The Co-operative Land Bank

A Solution in Search of a Home

By Michael Lewis with assistance from Dr. Shann Turnbull

Outside Southwark Underground Station, London, by Joanne Hacking (twitter.com/talesofjo) (CC BY-NC-SA 3.0).

The taxpayers of London, England invested £3.5 billion in the 1990s to extend the underground system. Following the completion of the Jubilee Line, property values within 1,000 yards of each of the eleven new stations jumped 3.7 times, to £13 billion. Who benefited from this windfall? Not average folks in Southwark, that is for sure. The spike in property values (which went up £9.5 billion) – and the rise in rents they justified – all went to landlords, most of them absentee, corporate owners. The wealth created by the investment of taxpayers' money in the underground was sucked out of the community, right into the pockets of the wealthiest.

If that's not bad enough, depreciation allowances will also have allowed those property owners to recover tax-free whatever money they invested in their properties. They even might have chosen to borrow against their property in order to acquire more.

These are a couple of the ways in which, year by year, exclusive forms of ownership concentrate wealth in the hands of a few at the expense of the many. Year by year, the public debt load rises and private citizens suffer the consequences: higher taxes, reduced pensions, massive cuts in public services and in state subsidies – for affordable housing, among many others. It is inefficient, it is unjust, and it has to change.

Dr. Shann Turnbull has designed a means to reverse this erosion of community wealth and accountability and in the process even restore some of the entrepreneurial spirit to a capitalism grown slothful on real estate speculation and tax breaks. His Co-operative Land Bank (CLB) creates the means to reward private investment in an area for commercial or industrial purposes more appropriately, while over the long term diverting ownership, wealth, and responsibility into the hands of local residents. In theory, affordable housing and many other social and economic benefits can be achieved without recourse to cash-strapped governments.

The Epiphanies of a Corporate Raider

Turnbull had an epiphany while taking a summer break from his MBA studies in 1962 to work as a financial analyst for Standard Oil in New York City. Proposals for refineries, chemical plants, ships, and the like came in from around the world, supported with 20-30 year cash flow projections. What amazed Turnbull was that these long-term projections did not affect the decision to approve a project or not. Instead, approval hinged on the likelihood that the invested funds could be fully recovered with a competitive profit in ten years or less, depending on the country. Any profits arising beyond that horizon were "surplus" to the incentive to invest, even if they were double or triple the original investment. This was the first revelation.

The second occurred a few years later back in Australia when he was a partner in a private equity firm hunting for undervalued companies to take over, break up, and sell off at a big profit. He looked at the financial statements of hundreds of firms listed on Australian stock exchanges. He discovered that most of the equity value of firms arose from the property they owned, not what they produced. The initial money invested in the business, and re-invested profits, were but a small fraction of their net asset value. A far greater portion derived from the rising value of the land owned by the business. But few firms included the full extent of these windfall gains on their balance sheets.

There was not then, nor is there now any mechanism for capturing for the public benefit either surplus profits or windfall gains. So Turnbull turned his mind to figuring out a way to redirect these unrecognized and unreported sources of wealth at source, through a redefinition of property rights.

Who Creates Value?

Traditionally, the property owner has enjoyed a timeless claim to the wealth associated with a piece of land, regardless of what s/he does with it. That is one of the secrets to the concentration of wealth. This situation is especially inefficient and inequitable in cities, because the value of the entire land base is determined so heavily by public investments in roads, schools, sewerage, transport, and the like. Why should the private owners of urban land or buildings realize windfall gains from value they did not create?

Turnbull's bold idea was to separate the ownership of the urban land base from the ownership of buildings on the land. He proposed that all the land belong to a co-operative, a Co-operative Land Bank (CLB). Its shares are distributed to residents pro-rata to the area occupied by their dwelling (e.g., one share per square meter). Ownership in a dwelling or commercial or industrial building takes the form of a transferable lease from the CLB. Whereas the leases on dwellings are perpetual (what some jurisdictions call a "strata" title), those for commercial or industrial buildings are time-limited. The CLB thereby captures all the uplift in land values created by public investment in infrastructure. Ownership and all its benefits go to those who create value by buying or renting dwellings.

Let us return to London and assume that all the land within 1,000 yards of those new subway stations was owned not by absentee landlords, but by a CLB. The CLB would be the beneficiary of the £9.5 billion uplift in property values, and higher property values would not prompt landlords to jack up residential rents. Instead, they and the lessees of offices, stores, and factories would pay higher rent-rates to the CLB. These would enable the CLB to service whatever debt it ran up as a partner in the original development. Surplus profits and profits from the sale of CLB shares would be additional sources of income with which the CLB could subsidize sustainable affordable housing and invest in other important community priorities and services. In this way the CLB would become self-financing, and all residents, as co-op shareholders, would draw benefit from community improvements. (See diagram p. 3, "Co-operative Land Bank.")

Note that residents share in this value whether they lease their dwelling or rent it. Indeed, since rented homes and apartments only have value insofar as they are occupied, Turnbull proposed that tenants acquire co-ownership rights in their dwellings over time. Again, ownership and its benefits go to those who create value by buying or renting dwellings.

This separation of the ownership of buildings from that of the community's land base also significantly enhances the political power of residents. With the shares comes the right to vote in CLB deliberations. Voting shares are not issued to the owners of office buildings, supermarkets, and factories.

Under this reallocation of ownership and political power, profits and rents stop leaking out of the community. Residents gain equity in the entire site, not just the area occupied by their dwelling. Tenants, as the eventual owners of their dwellings, are encouraged to maintain and improve them. Commercial and industrial investors retain ownership only until they recover their investments (with the opportunity to obtain a competitive profit). Incentive for entrepreneurship is preserved, while the system which progressively enriches the few and marginalizes the many is reversed.

The implications are many and fascinating. But first let us explain a way to put a CLB in place.

Year by year, exclusive forms of ownership concentrate wealth in the hands of a few at the expense of the many. Year by year, the public debt load rises and private citizens suffer the consequences, including massive cuts in state subsidies for affordable housing. It is inefficient, it is unjust, and it has to change.

How to Establish a Co-operative Land Bank

While untested since Turnbull hatched it 40 years ago, the CLB model can be applied as readily to the construction of a new community of up to, say, 100,000 residents or to the redevelopment of an impoverished inner-city neighbourhood from upwards of 5,000. Whichever the case, several steps apply.

1. A company is registered for the purpose of operating the CLB. It is thus able to issue preferred shares. However, organizationally speaking, it operates under co-operative principles. There is one vote per resident, no matter how many shares s/he may hold.
2. The CLB obtains an option to purchase a large parcel of land for development or redevelopment at its existing use value.
3. The CLB successfully applies for the land to be re-zoned for development. This decision will increase the value of the site just as it does when private developers obtain a rezoning permit. The increased value is captured by the CLB, thus enhancing its ability to raise loans for development.
4. The land is then mortgaged. This puts money in the hands of the CLB to finance sub-division development or redevelopment. It also finances the

Co-operative Land Bank (CLB)*

approximate area: 10% | 40% | 40% | 10%

commercial, entertainment, industrial

Profitability of non-residential investment increased by eliminating the cost of land. However, investors transfer the ownership of their buildings to the CLB as they recover their investment costs through tax write-offs.

schools, hospitals, parks, roads

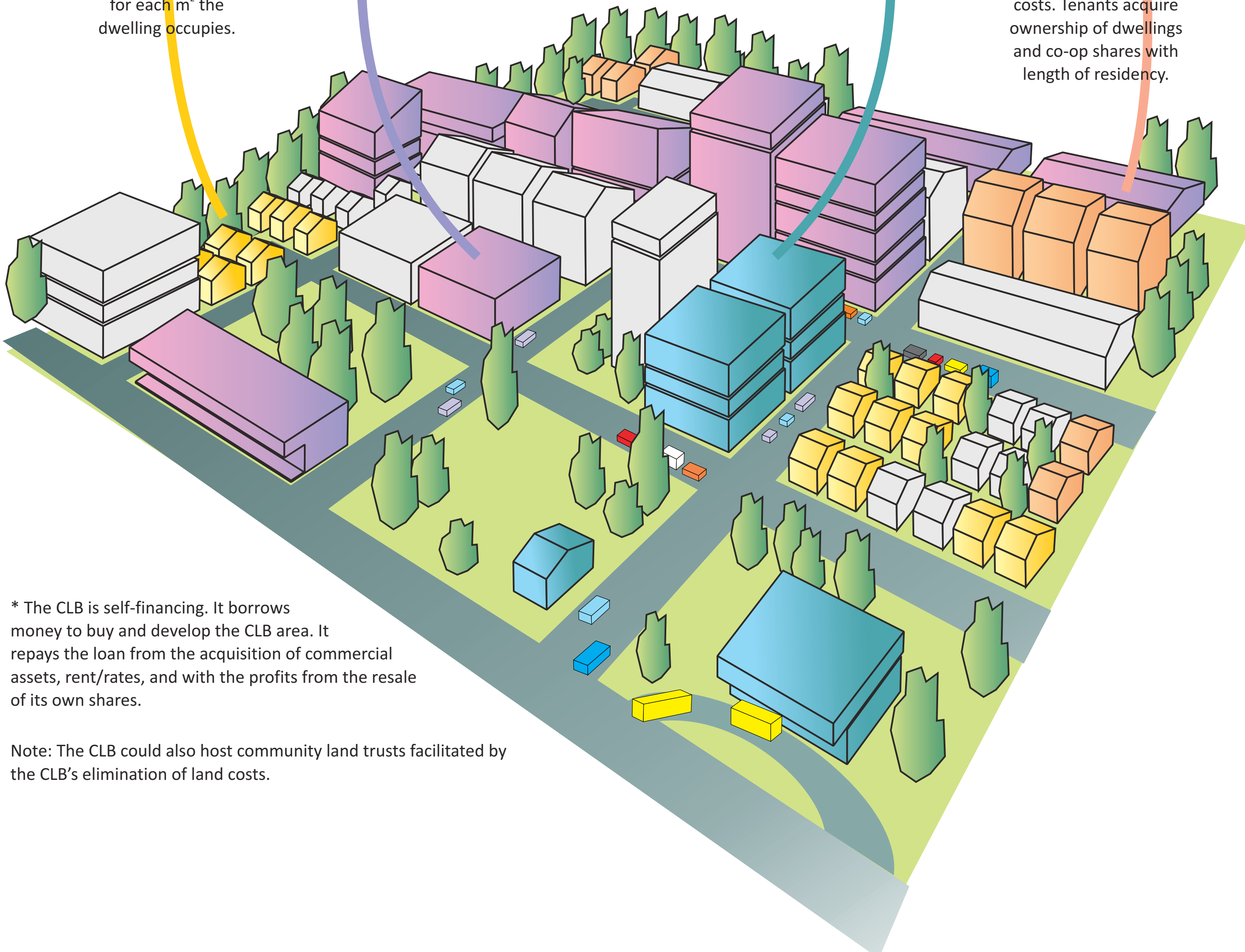
Public assets add value to all buildings and to the CLB site, but no longer provide windfall gains to non-residents.

owner-occupied

"Pioneer" homebuyers receive shares in the co-operative (gratis) for each m^2 the dwelling occupies.

rental dwellings

CLB provides higher profits to rental investors due to the elimination of land costs. Tenants acquire ownership of dwellings and co-op shares with length of residency.



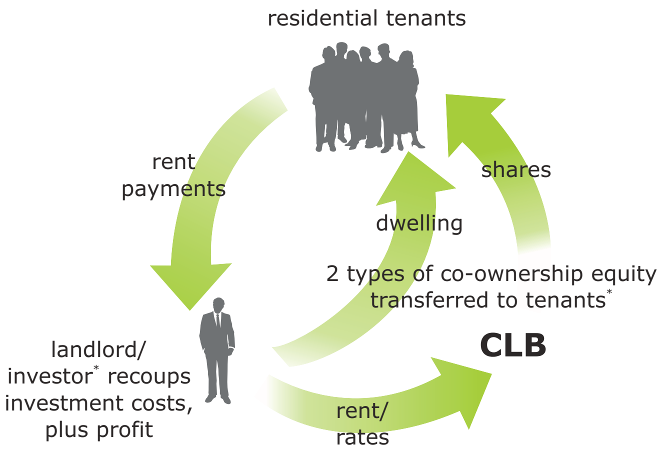
* The CLB is self-financing. It borrows money to buy and develop the CLB area. It repays the loan from the acquisition of commercial assets, rent/rates, and with the profits from the resale of its own shares.

Note: The CLB could also host community land trusts facilitated by the CLB's elimination of land costs.

operating costs during early stages of the development. As in private property development, this stage also increases the value of the land.

5. The CLB issues leases and shares. The leases include terms and conditions that allow the land and buildings to be mortgaged. The first ("pioneer") homebuyers are issued their shares gratis. Later buyers purchase the dwelling from the previous owner, and from the CLB, the requisite number of shares for the dwelling in question.

Ownership Goes to Those Who Create Value



* Landlord/investor owns building, but not co-op shares. Landlord's equity in the building is transferred to tenants at the same rate as investment costs are written off for tax purposes. CLB issues free co-op shares to tenants.

The CLB also issues the time-limited leases for commercial and industrial investors. The terms of these leases mimic the annual deductions that the businesses are permitted to make for the depreciation of their costs of investment. Here, however, the mechanism serves as a way gradually to transfer ownership to the CLB.

For example, a new shopping centre might be depreciated over 25 years, with a tax deduction of 4% per year. For the $80 million building (no land costs apply), the leaseholder would be able to write off $3,200,000 annually until the building was paid for. Co-ownership of non-residential developments like this would be obtained by the CLB as they are written off for tax purposes. The rights to income would remain with the commercial operator.

In residential developments, equity in the building would be transferred in a similar fashion but in this case to the tenants, who also receive shares from the CLB. In short, the landlord "writes off" ownership while s/he writes off the costs of investment. (See diagram, this page, "Ownership Goes to Those Who Create Value.")

The accounting profits of commercial and industrial investors would not change as ownership is written off; the bottom line remains the same. At the end of the 25 years, however, all shopping centres, office blocks, factories, entertainment facilities, and all other non-residential developments would be wholly-owned by the CLB. This puts a cap on the "surplus profits" – those that did not affect the private owner's decision to make an investment in the first place. S/he could then lease the building back or it could be leased to others or redeveloped. (Likewise, windfall gains from the long-term uplift in the value of the land would accrue to the CLB, not to the investor, as shown in the diagrams, "Equitable, Effective Distribution of Incentives," p. 5 and "Commercial Investment and the CLB," pp. 6-7.)

6. Residents buy their homes by mortgaging their perpetual lease. If they rent it out at some point, the incoming tenant (once again) becomes a co-owner at 4% per year. This provides an incentive for leaseholders to sell rather than become a landlord. Why lose 4% ownership of their house each year to a tenant?
7. Revenue flows to the CLB from several sources: from residential rents and charges for services; from commercial and industrial rate/rents; from the surplus profits. In addition the CLB builds up its equity from the windfall gains associated with CLB-owned buildings, and from trading in the CLB's own shares.

Résumé : La Co-operative Land Bank

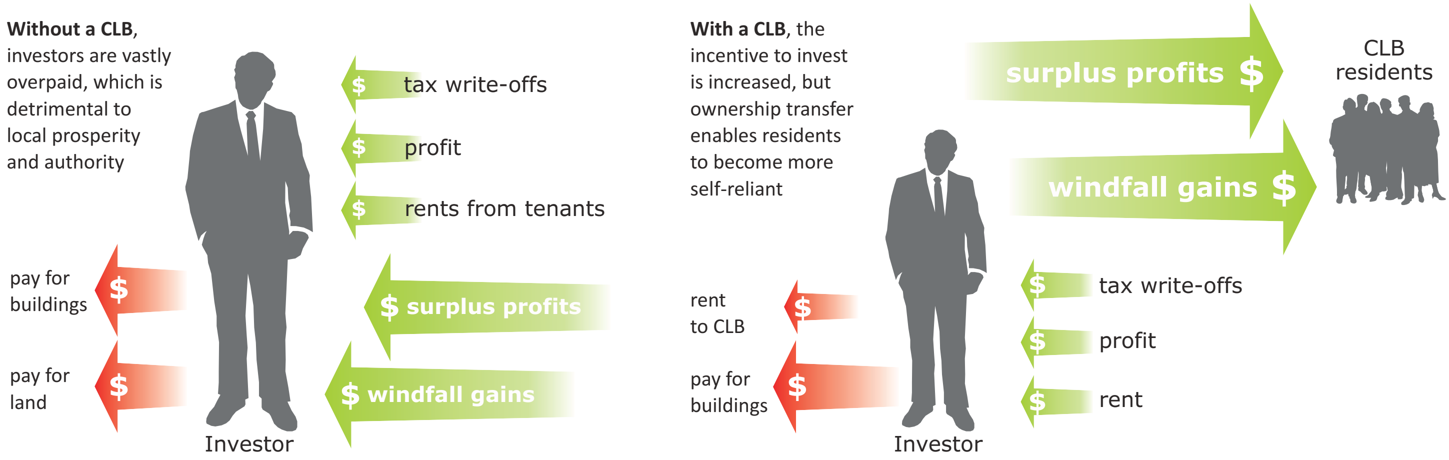
Chaque année, les modes exclusifs de propriété concentrent la richesse dans les mains de la minorité aux dépens du grand nombre. Chaque année, la dette publique augmente et les citoyens en subissent les conséquences, incluant des coupes massives dans les subventions gouvernementales pour le logement abordable. C'est inefficace, c'est injuste et ça doit changer.

Shann Turnbull a développé une façon d'arrêter ce processus. Sa Co-operative Land Bank (CLB) crée une façon de récompenser l'investissement privé à des fins commerciales ou industrielles dans une région à moyen terme, tout en détournant la propriété, la richesse et la responsabilité vers les mains des résidents locaux sur le long terme.

Il propose que la propriété du fond de terre urbain soit séparée de la propriété des édifices sur le terrain. Le fond de terre appartient à la CLB. Ses parts sont distribuées aux résidents en fonction de l'espace occupé par leur demeure (p. ex. une part par mètre carré). La propriété d'une demeure ou d'un édifice commercial ou industriel prend la forme d'un bail de la CLB transférable. Alors que les baux pour les demeures sont perpétuels, ceux pour les édifices commerciaux et industriels sont limités dans le temps; de tels investisseurs ne conservent la propriété que jusqu'à ce qu'ils aient récupéré leur investissement. Les privilèges de vote dans les délibérations de la CLB sont réservés aux personnes qui détiennent des parts communautaires.

Par conséquent, les résidents acquièrent de la valeur nette dans l'ensemble de l'emplacement. Les profits et les loyers sont canalisés vers la CLB, qui récupère aussi l'augmentation en valeur des fonds de terre suite à l'investissement public dans les infrastructures. Elle devient autofinancée. L'incitation à l'entrepreneuriat est conservée, alors que le mécanisme qui enrichit la minorité et marginalise le plus grand nombre est disloqué.

Equitable, Effective Distribution of incentives



Let's look at the latter in a bit more detail.

When someone sells their home in a CLB, two types of equity change hands. The vendor sells his/her lease to the dwelling to the buyer. The vendor also redeems his/her co-op shares from the CLB. Finally, the CLB sells the co-op shares to the new buyer. Only a portion of the receipts are paid to the vendor, however.

Say there are 100 shares associated with the dwelling, which the vendor (a pioneer homeowner) has occupied for ten years. In the current market, the 100 shares the vendor got for free are worth $1,000 each. The homebuyer would pay $100,000 to acquire the shares from the CLB. However, the vendor would only realize $40,000 of that (10 x 4% of $100,000); the CLB retains the remaining $60,000. The difference between $60,000 and the price at which the shares were originally issued ($0, in this case) is profit to the CLB. Transient homeowners thus get less for their homes, and extract less from the community, while the CLB shares in some of the capital gain. (See diagram below, "Two Types of Equity.")

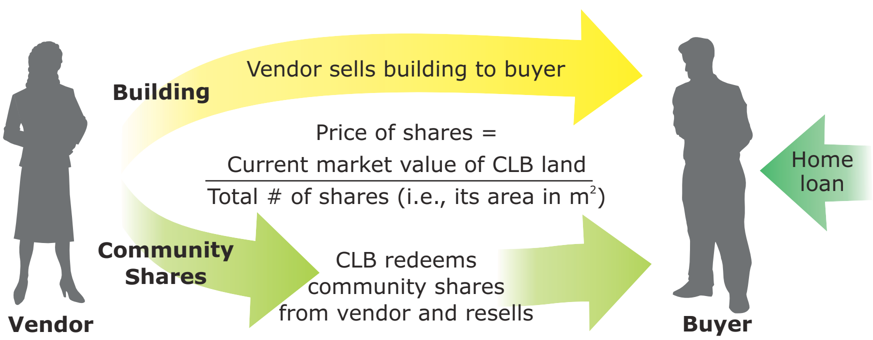
What Benefits Would a CLB Generate?

First, a CLB would eliminate the cost of land for pioneer homebuyers and for commercial developers new or old. CLBs could also host and thereby accelerate the development and expansion of Community Land Trusts over a portion of the land area to ensure affordability for lower income people in perpetuity. Moreover, a portion of the profit made in buying and selling CLB shares could be set aside as a reserve pool to subsidize very low income people where required.

Second, a CLB could significantly reduce, and perhaps remove the need for taxpayer support for affordable housing. As CLBs remove the cost of land from a home and land typically represents half the cost of a house, CLBs provide half-cost housing. At the same time, their revenue and equity-building features enable CLBs to become self-financing.

Third, a CLB would capture for community benefit the value created by public investments in schools, hospitals, transportation, etc. This is only fair, as without the residents these assets would have little value. It remains to work

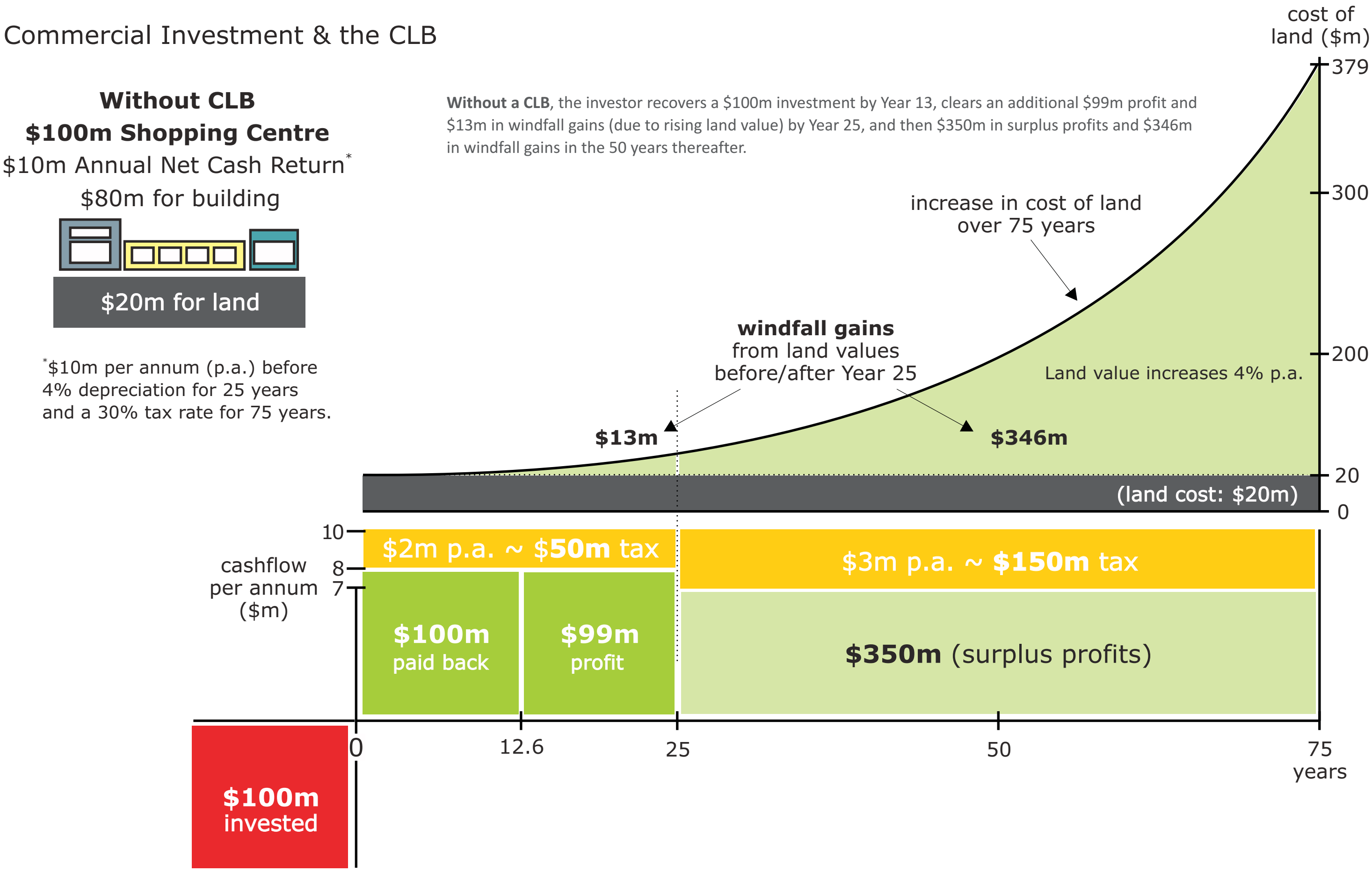
Two Types of Equity, Two Markets



To sell, a homeowner in CLB disposes of 2 types of equity. Her community shares are redeemed at the market price, minus a discount; the longer the homeowner has lived in the dwelling, the smaller the discount. To buy a home in the CLB, the homebuyer acquires 2 types of equity. He buys from the CLB one share for every m^2 which the dwelling occupies.

CLBs could help democratize economies. Land speculation would give way to a positive and structured incentive to invest in transparently productive businesses, to which the cost of urban land would prove less of a hurdle. By capturing rising property values and surpluses, CLBs would pool investment assets which could be applied to local transition challenges.

Commercial Investment & the CLB



out how uplifts in value (like those experienced around the London subway) would be shared with public authorities in order to recognize the contribution of taxpayers to such large investments.

Fourth, a CLB would eliminate speculative real estate investment by commercial interests. The influence of developers on local and other governments, often applied to increase the value of existing private assets, would also diminish considerably. The role of developers would change from buying, owning, and selling to acting as an agent in the establishment or redevelopment of democratic communities. This substantially reduces the funding and business risks for developers.

Fifth, a CLB would eliminate the ability of companies to sit on property for speculative purposes. They would no longer capture windfall gains from rising land prices.[1] Similarly, the ability of companies to misrepresent their assets to shareholders would diminish. CLBs would facilitate a back-door corporate reform that could make market economies more efficient, equitable, and sustainable.

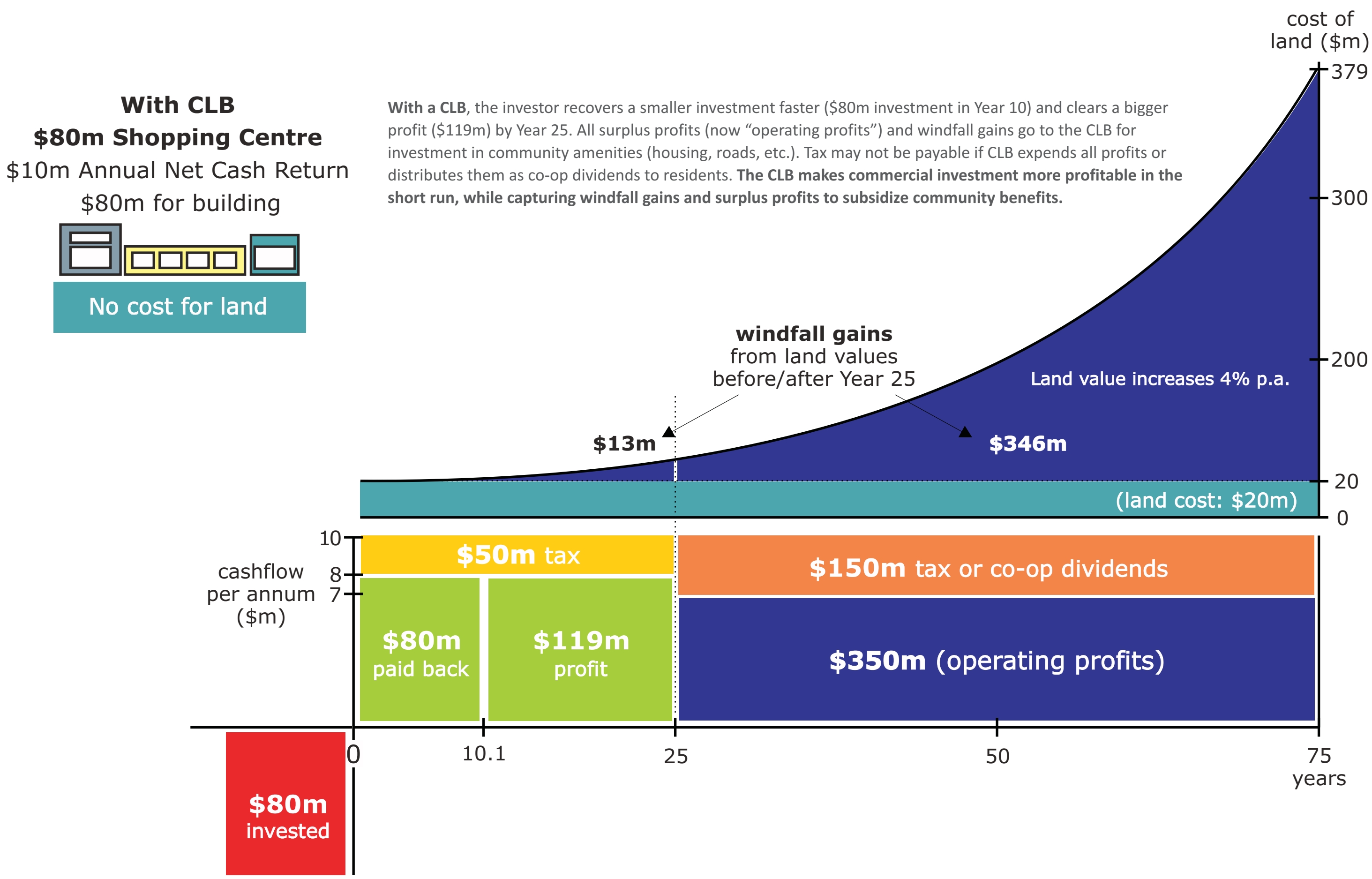
Sixth, under a CLB, pioneer homebuyers and all residential tenants obtain, without cost, equity in their dwelling and CLB shares associated with the dwelling. A tenant's equity in a dwelling and in shares increases pro-rata to his/her usage of the dwelling at a rate of 4% per year. This means that a tenant cannot cash out his/her equity until the dwelling has been sold. However, it also means that all tenants eventually receive a "nest egg" that could contribute to their pension. In mature CLBs both homeowners and tenants could obtain dividends from the CLB shares. The CLB shares thus provide a way to reduce welfare dependency and costs and to assure dignified retirement incomes. All this reduces the burden of transfer payments on government.[2]

Seventh, by halving the cost of buying a home, a CLB would attract other developers to the housing market. Commercial investors would provide more rental housing. Nonprofit investors would set up CLTs to provide sustainable affordable housing.

Implications of the CLB for Transition

The CLB turns on its head the dominant paradigm of property rights and who should benefit from them. One illustration of the CLB concept is the garden city of Letchworth created in 1903, 60 miles north of London. As understanding grows of how property rights feed inequality and unsustainable cities, interest in CLBs is growing in the U.K.

Aside their implications for housing, if CLBs became widely adopted, they would introduce a "third" way to distribute wealth. The distribution of surplus profits as dividends to CLB members would reduce the need for government to raise taxes, pay pensions, and provide social assistance. This could create a basis for truncating the size of centralized bureaucracies. It would also reduce the constant pressure to grow the economy any which way in order to create jobs, in



order to increase tax revenue, in order to pay for these public expenditures, etc.

Also, CLBs could act powerfully to help democratize economies. Land speculation would give way to a positive and structured incentive to invest in transparently productive businesses, to which the cost of urban land would prove less of a hurdle. In addition, by capturing rising property values and surpluses, CLBs would pool investment assets which could be applied to local transition challenges. Combined heat and power, retrofitting for energy efficiency, and renewable energy production are all examples of initiatives that hitherto have been starved for investment. Given their larger scale, CLBs could issue bonds. They could even establish local or regional currencies and credit systems tied to a locally created unit of value (like the electricity generated from renewable sources[3]).

In short, CLBs would help steer us in the direction of a steady-state economy. Turnbull argues that no public decisions regarding major infrastructure investments or any major rezoning decisions should take place without the adoption of a CLB.

One can see the potential of such a creative and dynamic transfer of ownership. True, there is much more detailed work to be done. But the consequences of Turnbull's insights are much more than a vision. They are another dramatic illustration of how, by SEEing the world differently, we can align our economies with the resilience imperative.

References

[1] The CLB will also offset any steep decline ("wipe out") in local land values, due to re-zoning for example, with gains in value elsewhere.

[2] Dr. Shann Turnbull, S. 2011, "Achieving environmental sustainable prosperity," presentation to 13th Conference of the Association of Heterodox Economists (AHE), Nottingham Trent University, UK, 10 July 2011, accessed 30 November 2011 <http://ssrn.com/abstract=1769349>.

[3] This is a proposal of the Green Money Working Group. See its statement (November 21, 2011 revision) at https://docs.google.com/document/d/1xq2Y_10mxRG799ksxGDNwo8L3s8Fi89e1LcjYARAqsA/edit?hl=en_US&pli=1.

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