BANGOR BUSINESS SCHOOL

Bank lending, land and inequality

The peculiar dispersion of land values seen in the UK is rooted in the relationship between valuation and bank lending, argues Dr Rhys ap Gwilym.

Over recent decades, a massive increase in banks' mortgage lending has re-established land as the primary store of wealth in the UK and many other developed economies. At the same time, wealth inequality within these economies has increased to levels not seen since the Second World War.

Recent work completed by Bangor University[1] on behalf of the Welsh government (ap Gwilym et al 2020) sheds light on the significance of land as a store of wealth and on the links between land and inequality. The work concludes that residential land values in Wales account for 48% of total property values – with the remaining 52% accounted for by the buildings located on the land. This is significantly lower than the equivalent figure of 70% for the UK (ONS 2019), providing evidence that land wealth is disproportionately concentrated in more affluent areas of the UK.

The methodology of the Bangor study allows for a granular assessment of land values, which is not available in the normally used Office for National Statistics (ONS) data. This intricate appraisal shows a vast variability of land values even within small geographical areas. The study estimates that the average value of residential land in the most affluent neighbourhood in Wales is £2,589 per square metre. At the other extreme, 0.9% of all neighbourhoods have negative land values. That is, the market price of a house built on an average piece of land in one of these locations would be less than the construction cost of the house.

Unsurprisingly, the most expensive land in Wales is found in concentrated pockets in affluent suburbs of the capital, Cardiff, and in holiday home hotspots such as Tenby, Abersoch and Newport (Pembs.). The cheapest land is found almost exclusively in the swathe of de-industrialised communities in the South Wales coalfield, as can be seen in Figure 1.

Why has this peculiar dispersion of land values developed? We argue this lies with the relationship between land valuation and bank lending. The traditional economics textbook explanation of the role of banks is to gather funds from households with excess liquidity and channel that money into productive investments, usually in the business sector. Since the 2008 financial crisis, many have suggested this view of the banking sector as highly contrived and divorced from reality. The crisis highlighted the growing importance of lending within the financial sector, but also the growing importance of mortgage lending to banks. Mortgage lending has come to dominate bank lending across developed countries over recent decades. For example, in 2016, mortgage loans represented 67% of all loans to non-financial private sector in the UK, and 63% in the USA (see Jordà-Schularick-Taylor Macrohistory Database).

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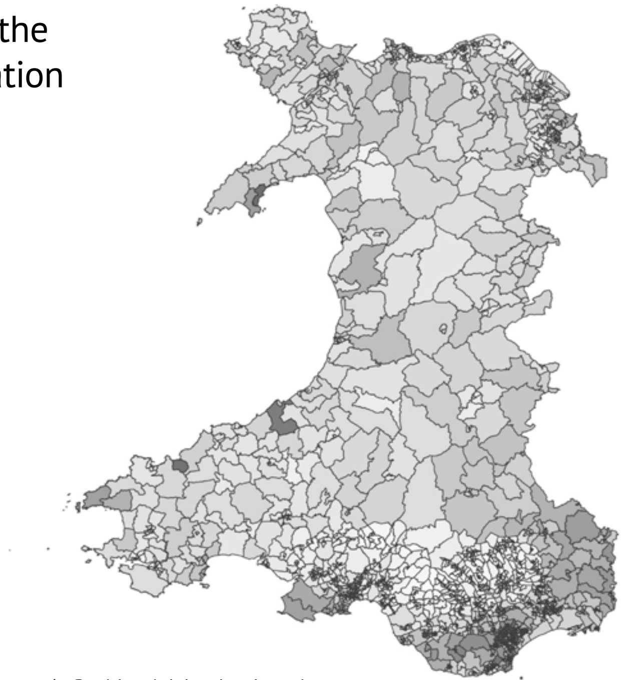

Figure 1: Residential land values in Wales (Darker shades represent higher land values per metre square of residential property). Source: ap Gwilym et al (2020)

The increasing importance of mortgage lending belies the fact that housebuilding has not increased significantly in most countries. Indeed in the UK, housebuilding over the past decade has been at its lowest level since the Second World War. As a result, the vast majority of mortgages are not funding new building projects, but rather have been used for the transfer of existing buildings and, crucially, the transfer of land. This increase in bank lending to fund the purchase of land has led to a significant increase in land prices, and the corresponding increase in the importance of land as a store of wealth.

This process is amplified as land, of course, is in fixed supply. Hence the value of land is driven by demand, and in this the banking sector plays a key role. Land and property have a central role in providing collateral for bank loans, and so lower land values can lead to higher financing costs. Hakenes and Schnabel (2010)[2], for example, show how moral hazard in financial markets impinges more severely in poorer regions than in regions with richer endowments. This process has also been recognised by financial regulators with Adair Turner, the former head of the UK's Financial Services Authority, long arguing the expansion of banks' mortgage business has come at the expense of investment in more productive areas of the economy. A case can be made that this trend in bank lending is helping to fuel levels of inequality that haven't been seen in developed economies since before the Second World War. Taken together, this evidence suggests that the mortgage-fuelled boom in land values that many developed economies have experienced over recent decades has been highly uneven across regions.

This outcome has wider economic and societal implications. Following the upheaval of the financial crisis and the ensuing period of austerity in many developed economies, economic inequality has re-emerged over the past decade as a key academic and political concern. While global inequalities have narrowed over recent decades, primarily as a result of the rapid economic growth experienced by China, inequalities within many developed nations have widened. Notably, inequality has increased on almost every measure in the United States, the UK and most other anglophone countries since the 1980s, reversing most of the gains in equality made during the period following the Second World War. For example, the central hypothesis of Thomas Piketty's (2013) influential work on modern-day inequality[3] is that over the past four decades the returns to capital, or accumulated wealth, have outstripped the overall rate of economic growth in developed economies. Those already endowed with significant wealth have seen their fortunes grow faster than those who rely on wages or salaries.

The nature of wealth has also changed over time. The re-emergence of land as the primary store of wealth has been particularly noticeable in the UK. Estimates from the ONS[4] show how the proportion of UK net worth accounted for by land swelled from 38% in 1995 to 58% in 2018. Therefore, the uneven growth in land values across regions might be expected to drive further economic divergence. At Bangor University we are continuing to explore this relationship. Ongoing research by ap Gwilym and Chrysovalantis Vasilakis is studying the extent to which the increased 'financialisation' of land via mortgage markets drives regional inequality. CB

1.Ap Gwilym, Rhys, Jones, Edward and Rogers, Helen (2019). 'A technical of the potential for a local land value tax in Wales', Cardiff: Welsh Government, GSR report number 17/2020. Available at: https://gov.wales/local-land-value-tax-technical-assessment. 2.Hakenes, H., & Schnabel, I. (2010). 'The Threat of Capital Drain: A Rationale for Regional Public Banks?', Journal of Institutional and Theoretical Economics (JITE), 166(4), 662-689. 3. Piketty T. (2013) Capital in the Twenty-First Century. Harvard University Press. 4.ONS UK balance sheet estimates (2019).