go to the state.

But Mr Heath is not going to introduce that in stage three. So, if he wants to look as if he is hitting property speculators, without also blocking more productive use of land, here are two suggestions:

First, property companies should pay corporation tax on their profits, whether realised or not. Their profits are the excess of the value of their completed developments over the costs of land and building, but they are usually not taxable as the developments are usually not sold. The stock market values property companies as if the buildings were sold, and thus the shareholders get the benefit of the increase in value that is denied to the Inland Revenue. Britain's largest property company, Land Securities Investment Trust, with a rent income of £42m, paid corporation tax of only £2.3m last year, during which its net assets increased from £336m to £704m. The companies' taxable income is reduced by the huge amounts of interest paid to create the untaxed developments.

Secondly, local authorities should become more commercially conscious. Most should employ independent professional surveyors to negotiate with property companies on their behalf. Camden Council in London has just been put in the rather embarrassing position of being offered a development partnership for the Tolmers Square area that would give all the profit back to the council—when it was on the brink of doing a conventional deal with Mr Joe Levy's Stock Conversion and Investment Trust. Mr Levy was going to sell land to the council for housing at what seemed the bargain price of £200,000 an acre in return for offices. But the alternative offer is £1 an acre for the same office content. Mr Levy already owns five acres of the proposed 11-acre site, and the council is scared of compulsorily purchasing it back from him, although he needs the council to purchase the rest for his scheme. It should be bold. Sometimes, in areas where redevelopment is plainly desirable, councils should compulsorily purchase areas for development and then sell the land off, with planning permission, to the highest bidder who will redevelop the area fast.