Land Reform Review Group – Call for Evidence

Back to the Future - 21st Century Land Tenure and Investment

Submission by Chris Cook, Nordic Enterprise Trust

1/ Introduction

21^{st} Century problems cannot be solved with 20^{th} century solutions

In the course of my research as a Senior Research Fellow at University College London's Institute for Security and Resilience Studies (ISRS), and my practical implementation of this research with the Nordic Enterprise Trust, I have come to the conclusion that the solutions to 21^{st} Century problems are, ironically, to be found - 'Back to the Future' style - in updating legal frameworks and financial instruments which date back hundreds if not thousands of years.

Many indigenous peoples, such as American Indians and Australian Aborigines, find it impossible to understand how anyone can own land. Whereas most religious traditions – including Christianity, Islam, and Judaism – were all founded upon a belief that absolute ownership, particularly of land, is God's alone, and that a tribute should be paid accordingly, such as a tithe.

In Mathematics there is +1, -1 and 0; in Physics , there is positive, negative and neutral; but the property rights which underpin modern political economy are based upon conflicting absolute property rights: Freehold vs Leasehold; Equity vs Debt; Public=State vs Private=Plc.

Intriguingly, the neutral/indeterminate state does exist in Scottish criminal law as the Not Proven verdict, which supplements the absolutes of Guilty and Not Guilty. However, there is no satisfactory and sustainable civil legal framework in Scotland or anywhere else for the Commons. This absence has led over many centuries, all over the world, and particularly in Scotland, to expropriation and enclosure of the Commons in one way or another and eventually to the concentration of land in relatively few hands.

In the absence of a word which describes a neutral framework for the property relationship in which no stakeholder is dominant I have adopted a neologism - ***Nondominium***. *S*uch a collaborative and consensual legal and financial framework for sustainable development and management of resources is capable of revolutionising Scotland's economy and society.

The enabling investment instrument for Nondominium is a form of investment which pre-dates modern finance capital, and in fact has existed for as long as mankind itself: ***Prepay.*** In this submission I shall describe firstly, the neutral ***Nondominium*** framework for land tenure and secondly, the ***Prepay*** investment instrument, and then address the application of these tools to the Land Reform Review.

2/ Nondominium

(a) The Property Relationship

As Jeremy Bentham pointed out, Property is not an object or thing, but a relationship: the bundle of rights and obligations which connect the subject individual to an object, such as land (real property) or increasingly, knowledge (intellectual property).

While there are many types of rights and obligations, this proposal identifies four key classes of stakeholder rights:

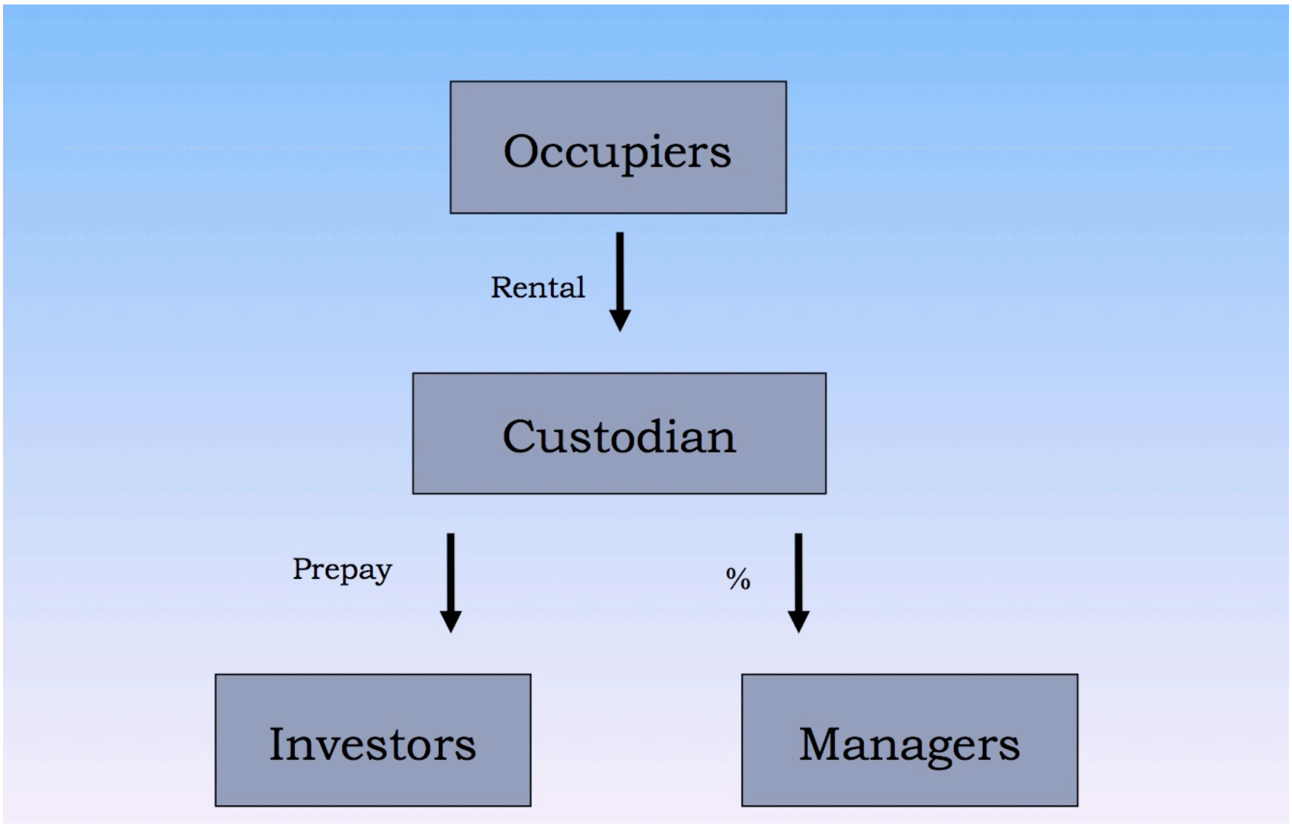
- Use – exclusive or otherwise
- Usufruct – the fruits of use
- Management
- Custody - stewardship.

Existing legal frameworks for the relationships between these stakeholders are riddled with conflicts and complexities. Apart from the basic forms of tenure, such as freehold and leasehold, there are further rights and obligations such as easements and burdens, mortgages and statutory restrictions such as those relating to planning.

Beyond these, is the use of an overlay of judge made 'common law' in respect of land to address shortfalls and iniquities arising from statute. There is also the use of corporate vehicles as a framework for property rights in land, which give rise to contractual rights of use, usufruct and management, and which is a subject to which I will return below.

(b) What is Nondominium?

Nondominium is an agreement which not only brings together these stakeholders jointly/collectively to hold land in common but also enables them severally/individually to share the rights and obligations as they may consensually agree.



In simple terms, the user of the land pays a rental in money or in kind ('money's worth' such as produce) and a proportion of this flow of value is allocated to a Manager stakeholder group which provides services such as introducing occupiers and investors; dispute resolution; valuation; maintenance or supervision of maintenance.

It will be seen that the Manager's interests are aligned with those of any Investors who participate in the Nondominium agreement by investing in the value which flows from use of the land. No stakeholder has a dominant or positive right to impose themselves on any other. But stakeholders do have certain veto rights within the agreement to say what may ***not*** be done by others.

The outcome of the use of what is essentially a 'Co-operative of Co-operatives' is that the Occupier, Investor, Manager, and even the Custodian may all change, but the land is never sold again, remaining in perpetuity within the Nondominium.

(c) Comparatives

Tenure
Existing multi-stakeholder forms of tenure are all flawed in one way or another.

Community Land Trusts own land on behalf of the community and lease the land to occupiers, and typically loans are secured against leases to develop the land - although an extremely complex and so far unsuccessful attempt has been made using trust law to create a type of unit investment.

Ebenezer Howard's Garden City movement was implemented through corporate ownership which was intended to keep the homes affordable in perpetuity, but increased land values led owners eventually to collectively agree to privatise their properties in order to collect windfall gains.

A form of co-operative individual Co-ownership was implemented in Scotland using Industrial and Provident Societies as a vehicle for the land ownership, but again this fell to privatisation through the introduction of 'right to buy' coupled with freely available bank credit.

Co-operative housing still exists, whereby contractual rights of occupation arise through membership of a corporate vehicle such as a Friendly Society or another, but such Co-ops rely on levels of altruism among members which are no longer widely in evidence.

Investment
There are several ways of investing in land and buildings.

One is to invest directly in the shares of property companies, some of which buy, develop and sell property, typically using debt financing to enhance returns. Other property companies buy and hold property and are popular with long term investors seeking reliable income.

Other legal forms such as trusts and limited partnerships are used as vehicles for property investment. More recently, we have seen the introduction of Real Estate Investment Trusts (REITs) which distribute to investors almost all the rental income received and which are said to be 'tax transparent' because the REIT pays no tax, and the income passes directly through to the investor. There are problems with all of these vehicles, such as a conflict of interest with the manager, and the difficulty in buying and selling Units, because the underlying properties can take a long time to sell.

(d) Why 'Nondominium' ?
There is an extremely successful form of co-ownership tenure known as 'Condominium' which is a combination of collective ownership and private use and management now in widespread use throughout the US, with variations in other countries. Developers of Condominiums finance the development, and occupiers fund purchase of completed apartments and houses, through bank mortgage loans, which were a major contributor to the US property bubble.

But the Condominium is interesting for another reason, which is that it was in the US a form of agreement introduced – 'bottom up' – by a lawyer and which was subsequently codified State by State as its use spread rapidly. Whereas the word 'Condominium' implies shared dominant rights, the proposed agreement brings within it the rights to the usufruct in a way that no stakeholder has dominant rights, and hence the neologism 'Nondominium' seemed appropriate.

(e) Company Limited by Guarantee (CLG)
A CLG is one of the most flexible corporate forms there is. In the UK, it is envisaged that the Nondominium agreement will form the constitution of a 'multi-stakeholder co-operative' CLG.

There are extremely topical precedents for this in the way that the Mount Stuart and Applecross Estates were both vested by their owners in perpetuity in CLG vehicles. However, the use of the CLG as a vehicle has been criticised for the absence of participation by community or tenants in the CLG, whom the former owners who founded these Trusts chose to exclude from participation.

But the use of the CLG restricts these Trusts in terms of their financial capacity to invest in the estates and this often gives an unsatisfactory outcome for tenants who rent land or houses from a CLG Trust.

The innovation which enables investors in land to participate in a CLG Nondominium agreement is an instrument which in fact pre-dates modern finance – **Prepay**.

3/ Prepay

(a) Origins

For many hundreds of years UK sovereigns funded their expenditure through creating IOUs which were returnable in payment for taxes, and exchanging them with tax-payers for value received.

In other words, tax-payers were able to 'pre-pay' their taxes, and they received as a record or token of that pre-payment the half of a 'tally stick' accounting record known as the 'stock'. The other part of the tally stick retained by the issuer (which in the case of taxes was the Exchequer) was known as the 'counter-stock' or 'foil'.

Clearly, no creditor would give £10 of value to the sovereign in exchange for a £10 tax IOU, and stock was issued at a discount which gave rise to a profit upon the return of the stock to the Exchequer. So tax-payers would pay forward, or 'pre-pay', their tax obligation, at a discount.

The phrase 'Tax Return' for tax-payers' annual accounting to HMRC originates from this annual settling of accounts. Even more significant is the origin of the phrase 'Rate of Return' which simply describes the rate over time at which the profit arising out of an initial discount was achieved through the return of the stock to the Exchequer for cancellation.

So by way of example, if £10 of tax was prepaid with £8 of money or money's worth, the profit of £2 would be achieved in a year if £10 tax was payable in a year, and this would give rise to a 25% annual rate of return (£2 divided by the £8 investment). If the tax rate was £5 pa then the profit would be made in two years and the annual rate of return would be 12.5% and so on. It will be seen that there is no compound interest, although there is a return in respect of the use of the money or money's worth provided by the creditor.

(b) Rental Prepay

If rentals are prepaid at a discount, the result is a simple new (but in fact, ancient) instrument for direct investment in land. A Rental 'Prepay Unit' or rental credit issued by the Custodian with a 'par value' of £1.00 will be accepted by the issuer in payment for £1.00's worth of rent.

An investor is not restricted through having to find another financial investor in order to realise a profit, but may do so by returning the Unit against land use himself. He may also sell to property occupiers either collectively, through periodic auctions conducted by the Manager before rental due dates, or by private treaty at any other time. The point being that Occupiers will **always** seek out and buy Units at the cheapest available price below £1.00 and then pay the balance of the rental in £ sterling.

(c) Outcomes

Occupier

The absence of compound interest, and the fact that no debt repayment need be made of debt in respect of the land element, means that the rental level may be set at a lower level.

The increased affordability means that the rental is more likely to be paid, and moreover, Occupiers who choose to maintain the property themselves or even invest in improvements, will be allocated rental credits, subject to valuation and supervision by the Manager.

Investor

For the Investor there is no possibility of default, because there is no debt obligation. The risk to the Investor is that the Rate of Return will be less than anticipated, or even zero, because the flow of rentals against which Units may be returned falls short of expectations.

By definition, an affordable rental is more likely to be paid, and therefore the risk that expectations that rentals will be less than expected is less, which justifies a lower rate of return. At a time when conventional investments pay derisory or even negative 'real' (after inflation) returns Rental Units will be attractive to long term investors such as pension funds.

The outcome is similar to a Real Estate Investment Trust (REIT), but with the feature that Units are returnable against property use. In this context the Holiday Property Bond (HPB) enables investors to acquire an entitlement of 'Points' which give rights to occupy HPB property.

Manager
In all other forms of legal and financial structure, with the limited exception of co-operatives, the interests of a Manager (where relevant) are not aligned with those of other stakeholders, and nowhere is this more evident than in Scotland, where the conduct and service levels of Factors has long been a running sore.

In Nondominium, a Manager shares proportionally in the gross rental flow, and therefore has an incentive to ensure high standards of quality and energy efficiency, since this minimises the cost of occupation and maximises returns.

However, a Manager may nevertheless be incompetent or otherwise fail to fulfil the expected duties, and the Nondominium agreement will incorporate provisions to enable that situation to be addressed.

4/ Land Reform Review

(a) Enable more people in rural and urban Scotland to have a stake in the ownership, governance, management and use of land, which will lead to a greater diversity of land ownership, and ownership types, in Scotland;

(b) Assist with the acquisition and management of land (and also land assets) by communities, to make stronger, more resilient and independent communities which have an even greater stake in their development;

(c) Generate, support, promote and deliver new relationships between land, people, economy and environment in Scotland.

The use of these tools opens up a plethora of urban and rural; public, private and third sector policy options, all with potentially wide ranging effects which combine to completely transform existing forms of tenure of and investment in land, both in Scotland and elsewhere

The consensual framework agreement is infinitely flexible, and will be used in a wide range of applications, depending upon existing use, tenure, and the extent of financial encumbrance.

Perhaps the most important outcome is that the use of these two complementary tools enables the resolution of unsustainable debt through exchanging debt for Prepaid Rental Units. As previously stated these undated credits were the ***original*** form of equity which preceded the absolute ownership form of equity comprised in shares of a 'Joint Stock 'Company as this entity evolved.

Such a 'debt/equity swap' of debt exchanged for rental credits, provides a better outcome for existing lenders than any refinancing with new debt can ever do. It also offers new hope for existing property owners with negative equity or insufficient equity to move and for a younger generation with little or no hope of a home they may call their own. For the older generations Prepay offers a form of equity release which is superior in outcome to any other.

So this ability to create rental credits opens up a new currency for social policy. A generation which is 'long' of land and 'short' of care both for themselves and their home could essentially exchange rental credits with a generation which is long of care and short of land.

The Nondominium – which is not so much an 'organisation' as a framework agreement for self organisation to a common purpose - enables community assets to be transferred simply and effectively. Public bodies who wish to transfer assets to a community may retain a measure of veto control in the public interest as a 'custodian' member. In terms of achieving 'best value' an agreed proportion of the flow of rental credits could also be retained by the public body, and allocated to a suitable use, such as to youth enterprise.

Development of land within a Nondominium makes redundant the existing form of profit-maximising development transactions where the developer's only interest is cost minimisation, and energy efficiency and build quality are secondary. This"4 B's" (Buy, Borrow, Build & B...er Off) model is replaced by a co-operative agreement to share in mutually created surplus value, where high standards of build quality and energy efficiency are implemented because they reduce the cost of occupation over time and maximise the rental value.

The principal stumbling blocks are regulatory, and taxation issues, but these are by no means insurmountable. Detailed, prescriptive financial services regulation is largely transcended by the fact that a 'Nondominium' is essentially a private 'club', but with open access due to the fact that anyone who agrees to the rules may join. It therefore does not involve the Public, and a combination of transparency and quality control by Manager stakeholders provides a form of self-regulation.

Taxation is an interesting issue, but there is the potential for a shift to a much more efficient and equitable fiscal approach than applies today.

To a great extent, since the Nondominium agreement is consensual, there is no reason why it needs legislation at all, and work is proceeding in respect of several prototypes.

The role of Government would be to disseminate best practice; to develop new policy options; to lead adoption of the model in respect of public land; and above all to facilitate the 'bottom up' evolution of a new wave of community-based value from land held in common.

The principal resistance to simple, consensual solutions tends to emanate from those with a vested interest in complexity and conflict, and some resistance may be expected from the professions and from consultants. But even here, emerging areas such as collaborative law, and accounting for a 'triple bottom line' demonstrate that the professions can and will change with the times.

5/ Open Capital Foundation

The proposal is to bring together interested stakeholders in policy development in the public; private and academic sectors within a suitable framework - itself a 'Nondominium' agreement - to develop, implement and conduct 'action-based research' through a programme of local property prototypes across a range of applications.

With this in mind, an unincorporated association with the working title of the 'Open Capital Foundation' has been founded for the explicit purpose of the development of the concepts of Nondominium and Prepay.