Why it is so obvious that. . .

IMPROVEMENTS Should be Taxed Much Less and LAND VALUES Should be Taxed Much More

Excerpted from the consensus of a Conference on the Financial Crisis of our Cities, worked out by representative leaders from

National League of Cities
U.S. Conference of Mayors
National Association of Counties
Council of State Governments
National Governors Conference
Committee on Economic Development
Advisory Commission on Intergovernmental Relations
National Commission on Urban Problems
Ford Foundation
Chamber of Commerce of the U.S.
The Conference Board
National Association of Manufacturers
National Housing Center
Regional Plan Association
New York Economic Development Council
Small Business Administration
Tax Foundation

The conference was cosponsored by the first five of these organizations in cooperation with Time *and* Fortune *and the Robert Schalkenbach Foundation, New York. The full text of the Consensus was published in March, 1969 in* Nation's Cities, *the magazine of the National Leagues of Cities, Washington, D.C.*

One very good way for cities to help themselves is to correct what's so wrong with the property tax

Wisely applied, the property tax on which local governments depend for 87 per cent of their tax revenue could be one of the wisest and fairest of all taxes; but as most cities apply it today it may well be the very worst—a weird combination of overtaxation and undertaxation, an incentive tax for what we don't want and a disincentive tax for what we do want. It harnesses the profit motive backward instead of forward to both urban renewal and urban development. Too often it makes it more profitable to misuse and underuse land than to use it wisely and fully, more profitable to let buildings decay than to improve them or replace them.

Too few tax levyers seem to understand that the property tax is not just one tax; on the contrary, it combines and confuses two completely opposite and conflicting taxes, and it would be hard to imagine two taxes whose consequences for urban renewal and urban development would be more different.

One of the two conflicting taxes fused and confused in the property tax is the tax on the improvement—the tax on what past, present, and future owners of the property have spent or will spend to improve it. And it must be obvious to anyone that heavy taxes on improvements are bound to discourage, inhibit, and often prevent improvements.

The other levy confused in the property tax is the land tax—the tax on the location value of the site, the tax on what the property would be worth if the owners had never done anything or spent anything to improve it, the tax on the value that derives mostly from an enormous investment of other peoples' money and other taxpayers' money to create the community around it and make the location accessible, livable, and richly saleable. And it must be obvious to anyone that heavy taxes on the location cannot discourage or inhibit improvements; on the contrary, heavy taxes on location could put effective pressure on the owners to put their sites to better use so as to bring in enough income to earn a good profit after paying the heavier tax.

All this is so obvious that you would think every city would try to tax land heavily and tax improvements lightly if at all; but just the opposite is the case. Almost every city collects two or three times as much money from taxes on improvements as from taxes on land. In fact, many cities tax improvements more heavily than the combined local, state, and federal taxes on any other product of American industry except hard liquor, cigarettes, and perhaps gasoline.

A 3-per-cent-a-year tax on improvements may not sound big compared with an income tax averaging, say, 30 per cent, but it sounds small only because it is expressed as a percentage of capital, whereas the income tax, as its name makes clear, is expressed as a percentage of income. The enormity of the improvement tax becomes self-evident when we restate it in income tax, in sales tax, and in consumer tax terms:

First in income tax terms:

A 3-per-cent-of-true-value tax on improvements is apt to tax away 75 per cent of the net income a new building would otherwise earn.

And now in sales tax terms:

A 3-per-cent-of-true-value tax on improvements is the instalment plan equivalent of a 52 per cent sales tax; i.e., it will cost the improver as much as a 52 per cent lump sum sales tax would cost him if he could finance it at 5 per cent interest over the 60-year life of the improvement.

And finally in consumer tax terms:

A 3-per-cent-of-true-value tax on improvements will cost the consumer more than a 25 per cent consumption tax; i.e., it will add more than 25 per cent to the rent a tenant must pay or more than 25 per cent to the carrying costs an owner must meet.

So no wonder New York's 4-per-cent-of-true-value tax on new improvements has stopped almost all private new construction in the city except for the seemingly unstoppable boom in never-mind-the-cost office buildings renting at $8 to $12 a sq. ft. and luxury apartments selling at $10,000 a room or renting at $100-plus a room.

And no wonder Boston's 6-per-cent-of-true-value tax on improvements brought all private construction to a halt until the law was changed so new improvements can be taxed only half as heavily as existing buildings.

The deterrent effect of the improvement tax is so obvious and so widely recognized that whenever government wants to encourage some favored project the first thought is to offer the builder tax exemption on the new construction. But this makes the city-wide problem worse by making it necessary to increase the improvement tax everywhere else, thereby increasing the tax deterrent for all other improvements.

Cities could help themselves by taxing land heavily instead of, as now, subsidizing land price inflation

By definition, the value of unimproved urban and suburban land is created not by anything the owners have done to improve it, but by an enormous investment of other peoples' money to build the community around it and an enormous investment of other taxpayers' money to provide the infrastructure of roads, schools, water systems, sewage systems, mass transit facilities, parks, pollution controls, police facilities, fire protection, etc., etc., etc., needed to make the location easily reachable, pleasantly livable, and richly saleable.

The enormity of this other-taxpayer investment is suggested by a Regional Plan Association port indicating that around New York it is averaging well over $16,850 per lot in single-family locations, many times $16,850 in multi-family locations. This $16,850 figure is confirmed and given broader significance by studies for the Southern California Research Council that come within about a thousand dollars of the same figure for Los Angeles.

But the selling price of land is bound to be less than its total value. How much less will depend on how much or how little of this enormous community investment of other peoples' money and other taxpayers' money the local government chooses to recover for the community by taxation and/or special assessments, and how much it allows the landowner to convert to his private profit. If the community made landowners pay back 100 per cent of this investment, the price of their land would often fall to zero or less. Today most local governments assess and tax unused, underused, and misused land so lightly that the tax makes the owners repay only a trifling share (perhaps 5 per cent) of the community investment that multiplied the value of their land. The other 95 per cent they are free to capitalize into higher and higher land prices.

This practice of public improvements for private profit gives land speculation an enormous hidden subsidy, a hidden subsidy so big that it may actually be bigger than all the farm subsidies plus foreign aid combined. And this is perhaps the biggest reason why building-site prices have been going up much faster than the prices of everything else. The Douglas Commission found that from 1955 to 1965 land prices climbed six times as fast as the index of wholesale commodity prices.

The smaller the land tax the bigger the land subsidy and the higher the land price can go. So we are shocked but hardly surprised to hear the Tax Foundation report that most of the federal urban redevelopment subsidies have gone to enrich the owners of slum property by raising the price of slum land ($484,000 per average acre for the slum properties bought for demolition by the New York Public Housing Authority) and have done little to help the poor people living in the slums (just as the federal *Report on the Causes of Rural Poverty* found that the federal farm subsidies "have created a class of wealthy rural landowners but done little to improve the condition of the rural poor").

Here are a few of the many reasons why most of us believe the unimproved location value of urban and suburban land should be taxed much more heavily:

- Quite simply, to help pay the cost of local government, including the cost of all the tax-paid improvements that make the location valuable.

- To offset the cost of untaxing improvements. Local governments depend on property taxation for nearly 87 per cent of their local revenue, so the only way they can afford to tax improvements less is to tax unimproved land values more.

- To slow down the pace of land price inflation.

- To exert heavy pressure on the owners of underused and misused land (including most specifically slums) to put it to better use now instead of waiting for further subsidies and further investments of other peoples' money to raise its price still higher (land speculators call this "waiting for it to ripen"). With land prices for building soaring 8 to 15 per cent a year, millions of idle acres are now so underassessed and undertaxed that the owner can hold $1 million worth off the market for a property tax cost of as low as $5,000 a year, with up to 77 per cent of that $5,000 deductible from his federal income tax.

- To let cities expand in an orderly manner instead of disintegrating in suburban sprawl and premature subdivision, with millions of close-in acres held off the market for speculation, thereby forcing homebuilders to leapfrog further and further out into the countryside to get land they can afford to build on and forcing industry to move further and further away from urban employment (and unemployment) centers to find enough land they can afford on which to build new plants.

- To save the tax waste of sprawl, which multiplies the cost of roads to reach sprawl-scattered homes, multiplies the cost of water distribution, multiplies the cost of sewage collection, multiplies the cost of mass transportation, inflates the cost of police and fire protection, and doubles the cost of getting children to and from school.

- To stop and perhaps reverse the futile spiral in which the multi-billion-dollar urban renewal subsidies are being capitalized into higher urban renewal land costs calling for bigger urban renewal subsidies that will in turn be capitalized into higher land costs requiring still bigger subsidies (land write-down subsidies, below-market-interest subsidies, tax exemption subsidies, or perhaps some new kind of subsidy).

These and other good reasons for taxing location values more heavily are spelled out at greater length in the careful research reports of Prof. Dick Netzer for the Brookings Institution and the National Commission on Urban Problems; Prof. Lowell Harriss for the United States Chamber of Commerce and the Tax Foundation; and Prof. Mason Gaffney for the Urban Land Institute, the Lincoln Foundation, and the Schalkenbach Foundation.

And the Douglas Commission on Urban Problems is unanimously recommending that state governments vigorously explore the desirability and feasibility of placing new or differentially higher taxes upon land values.

And the President's Committee on Urban Housing (the Kaiser Committee) is urging a similar tax study "with particular emphasis on the potential beneficial effect of shifting more of the relative burden from improvements to land. Heavier taxation of site values has the apparent advantage of discouraging speculative withholding of land from development and of enabling the public to recoup more easily the benefits it bestows on local land owners through improvements like roads and sewers. Lighter taxation of buildings might remove existing tax disincentives which discourage new construction, rehabilitation, or adequate maintenance. This area seems a promising one for reform."

Says a Tax Foundation research: "A point of great significance and some urgency (is that) under present arrangements much of the intended benefit (of urban aid) will almost inevitably be incorporated into gains for land owners. They are not the persons for whom the assistance is designed."

No urban renewal subsidy at all should be needed if the property tax were shifted to land alone

This is just one of the many significant findings of the Urban Land Institute Study—specifically for Milwaukee, but by implication for almost any other central city facing problems of blight, obsolescence, slums and decay (as all big cities do).

This four-year sampling of more than 2,500 separate land parcels—property-by-property, district-by-district—was conducted with the cooperation of the Milwaukee Tax Commissioner. It provides the first comprehensive analysis anywhere of just what could be expected if a city were to (1) stop collecting any property tax at all on improvements, (2) assess all land as if the owner was putting it to a use commensurate with its market price, whether he was or was not, and (3) raise the tax rate on location values high enough to make up for the revenue loss from untaxing improvements. At long last, this study (of which we were given the first preview) provides a factual basis showing that in Milwaukee and any similar city that now collects roughly two-thirds of the property levy from improvements and one-third from location values . . .

I

The shift would roughly triple the tax take from idle land, parking lots, gas stations, slums, and other decaying, obsolescent, or ill-advised buildings that add little (and sometimes less than nothing) to the value of the land they preempt. Actually it might do much more than triple their tax, because Milwaukee assessors, like all other assessors, tend to confuse the property tax with an income tax and therefore grossly under-assess underused land that is not bringing in enough income to pay the full tax on its market value.

So the shift would make it almost prohibitively unprofitable to keep close-in land idle or misused.

II

The shift would add roughly 50 per cent to the tax take from properties whose improvement value approximates the location value, and it would make no change in the tax take from properties whose improvement-to-land ratio is close to the city average of two to one.

But on good homes, good apartments, good office buildings, and good commercial and industrial structures whose improvement value is likely to run at least four times their location value, the shift would cut the tax take by 40 to 75 per cent.

III

The prospect of much lower taxation of good new buildings would jump the market price of close-in locations ripe for rebuilding at the same time that increased site value taxation would be putting heavy tax pressure on the owners of underused land to put it to more productive and more profitable use.

So the shift would so change the arithmetic of property ownership that no subsidy at all should be needed to make it profitable for the owners of almost all the parking lots and obsolete decaying or inadequate buildings that now preempt nearly three-quarters of the valuable land near the heart of Milwaukee (and most other big cities) to replace them with new buildings that would put the site to its "highest and best" use. This might be new offices, or new stores, or new low-cost housing, or new parking garages, or new high-rise apartments, or new garden apartments, or new single-family homes, or what have you.

IV

The shift should not only end the need of any subsidy for urban renewal; it should provide such a stimulant to new construction and redevelopment that it could create just the opposite problem. The old problem has been how to end the construction stagnation that results in slums and decay; the new problem would be how to control a building boom that could wildly overtax the construction labor and construction financing resources of the city as thousands of property owners rush to take advantage of the tax shift.

The shift would, in fact, be such strong medicine for what ails our cities that it would have to be given in small doses spread over a period of perhaps 10 years (as was done 50 years ago when Pittsburgh and Scranton shifted to the graded tax plan making the city tax on land twice as heavy as the tax on improvements).

V

The shift would make good city planning at once much more necessary and more effective.

City planning is a negative power; it can keep property owners from doing what they ought not to do, but in a free economy it cannot compel them to do what they ought to do. Says the Douglas Commission in a fine understatement: "Regulations do not build cities;" and again: "Regulations seldom effect significant upgrading of deteriorating areas;" and again: "Regulations seldom effectively encourage imaginative urban design and too many times effectively discourage it."

Under the present property tax system that discourages new construction by heavy taxation and encourages obsolescence and decay by undertaxation, most of Milwaukee has passively defied effective city planning.

But when, as, and if a tax shift off improvements to land starts an all-out building boom, the planners would at last have a chance to prove their worth by directing its course to create a better city.

VI

Contrary to common belief, tripling the tax on land would not be bad for landowners if at the same time the tax is taken off improvements. A three-times-as-heavy tax on land would indeed be almost confiscatory if the owner of unused or underused land persisted in leaving it that way, but untaxing improvements would enable him to triple his profits if he improved his property and put his land to its highest and best use. (See III above.) This smaller tax on the improved package would be capitalized into a higher price for the land, so the landowner would find himself better off instead of worse.

Perhaps surprisingly, first to benefit from the shift might be the owners of valuable idle land, for they could be first to take advantage of the tax exemption on improvements.

The only landowners who would stand to lose by the tax shift are the owners of fringe land that now derives a fictitious value because the owners of so much closer-in land can now afford to hold it off the market waiting for still higher prices.

VII

The shift would stimulate much more intensive use of valuable close-in land near the center of the city. In conjunction with heavier tax pressure on the owners of underused outlying land this would have important side effects:

- People who prefer low-density living should be able to find land they could afford roughly half as far out as now, for more intensive land use downtown would siphon off much of the demand that is now proliferating sprawl.

- Inner city and slum unemployment problems should be eased, because factories and other blue-collar employers could likewise find land they could afford closer to where poor people live. (Nationally, says the Department of Labor, 62 per cent of all new factories from 1960 to 1965 were built outside the central cities, i.e., remote from where unemployment is concentrated and more jobs are needed most.)

- More intensive use of downtown should, perhaps surprisingly, lessen downtown traffic congestion, because more people could walk, escalate, or use public transportation instead of driving to where they want to go. Says Professor Gaffney: "Sprawl is not a flight from congestion; it is a major cause of congestion by making more people use more cars to travel more miles to downtown."

- More intensive use of downtown should result in substantial savings on city costs, most of which are magnified by distance.

VIII

How big a tax rate increase the shift would require to make up for untaxing improvements would depend on whether the assessors assign to the taxable land or the tax-exempt improvement the big increase in the value of fully improved property that would result from reducing the tax on it by more than 40 per cent.

If assessors follow their present practice of assessing the building first at cost-less-depreciation and assign all the big increase in residual value to the land, then the tax rate increase required by the tax shift could be small. If, on the other hand, they assess the land first and assign all the big increase in residual value to the improvement, then the tax rate on land alone would have to be at least tripled.

Serious doubts as to the correctness and soundness of today's practice of assessing the building first are raised by the Milwaukee sampling, which showed nearly a fifth of the properties on which the assessors assigned a substantial value to the improvement would have sold for as much or more if the land had been bare.

IX

Assessment would be much easier and could be kept more accurate and closer to the present market if the assessors were relieved of the almost impossible task of assessing every improvement separately. Land only could then be assessed quite quickly from cadastral maps kept current by recording on them the market price shown by each sale in the area.

In Milwaukee today the assessors must spend 80 per cent of their time on improvements, only 20 per cent on land values.

X

First step in the tax shift could be taken by just reversing the present practice of assessing underused land at a much smaller percentage of market value than fully improved properties, a practice that is somewhat less notorious in Milwaukee than elsewhere. But a complete shift in Wisconsin (as in every other state except Hawaii) would of course require the repeal of state restrictions requiring that the tax rate on land and improvements must be the same.

XI

The shift should be popular with most voters because it would reduce the taxes on most owner-occupied homes (since their improvement-to-land value ratio is well above the city-wide average).

Taxes on slum property would be doubled or tripled but this would not affect many voters living in the slums, since most slum dwellers are renters and (as any good economist can demonstrate) taxes on land cannot be passed on, but must be paid out of the owner's own pocket (except under rent control).

The only voters hit hard by the tax shift would be the land speculators who are now making such a good thing out of today's property tax practice. (Unfortunately, they are by far the most powerful and effective pressure group in local politics.)

XII

Last, but not least, the tax shift would make the financial plight of the local government easier. Instead of depending on a tax base subject to accelerating erosion as the older close-in buildings deteriorate without replacement and as industry and upper-income families move to the suburbs, the city would find its tax base growing and the flight to the suburbs checked by the tax-shift-induced construction boom close-in.

The 40-per-cent-or-more property tax saving that the shift would assure new offices and new industrial plants would make the city a more profitable place to do business in, and could therefore be expected to attract more business and industry, thereby further strengthening the tax base.

* * *

Findings of the study in Milwaukee are already getting confirmation from the actual experience of Southfield, Mich., which almost overnight became the boomingest city in the state after a 1962 reassessment by outside assessors doubled the assessment (and therefore the tax) on land, thereby permitting a substantial reduction in the tax on improvements. Since then Southfield has recorded more new office building construction than 30-times-as-big Detroit next door; land values have continued to soar, until some acreage that was assessed at $2,400 in 1961 is now assessed at $100,000; and grateful voters have three times re-elected the mayor who instigated the tax shift.

Here are the Panel Members Who joined in this Consensus to tax land much more and improvements much less

From the National League of Cities and the U. S. Conference of Mayors:

PATRICK HEALY
Executive Director of the League

JOHN GUNTHER
Executive Director of the Conference

HENRY W. MAIER
Mayor of Milwaukee
Past President of the League of Cities

JOHN R. COLLINS
Ex-Mayor of Boston
Past President of the League of Cities
Professor of Urban Affairs, M.I.T.

TRAVIS H. TOMLINSON
Chairman
Revenue & Finance Committee
Mayor of Raleigh, N. C.

NATHAN B. KAUFMAN
Vice Chairman,
Revenue & Finance Committee
Mayor of University City, Mo.

WAYNE ANDERSON
City Manager, Evanston, Ill.

ROBERT W. SWEET
Deputy Mayor of New York City

From the Council of State Governments and the National Governors Conference:

BERNARD CRIHFIELD
Executive Director

SEN. EDWARD L. MARCUS
(CONNECTICUT)
Chairman of the Governing Board

SEN. JOHN J. MARCHI
(New York)
Chairman,
Committee on State Urban Relations

T. N. HURD
New York State Budget Director

ALBERT G. GILES
Director,
Ohio Department of Urban Affairs

WAYNE F. McGOWN
Secretary, Wisconsin Department of Administration

JULIAN STEELE
Massachusetts Commissioner of Community Affairs

From the National Association of Counties:

BERNARD HILLENBRAND
Executive Director

From the Advisory Commission on Intergovernmental Relations:

WILLIAM G. COLMAN
Executive Director

From the National Commission on Urban Problems:

ALLEN D. MANVEL
Associate Staff Director

From the Small Business Administration:

HOWARD J. SAMUELS
Administrator

From the Committee for Industrial Development:

ALFRED C. NEAL
President

From the National Association of Manufacturers:

A. WRIGHT ELLIOTT
Vice President,
Industrial Environment Department

From the U. S. Chamber of Commerce:

CARL MADDEN
Chief of Economics

From the National Industrial Conference Board:

JOHN MURPHY
Director, Department of Business and Government Relations

From the N. Y. Economic Development Council:

PAUL BUSSE
Executive Vice President

From the Tax Foundation Inc.:

HERBERT J. MILLER
Federal Affairs Counselor

For Public Education:

FRANCIS KEPPEL
Ex-Commissioner of Education, HEW

From the Universities:

RAYMOND J. SAULNIER
Columbia University (former Chairman, Council of Economic Advisers)

DICK NETZER
New York University

MASON GAFFNEY
University of Wisconsin

From the National Housing Center:

THOMAS P. COOGAN
Past Chairman

From the Regional Plan Association Inc.:

JOHN P. KEITH
Executive Vice President

From the Ford Foundation:

LOUIS WINNICK
Deputy Vice President for National Affairs

From the Schalkenbach Foundation:

ALBERT PLEYDELL
President

Moderator and Rapporteur

PERRY PRENTICE, Time, Inc.

Reprinted by:

Robert Schalkenbach Foundation
41 East 72nd Street, New York, NY 10021