Written evidence submitted by Centre for London [FSR 042]

Centre for London is the capital’s dedicated think tank. We develop new solutions to London’s critical challenges and advocate for a fair and prosperous global city.

We are submitting evidence to this inquiry because greater fiscal devolution to London would help the city to meet its needs and tackle its specific challenges, while supporting the UK economy as a whole.

Submission summary

- A new local government funding settlement, with fiscal devolution and local taxation reform, could help to put London’s services on a sustainable footing.
- Domestic property taxes – council tax and stamp duty land tax – are outdated, regressive and hamper mobility within the housing market.
- Revaluation and reform of the Council Tax would make marked progress towards fairer and more effective taxes on land, by bringing values up to date, and allowing more variation between tax rates for the cheapest and most expensive property.
- More radical approaches to local property taxes would include property or land value taxation. Both would be more progressive, and a land value tax could also potentially promote more efficient land use in a city where development sites are scarce, though implementation would be politically difficult.

Recommendations for action by government

- The government should devolve property taxes to the Mayor of London, and enable the Mayor to experiment with reforms, from updating council tax ratios to exploring the impact of land value taxation in London.

What lessons can be learned from past changes to local government funding in England, the current financial situation of councils, and how this has affected their ability to deliver services.

Following the London borough elections in May 2018, Centre for London published a spotlight on local authority spending data as part of our quarterly publication, *The London Intelligence*, focusing in particular on the size of cuts and where these cuts have fallen. We summarise these findings below.

- London’s local authorities, like other metropolitan authorities have been hard hit by spending cuts. London boroughs saw their expenditure fall significantly between 2010/11 and 2017/18.
- Total budgeted service expenditure (excluding education, public health and police services) by London’s 33 councils fell from £7 billion in 2010/11 to £6.3 billion for 2017/18, a fall of 10.3 per cent.
- Outturn – the actual amount spent by councils over the year – fell at a slightly slower rate: between 2010/11 and 2016/17 (the latest available year at the time) total spending fell 8.7 per cent.
- The last two years (2015/16 and 2016/17) saw outturns higher than budgets, as councils were beginning to draw down their financial reserves, having built them up for the previous four years.

When London’s population growth over this period (from 8.2 to 9 million) is accounted for, the fall is even steeper. Budgeted spend per head was £879 in 2010/11, but fell to £715 by 2017/18, a drop of 19 per cent. These figures do not account for inflation, so the real terms fall will have been steeper still.

The extent to which councils have seen reductions in their budgeted service expenditure per head varies across the capital. Some of the largest reductions have come in Inner London boroughs – Camden and Westminster saw budgets fall by 29 per cent each – but the council with the largest per

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capita fall was Newham (-33 per cent). Only Sutton, Barnet, Bexley, Richmond and Havering had falls of less than 10 per cent. The variation in spend per resident has dropped over time, with the range between the highest and lowest spending boroughs (excluding the City of London) falling from £670 to £460 per person between 2010 and 2017.

Breaking down London councils' budgets by service area shows what proportion of spend is made up by each service, and where expenditure has fallen the sharpest. Social care services for children and adults have seen the smallest falls in expenditure per person, falling 2.8 and 10.6 per cent respectively. Larger falls have been experienced by planning and development (55 per cent), cultural and related activities (41 per cent) and highways and transport (38 per cent). An increasing proportion of funds are spent on adult and child social care – accounting for 38 and 24 per cent of these totals in 2017/18, compared to 34 and 20 per cent in 2010/11. Other service areas saw a declining proportion of overall spend, with planning and development accounting for the least – only 2 per cent in 2017/18, down from 4 per cent seven year prior.

Despite the urgency of London’s housing crisis, planning and development services have borne the brunt of cuts. Budgets fell by 50 per cent (per head this was 55 per cent), and within this, development control and planning policy budgets have seen drops of 63.5 and 31.9 per cent respectively. Cuts to planning and development budgets threaten local authorities’ capacity to plan for and deliver new housing to meet London’s urgent needs. Over the same period cultural activities, such as recreation and sport, open spaces, tourism and libraries have seen budgets reduced by 41 per cent, and highways and transport including structural maintenance, street lighting, traffic management and road safety have seen budgets reduced by 38 per cent.

In the face of austerity, London’s local authorities have showed ingenuity in finding efficiencies and protecting statutory services and social services, but continued cuts are likely to force some hard choices in the years to come.

The efficiency, fitness for purpose and sustainability of the current system for funding local government (central government funding, council tax, business rates retention and other income); how it could be improved, including options for widening the available sources of funding; and what lessons can be learned from other jurisdictions.

In July 2017, Centre for London published Open City: London After Brexit which considered the challenges Brexit poses for London’s position as a global city, setting out the most urgent areas for action. Brexit opens the door to and strengthens the case for considering radical options for fiscal devolution and reform. Chapter 5 of Open City reviewed some possible routes to create a tax system that is fairer for Londoners, while also supporting infrastructure and housing delivery. We summarise the findings of the chapter below.

The Mayor of London and London boroughs have very limited power over taxation compared to authorities in other capital cities of developed economies around the world. Nearly 70 per cent of London’s revenue comes from central government, compared to 26 per cent in New York, 16.3 per cent in Paris, and 5.6 per cent in Tokyo. National government sets the tax base and bands for Council Tax, and both sets and levies non-domestic business rates and property transaction taxes. There are no London-specific rates of income or sales taxes, or locally-assigned revenues. London’s fiscal powers operate at the margins: setting the level of Council Tax and the Metropolitan Police precept, within clearly defined limits; charging a supplementary non-domestic levy for Crossrail; and operating the Congestion Charge and now the Ultra Low Emission Zone.

These constraints on London’s fiscal powers limit its ability to respond to changing economic and social needs. It cannot levy new taxes to fund the infrastructure it needs to grow, or properly capture the uplift in land values that is created by public investment in transport or local amenities. It is constrained from taxing the wealth and income generated in the city in order to reduce London’s high

levels of inequality and poverty, or to provide more and better housing. It is not accountable for the
majority of the taxes that are levied on its residents and businesses for the public services they
receive, and by the same token, it cannot propose different or better ways of raising those taxes.

Reform of London’s property tax system is particularly pressing. Council Tax is regressive in that
more expensive properties benefit from a much lower tax rate, and provides no incentive for efficient
use of land or property.\(^4\) The tax base is also outdated: bills are calculated using 1991 property
values, meaning the proportion of the property value that is charged has halved on average across
London, and even more in areas where prices have risen the fastest.\(^5\) This has weakened the
incentives to use property more efficiently. Different approaches to tax policy across boroughs have
also built up wide variations over time – a band D property in Barking and Dagenham is liable to
higher Council Tax than the most expensive properties in Westminster.

Stamp Duty Land Tax is more progressive, but only taxes property wealth at the time of transaction,
inhibiting transactions and liquidity. Additionally, our property tax system is very poor at capturing land
value uplifts: it allows for nearly all the property wealth generated by public investment to flow to
landowners untaxed. Transport for London estimated that its rail projects would yield twice their cost
in (uncaptured) land value uplifts.\(^6\)

The case for increasing fiscal devolution to London has been made in the two reports of the London
Finance Commission, a body of independent experts and interested parties convened by the Mayor of
London. In its most recent report, Devolution: A Capital Idea, the Commission argued that the power
to make long term commitments on infrastructure, housing, and employment policy would best enable
London to meet the challenges of uncertainty caused by Brexit. It proposed the devolution of the full
suite of property taxes to London, including Council Tax, business rates and Stamp Duty Land Taxes;
the assignment of a proportion of income tax and VAT yields to London; the creation of new powers
for London to levy business rate supplements, charges and minor taxes; and consideration of a new
charge to tax the uplift in property value created by new transport or regeneration schemes, such as
tube line extensions.\(^7\) In a recent report, Transport for London sketched out how such a charge could
work. A levy on new buyers and renters of properties around new transport links would enable
capture of some of the value uplift resulting from improvements in connectivity, and its reinvestment
into further transport upgrades.\(^8\) Below we model some of the options proposed by the London
Finance Commission and consider a series of incremental reforms to taxation in London.

**Council Tax Reform**

Council Tax is levied in nine bands, based on 1991 property values. Each London borough sets tax
levels annually to meet its funding needs (after taking grants into account), as well as costs for the
Greater London Authority, and Police and Fire Services. The ratio between the bands is fixed: the tax
charge for the highest value properties (Band H) within any local authority is fixed at three times the
tax rate for the cheapest properties (Band A).

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\(^7\) London Finance Commission 2017. WIPIssuess receiving EU funding, allLndon and Inequality in London. Centre for London.
Numerous experts have recommended that Council Tax be reformed. Because of its exceptional levels of house price growth, the issue is most pressing in London. In research to support the London Finance Commission, the Greater London Authority modelled a dozen reform options that would be at least revenue-neutral if they followed devolution to London. The options are summarised in the box below.

<table>
<thead>
<tr>
<th>Options for Council Tax Reform</th>
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</thead>
<tbody>
<tr>
<td>1 Revaluation</td>
</tr>
<tr>
<td>Properties that have gained most in value since 1991 pay more (they are mostly in inner London); properties that have gained least in value pay less tax. This does not change to the way Council Tax is set. The tax is still regressive.</td>
</tr>
<tr>
<td>1+2 Adding (up to 10) more bands</td>
</tr>
<tr>
<td>The more expensive properties are placed in new bands that are charged higher rates than in the current top band H, though the ratio between existing bands is retained. The tax becomes less regressive and Council Tax bills increase by larger amounts for more expensive properties. But the tax is still regressive, i.e. higher value properties still pay a lower proportion of their property value in Council Tax than the cheaper properties.</td>
</tr>
<tr>
<td>1+2+3 Changing the ratios between bands</td>
</tr>
<tr>
<td>This would be required to make Council Tax progressive. In the example provided by the GLA, the most valuable properties would pay three times more than band D properties – instead of a third more today. At the opposite end, the cheapest properties would pay three times less.</td>
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<tr>
<td>4 Introducing a rate-based tax</td>
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<td>Instead of bands, the tax would be charged as a proportion of property value/rental value. The tax is neutral in distributional terms since all households pay the same proportion of their property value in Council Tax.</td>
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Centre for London has modelled a similar system for domestic property to that currently used for business rates – that is, charging Council Tax as a proportion of the annual rental yield of the property. We modelled revenue in the London Borough of Hackney – one of the boroughs where property values have risen most rapidly since the 1990s. In Hackney, taxing seven per cent of the annual rental yield (assumed to be four per cent of property value) sustains revenue at current levels, and equates to a 0.27 per cent tax on property values.

This level of tax would keep Council Tax bills at the same level for the median band D property. Lower value properties would see their tax bill fall; higher value homes would pay more – as set out in the table below. These findings are comparable with the Greater London Authority’s: they suggested property values be taxed at 0.2 per cent London-wide to raise the same revenue as current Council Tax.

Council Tax bills in the London Borough of Hackney, under the current and a rate-based system

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11 The distribution of sales across bands was estimated from Land Registry sales data (average for years 1995/1996/1997 (earliest available) and 2013/2014/2015). We assumed that the distribution of sales in both time periods was similar. The Land Registry sales data was then cross-referenced with ONS’s House Prices estimates.
<table>
<thead>
<tr>
<th>Band(^{12})</th>
<th>1991 Banding</th>
<th>Number of properties in band (2015)</th>
<th>2015 Council Tax bill (£)</th>
<th>Bill based on taxing 7% of rental yield – for the median property in each band (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Up to £40,000</td>
<td>6,730</td>
<td>863</td>
<td>599</td>
</tr>
<tr>
<td>B</td>
<td>£40,001 to £52,000</td>
<td>31,520</td>
<td>1,007</td>
<td>827</td>
</tr>
<tr>
<td>C</td>
<td>£52,001 to £68,000</td>
<td>33,200</td>
<td>1,151</td>
<td>1,035</td>
</tr>
<tr>
<td>D</td>
<td>£68,001 to £88,000</td>
<td>21,210</td>
<td>1,294</td>
<td>1,294</td>
</tr>
<tr>
<td>E</td>
<td>£88,001 to £120,000</td>
<td>10,800</td>
<td>1,582</td>
<td>1,689</td>
</tr>
<tr>
<td>F</td>
<td>£120,001 to £160,000</td>
<td>4,100</td>
<td>1,870</td>
<td>2,344</td>
</tr>
<tr>
<td>G</td>
<td>£160,001 to £320,000</td>
<td>1,110</td>
<td>2,157</td>
<td>3,541</td>
</tr>
<tr>
<td>H</td>
<td>More than £320,000</td>
<td>50</td>
<td>2,589</td>
<td>N/A(^{13})</td>
</tr>
</tbody>
</table>

Because Council Tax has not been reformed since its creation, changes to the way it is operated will inevitably shift the tax burden between households and across boroughs – with gains and losses greater as the tax is made more progressive. Carefully designed transitional arrangements would be required to make the reform more politically palatable, in particular for lower income people in higher value properties, who might be able to defer payments until properties were sold.

There would also be significant governance issues. For Council Tax to be operated more effectively and fairly, the GLA would need to play a greater role in setting London-wide bands and tax rates. A system redistributing revenue between boroughs will also be needed to ensure revenue matches council tax requirements.

**Devolving Stamp Duty Land Tax to London**

The devolution of stamp duty powers to Wales and Scotland in recent years provides clear precedents that London can follow. Reforms enacted in 2014 to remove the “slab” structure of Stamp Duty in England and Wales mirrored the model established in Scotland, demonstrating the policy innovation that can come from devolution.

\(^{12}\) Average property in each band.

\(^{13}\) There are too few properties in Band H in the London Borough of Hackney to estimate a reliable average property price – but a £12m property would face bills of £34,000 a year under this rate-based system.
Nearly half of all Stamp Duty paid on residential property transactions is levied in London. In recent years, some 98 per cent of properties sold in London were sold for more than £125,000; 85 per cent of properties were sold for more than £250,000; and about 4 per cent of properties were sold for more than £1.5 million. Property sales over £925,000 represent 11 per cent of total sales but half of Stamp Duty receipts. Stamp Duty receipts are therefore highly contingent on higher value property transactions.

Catherine Barnaby from the University of Bath modelled the volatility of Stamp Duty receipts for different housing market scenarios, in order to measure the future volatility of the tax receipts. These projections demonstrate the likely magnitude of the risks and rewards – on the upside and downside – for both central government and London government in devolving stamp duty receipts. Formula arrangements would be necessary for determining the fiscal relationship between London and the Treasury to apportion these risks and rewards, as with Scotland and Wales, and ensure that regions outside London do not lose revenue.

### Scenario testing Council Tax receipts

**Scenario 1 – The market develops in line with trends over recent years**

If total sales follow trends since 2010, and proportion of properties sold in different price bands follows the patterns of the last twenty years, then Stamp Duty revenues in London will rise from £3.8 billion in 2017 to £5.38 billion in 2021 (2016 prices).

**Scenario 2 – The market is flat**

If the total volume of sales and the prices of properties are stagnant, revenues fall from £3.35 billion in 2017 to £3.11 billion in 2021 (2016 prices).

We modelled one year’s worth of revenue loss. If properties sold by price band broadly mirror recent trends, a hypothetical crash in 2017 would see revenues fall to £1.59 billion – about 47 per cent of 2016 revenues. If prices fall more sharply for all properties above £250,000, revenues drop to £1.19 billion, about 35 per cent of 2016 revenues.

**Land value based taxes for London**

Even with reform, Council Tax, Stamp Duty and Business Rates remain taxes on property – as such they would only partially incentivise a more efficient use of land, a particularly scarce commodity in London.

The Institute of Fiscal Studies’ 2010 Mirrlees Review highlighted that the economic case for replacing our property taxes with a land-based taxes is a very strong one:

“Taxing land ownership is equivalent to taxing an economic rent—to do so does not discourage any desirable activity. Land is not a produced input; its supply is fixed and cannot be affected by the introduction of a tax. With the same amount of land available, people would not be willing to pay any more for it than before, so (the present value of) a land value tax (LVT) would be reflected one-for-one in a lower price of land: the classic example of tax capitalization.

Owners of land on the day such a tax is announced would suffer a windfall loss as the value of their asset was reduced. But this windfall loss is the only effect of the tax: the incentive to buy, develop, or use land would not change. Economic activity that was previously worthwhile remains worthwhile.

Moreover, a tax on land value would also capture the benefits accruing to landowners from external developments rather than their own efforts.”

Despite this strong in-principle case, pure LVTs (or Land Rental Value Taxes) are relatively rare.

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14 Full details of the methodology and results are given in a background paper.
15 Mirrlees 2010 do acknowledge that planning regulations can marginally change the supply of land
16 Mirrlees 2010.
Introducing LVTs is politically risky, since it requires major reform, creating winners and losers across the whole population of a defined territory. It is also practically difficult, since land in urban areas is rarely sold without existing property on it, and therefore cannot be readily valued through market prices. An additional complication in the UK is that the ownership of around 12 per cent of the land in England and Wales is not registered with the Land Registry.\(^\text{17}\)

Nonetheless, there is considerable international experience of land valuation worldwide: the interim report of the Lyons Review into local government finance in 2005 noted that there were over 700 cities worldwide in which land and buildings were valued separately. In Denmark, which has had a land tax since 1926, land is valued on the basis of its best economic use every two years (with indexation applied in the alternate year) using a computerized hedonic model. The problem of “asset-rich, income-poor” pensioners is overcome by allowing the over 65s to roll up LVT due until the property is sold, when it is levied in full.

Examples of what a Land Value Tax could look like in London are available on our website.

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