

RESPONSE TO MEMBER FORUM

Tax Reform Motivates Sustainable Development

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Carl Elefante wrote that, regardless of whether or not "sustainability" is a fad, its underlying concepts and issues are important. Furthermore, architects are responsible for buildings that are energy efficient and promote community, or that promote auto dependence, sprawl, and environmental degradation. Yet, architects must satisfy their clients who may not share their concerns. Fortunately, property tax reform can provide clients with an economic motivation to promote more sustainable development that is compact and transit-friendly.

As Elefante indicated, sprawl inhibits the use of transit, necessitates auto travel, pollutes the air and creates political and economic dependence on petrochemical suppliers. Energy and time are wasted in traffic jams, reducing productivity. Health is endangered from pollution and automobile accidents. Per capita infrastructure costs are high because roads, sewers, etc. must be extended through sparsely occupied areas. Undeveloped areas are too small and too scattered to support meaningful agricultural or conservation uses.

The antidote to sprawl is compact, mixed-use development that places homes in close proximity to jobs, schools, recreation and shopping. This promotes walking and cycling. It also enhances the efficiency of transit.

The economic incentives promoting sprawl can be partially explained by the second of two ways in which land owners earn money. First, a land owner can make money by developing a site, and renting or selling it to someone who will use that development. Second, a land owner can wait for population increases, wage increases, or public infrastructure improvements to impart value to a

site, which the land owner can appropriate through a higher rent or sales price.

All too often, land near public infrastructure at "Point A" (like a subway station or major road intersection) remains vacant or grossly underutilized because a land owner is waiting for a price in excess of what most space users will pay. This drives developers to seek cheaper sites, farther away from public infrastructure at "Point B." Once this cheaper land is developed and inhabited, the occupants of this area create political pressure to extend the infrastructure from "A" to "B." Once this occurs, land prices at "B" rise, choking off development there (even though additional capacity exists) and driving developers and users farther away to "Point C."

Property tax reform can help create economic incentives to develop land adjacent to public infrastructure and amenities while reducing development pressures at sites farther away. This reform recognizes that the property tax is really two different taxes, each with very different economic consequences.

One part of the property tax is a tax on the value of buildings. Because buildings must be produced and maintained in order to have value, a tax on building values is a cost of production. All taxes on production result in lower production and higher prices. It does not make sense to inflate the cost of housing when so many cannot afford decent shelter.

The other part of the property tax is a tax on the value of land. Land is not produced. Because a tax on land cannot be avoided by producing less land, or by moving land from one jurisdiction to another, a tax on land values is not a cost of production, but a cost of ownership. By making land ownership more costly (less desirable), a tax on land values results in lower land prices.

To counteract sprawl, the property tax can be reformed by reducing the tax rate applied to building values while increasing the tax rate applied to land values.

The higher land tax cannot be avoided or passed on to space users. Thus land owners are motivated to generate income from which to pay the tax. The greatest economic imperative to develop land will exist where land values are highest, adjacent to existing infrastructure and amenities.

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At the same time, a reduction in the tax rate applied to building values makes that development more profitable. Away from infrastructure, where land values are low, taxes will be low and there will be less economic motivation for development.

Thus, property tax reform can encourage development adjacent to existing infrastructure. Because the demand for developed space is limited at any given time, the greater utilization of land adjacent to existing infrastructure will help reduce the demand for development in outlying areas. Reduced demand to develop outlying areas combined with a lack of nearby infrastructure will keep land values and taxes low, minimizing economic imperatives for development.

An econometric study, published in the *National Tax Journal*, indicates that this tax reform would shrink an urbanized area.¹ In reality, an urban area would not shrink, but new development would tend to occur within the existing urbanized area, rather than outside it. The econometric model assumed that land owners maximize present income by renting to the uses that bid the most for their land. In the real world, vacant and underutilized land exist within an urban area. Thus, the prospect exists that property tax reform could have an even more robust impact than the model indicated.

Pittsburgh is the largest city in the United States that taxes building values less heavily than land values. Until the late 1970s, Pittsburgh taxed buildings at half the rate on land values. At that time, Pittsburgh increased the tax on land, leaving the building tax the same. Today, Pittsburgh taxes buildings at one-sixth the tax rate on land values.

In spite of the severe depression in steel and related industries that was occurring during this time, residential and office development within Pittsburgh grew substantially. Contrary to national trends, the pace of development within the city limits exceeded development in the suburbs.² In 1978, five Pennsylvania cities employed this "split-rate" property tax. Today, fifteen cities do. These cities experienced more development after increasing the tax rate on land values than did neighboring cities of comparable size and economic character.

Both theoretical models and practical experience lead to the conclusion that property tax reform can provide economic incentives to help reverse urban sprawl. Compact development, by utilizing existing infrastructure, conserves natural and financial resources. Compact development patterns also facilitate the use of walking, cycling and transit. Of course, zoning and other land use controls must be coordinated to insure appropriate

development and the establishment of public open space within the urban area.

Political feasibility is shown in a revenue-neutral study comparing the traditional property tax to a split-rate property tax. This study showed a reduction in the tax burden on most residential and neighborhood business properties. Vacant lots and surface parking lots experienced tax increases.³

Land derives its value from the desirability of its surroundings (location). Increasing taxes on land discourages speculation and returns to the public economic values that are largely created by public expenditures in the first place.⁴ A building, on the other hand, derives its value from the owner's work in constructing and maintaining it. Reducing

taxes on buildings reduces the cost of providing commercial and residential space.

Together, these tax changes promote the clustering of development adjacent to existing infrastructure, reducing development pressure on outlying areas and discouraging urban sprawl. They motivate land owners to employ architects to design more sustainable buildings and patterns of development. A split-rate tax can help harmonize economic incentives with public policy objectives for affordable housing, economic development and environmental protection. ■

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NOTES

1. Joseph DiMasi, "The Effects of Site Value Taxation in an Urban Area: A General Equilibrium Computational Approach," *National Tax Journal*, vol. 40 (December, 1987), pp 577-590. Using data from Boston, the distance from the central business district to the outer urban ring of the model contracted by more than half a mile when the current property tax was replaced by a property tax that taxed land values at three times the rate on building values.
2. Wallace Oates & Robert M. Schwab, *The Impact of Urban Land Taxation: The Pittsburgh Experience*, Working Paper No. 95-02, University of Maryland, January, 1995. (see Appendix, table 5).
3. Pro-Housing Property Tax Coalition, "Real Property Tax Rates for Tax Year 1992," June 21, 1991.
4. "Value Capture," as described here is listed as an innovative financing technique in the Intermodal Surface Transportation Act which requires jurisdictions to identify operating and maintenance funding sources for federally assisted transportation projects. See sections 134(g)(2)(B) and 134(h)(2)(B).