

Land Value Taxation: An Underutilized Complement to Smart
Growth Policies

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Abstract

A land value tax (LVT) is an economic policy tool that can be used to support the objectives of Smart Growth development. Its importance is significant to government finance directors as well as community and city planners. This tool splits the standard property tax into its two components of land values and building values. The tax rate is increased on the land part of the property and decreased on the building. The increased tax on land has a negative capitalization effect, resulting in land being priced closer to its true market value. The ability to obtain buildable infill lots at competitive prices makes this type of development more attractive to builders. The decreased tax on building improvements has a positive capitalization effect, similar to other property tax abatements. This provides an economic incentive to develop densely and compactly. This combination of disincentives (the increased holding costs on vacant or underused lots) and incentives (diminished or eliminated taxes on buildings), supports Smart Growth goals of infill directed, compact and dense development, affordable housing, distinctive neighborhoods, and mixed use building.

Land value taxation needs proper zoning and land use controls to be truly effective. The advantages of the tax, such as its ability to promote denser development, will be diminished without proper land use planning. A land value tax has advantages over more traditional economic incentive programs such as tax increment financing and abatements. These advantages include being less targeted and broader reaching. In addition, a land value tax is not mutually exclusive to other tax programs, but can be used in combination or to complement these programs if desired. Legally, a land value tax needs state enabling legislation written into the state constitution to allow municipalities

to implement LVT. This can be done through legislation or a constitutional amendment.

Where administered, a land value tax has produced the desired results. There are those however, who feel that this tax structure is not adaptable to all areas and can be damaging under certain circumstances. For planners and others involved in municipal government, the land value tax has been shown to be a successful, yet little known tool that is helpful in building Smart Growth communities.

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Part 1 - Introduction

I. Introduction

A land value tax (LVT), also known as a split rate or two-rate tax, has been used by municipalities in Pennsylvania since Pittsburgh and Scranton enacted the first land value tax in 1913.¹ Since then LVT has been enacted in multiple towns in Pennsylvania. These include Aliquippa (1988), Allentown (1997), Altoona (2002), Clairton (1989), DuBois (1991), Duquesne (1985), Ebensburg (2000), Harrisburg (1975), Lock Haven (1991), McKeesport (1980), New Castle (1982), Pittsburgh (1913), Scranton (1913), Titusville (1990), and Washington (1985) (figure 1). These cities are spread across Pennsylvania and range in population from 2,901 in Ebensburg to 107,815 in Allentown.²

Figure 1 – *Courtesy of the Center for the Study of Economics*



¹ “LVT Jurisdictions and Rates,” Our Common Wealth,
<<http://www.ourcommonwealth.org/news/lvt-jurisdiction-rates>>

² Ibid.

In addition to the goal of encouraging development, LVT has been promoted by supporters as providing an added incentive to many of smart growth's design patterns. These patterns include compact building design, dense neighborhoods, distinct communities with a sense of place and vitality, the re-population of downtowns and elimination of blight, economic vitality, and increased transit options. Research has been performed and studies have been done on how effective land value taxation actually is in promoting the goals of Smart Growth. This paper will look at those studies and attempt to answer the research question: "Does a land value tax promote and encourage Smart Growth principles."

Smart Growth is a phrase that encompasses many design and development ideals. To best measure the impacts of a land value tax, it is necessary to disaggregate them, and examine them individually. Each of the components commonly associated with Smart Growth will be examined, comparing various tax structures and their effect on that individual Smart Growth component. There are three components of Smart Growth programs that we will look at. These three areas are development, transportation, and the environment. Since the development component is such a major area of smart growth, this paper will sub-divide that area into five sub-groupings. The five sub-groupings will be infill direction, compact and dense development, affordable housing, distinctive communities, and mixed-use and walkable neighborhoods.

A two-part method is employed to gauge the effectiveness of promoting each of these Smart Growth principles. The first will look at the existing literature and compare and balance the differing viewpoints and studies. It will look at both proponents and opponents of land value taxation and compare arguments as to their effectiveness in

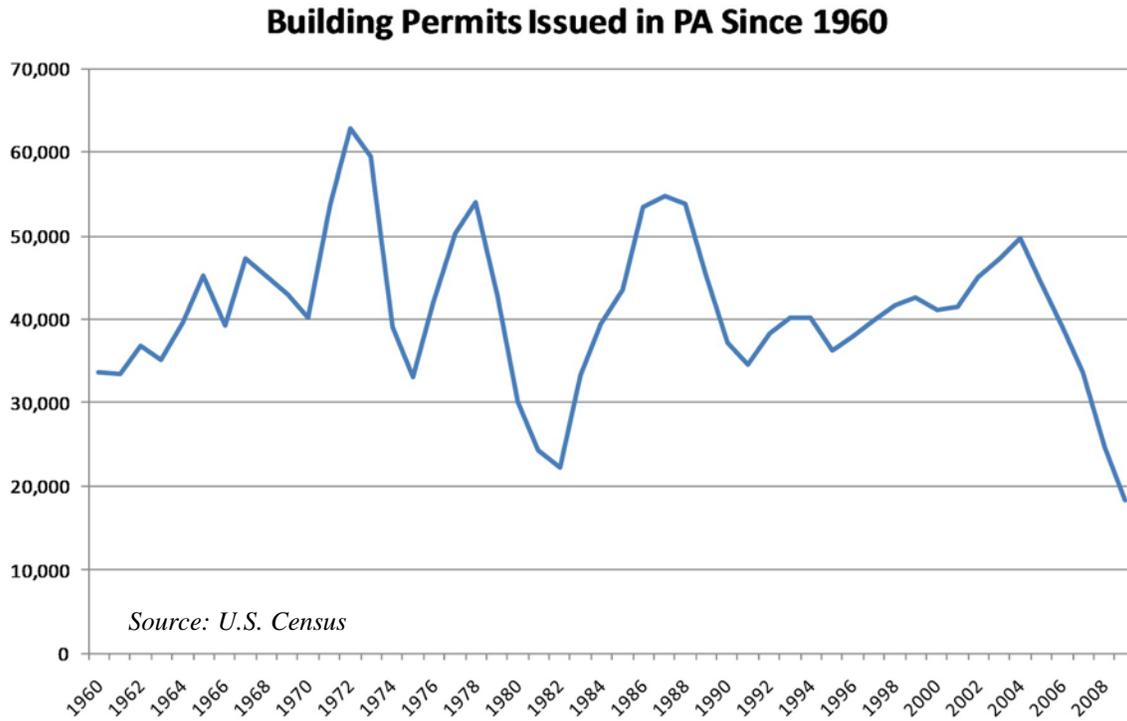
promoting Smart Growth practices.

The second method will use an individual example as a hypothetical case study of how a land value tax supports Smart Growth development on an individual lot. Graphs and tables will be constructed to illustrate how a lot in a municipality would fair using two separate tax structures, the LVT structure and a traditional tax structure. The results will show how the different tax structures positively affect each individual Smart Growth objective.

After examining the impacts, the paper will then proceed to discuss some of the issues confronting the implementation of smart growth, such as legal concerns and combining LVT with other taxing programs, such as tax abatements and tax increment financing.

A. The need for an economic complement to Smart Growth

Figure 2



In Pennsylvania (figure 2), there has been a steep decline in building permits since 2004. Concurrently, the economic downturn has created budget problems in many government entities. This could have an effect on programs that involve public expenditure such as protecting farmland and open space and expanding public transportation. These are the areas that a land value tax could be beneficial.

It should be understood, however, that remedies are holistic; there are other dimensions and tools available that should be used to complement a land value tax. Regulations, for one, are important since they give the framework in which development

will operate. They allow the density and compactness which a land value tax encourages. But while regulation can keep owners from using their property for any harmful purposes, in a free economy it cannot compel them to do something with it that would benefit the community. Encouragement of development relies more on economic knowledge of fiscal models.³

Smart Growth is comprehensive. It needs economic remedies as well as regulations to be successful. The tools available for both environments are needed to not only control development, but to stimulate and encourage development. To begin a discussion on how a land value tax encourages development in a Smart Growth manner we first need to define what we mean by Smart Growth development and later what a land value tax is.

B. Smart Growth definition

“Smart Growth means planning for growth, not slowing growth or no growth.”⁴

Planning for growth in a ‘Smart Growth’ way means planning for restoring community and vitality to center cities and older suburbs where there is existing infrastructure (roads, sewer, etc.). It involves channeling housing and job growth into urban centers. It is town centered, transit and pedestrian oriented with a greater mix of housing, commercial and retail uses. It means development that is

³ Dale Bails, “Two Municipal Revenue Sources Contrasted: The Land Value Tax and the Property Tax,” *American Journal of Economics and Sociology* (1974): 190.

⁴ Stuart Meck general editor, *Growing Smart Legislative Guidebook*, (Chicago: American Planning Association, 2002) A-8.

compact and dense, that uses infill lots with mixed use buildings; it has copious housing choices, walkable neighborhoods and distinctive communities. Finally, it is transit oriented with protection of parks and open space as well as a strong mandate to protect the environment.

There is more to Smart Growth than a list of objectives. The idea of Smart Growth is not only as a tool but as a total plan. It is comprehensive, all parts must work together to accomplish all goals. Plans that are done piecemeal and not holistically are going to have a lower chance of success. In a good plan all pieces are connected, there is no separation of land use from transportation or the environment from social concerns, the separate parts of a good plan work together. All parts are equally important; concerns for the environment, the economy, and social equity or justice are interconnected. All elements must be balanced. All parts should be considered important and all elements should receive, if not as much time, as much thought as any other part.⁵

In this balanced equation, a land value tax addresses one part of the economic component. All other components, zoning, permitting, etc., must be addressed and balanced as well. The planner that takes the broad view that encompasses all factors that affect Smart Growth development will greatly improve his or her chances of success.

⁵ Meck A-8 – A-9.

C. LVT definition

“The property tax is, economically speaking, a combination of one of the worst taxes—the part that is assessed on real estate improvements. . . and one of the best taxes—the tax on land or site value. —William Vickrey (1999)”⁶

Property taxes are a tax on real estate and any improvements, such as buildings, to that real estate. They are the main resource for local government’s revenues for services. These services include police and fire protection, infrastructure such as roads, water, sewer, waste, recycling and other utilities, as well as money needed to fund school districts.

Property taxes start with the assessor. In many states, such as Pennsylvania, the county is responsible for conducting assessments; in other jurisdictions, localities are responsible. The assessor collects parcel information so the value can be accurately determined on the two separate parts of a parcel. The assessor calculates separate values for land and for structures. The municipalities then set the actual tax rate on the assessment for local taxes which determines what the individual property owner will pay. Other jurisdictions (school, county) also use these assessments to set their own tax rates. With a traditional property tax, tax rates are applied against the combined land and structure value to get one total value. With a land value tax, a higher rate is applied to the land and a lower rate on the buildings.

Economists, such as Gregory Ingram of the Lincoln Institute of Land Policy, like a

⁶ Richard Dye and Richard England. Land Value Taxation: Theory Evidence and Practice. (Cambridge: Lincoln Institute of Land Policy, 2009) 3.

land value tax for its ability to be an efficient tax that produces few unintended costs while still raising revenue. To economists, a tax on land is different than a tax on other things like sales, income or buildings. Economists talk about the efficiency of a tax, which means how the tax affects other goods and services in the economy. With a sales tax, the tax increases the cost of the good sold. If you put a tax on cars or clothing, the selling price of those products will go up. This diminishes the quantity demanded for the product, so less is sold. This leads to decreases in production by the firms making the product. Less production leads to fewer jobs, which leads to less money spent in the economy. Put in economic terms; “the resulting reduction in production and consumption of the good is a distortion caused by the tax, and this reduction imposes an additional cost on the local economy.”⁷

Fairness is an issue with an ad valorem tax such as the property tax. With a traditional property tax, developers and home owners who improve their property are penalized by having to pay taxes on value they created. Landowners, on the other hand, when they sell their land are often the recipients of windfall profits that are the result of no effort or investment of their own but are the result of investment and improvements of the larger community. Capture of this publicly created value could be used to fund other public projects.

Land is fixed in quantity. It is not manufactured in its raw state by humans so production of it cannot be decreased. Since the amount is fixed permanently, “when a tax does not affect the amount of the commodity produced or consumed, there is no additional cost, and such a tax is more efficient (less costly to the local economy) than

⁷ Dye ix.

other taxes that reduce production.”⁸

This is one of many economic arguments for taxing land. Another economic argument is that by penalizing non-production, it encourages landowners to develop their land, thereby creating jobs and other benefits. It also reduces speculation, bringing land prices more into line to true market rates. Finally, it promotes economic development, eliminates ‘deadweight’ loss, and helps foster employment.

D. Administrative challenges of implementing LVT

Introducing a land value tax to replace a traditional property tax is a straightforward proceeding. No additional staff or expenses are required. Since the assessor automatically divides the assessment into land and improvement values, only a software update is needed for billing. However, because it can affect significant changes for some property owners, a land value tax is normally phased in over time, usually six to ten years. In addition, for political as well as practical reasons, municipalities can keep a partial tax rate on buildings with a higher rate on land; this would be called a split rate tax. This would be done when a full land value tax may affect too strongly certain parcels and this effect would need to be moderated.

When the city of Harrisburg switched to a land value tax, the main expense came from reprogramming the software. The system needed to be programmed to allow the two rates to be separated and the calculations for each property tax bill redone to reflect the separation. The amount of time taken to complete the property tax billing programming changeover was approximately one week. The appearance of the bills and an explanation of

⁸ Dye ix.

the change to a two-tiered tax system attached to the bills were the only changes affecting the taxpayer. This system was implemented by City ordinance and approved by the City Council.⁹

In most cases, the land value tax is not meant to reduce or raise taxes but keep them revenue neutral. In other words the land value tax shifts the tax burden; it does not decrease or increase the tax base for the municipality. However, if a tax cut or increase is desired, this can be done also.

E. Summary

From the definitions of Smart Growth and land value taxation, the common purpose can be easily seen. Both strategies are land use centric as well as comprehensive. Both strategies revolve around directing development into urban areas while keeping it from greenfields. Both are holistic in their plans for community improvement. Finally, the goals and objectives of both are the same, only the methodologies may differ.

In the sections below, these similarities and common goals will be analyzed. Smart Growth will be broken into its component parts and the effectiveness of LVT in supporting each part will be discussed. Strengths and weaknesses in this ability will be contrasted and compared with an emphasis on individual examples.

⁹ “City of Harrisburg Two-Tier Tax Rate,” Center for the Study of Economics, <<http://www.urbantools.org/research-and-studies/harrisburg-pennsylvania/City%20of%20Harrisburg%20%20tier%20tax%20rate.pdf/view>>

Part 2 - What is a Land Value Tax?

I. How LVT Supports the Objectives of Smart Growth Development

For this study, Smart Growth is understood as planning for restoring community and vitality to center cities and older suburbs where there is existing infrastructure (roads, sewer, etc.), channeling housing and job growth into urban centers that are transit and pedestrian oriented, with a mix of housing, commercial and retail uses, it means development that is compact and dense, that is infill directed with mixed use buildings, and has walkable neighborhoods with distinctive communities. Finally, it is transit oriented with protection of parks and open space as well as a strong mandate to protect the environment.

These are general descriptions of Smart Growth. To reach these goals there needs to be concrete objectives in place that can be enacted. For this study the objectives of Smart Growth are broken down into three categories. The first is Smart Growth development, which is the actual physical building of a neighborhood. Smart Growth development is broken into five sub-categories. These are directing development toward existing communities, building compact and dense, support for affordable housing, creating distinctive and vibrant communities, and building mixed use and walkable neighborhoods. The second is the important role transportation plays in Smart Growth design. And the third is the environment and sustainability. Each of the Smart Growth objectives and sub-objectives are looked at below using previous research as well as original analysis to see how a land value tax supports the Smart Growth objectives listed.

A. Smart Growth development

1. Direct development toward existing communities

One of the main goals of Smart Growth programs is to seek to encourage infill development in urbanized areas and reduce the spread of development to adjoining rural areas.¹⁰ LVT has the ability to direct development toward urban areas and create infill development, thereby making it less attractive to build on greenfields. This ability to strengthen and direct development toward existing communities and away from greenfields is where LVT shows its greatest strength in promoting elements of smart growth.

To help reduce sprawl, state and local policy makers have been looking for ways to increase compact development. A land value tax as used by city managers has usually been introduced as an efficiency-enhancing policy that favors economic development. Previous research suggests that taxing land values more heavily than building values can promote urban revitalization while protecting undeveloped land at the same time.¹¹ However, the effectiveness of a land value tax on urban sprawl is affected by many factors including demand for neighborhood open space, as well as lot size and proximity to the central business district.¹²

From the developer's perspective, urban redevelopment, particularly in possible

¹⁰ Gregory Ingram, Armando Carbonell, Yu-Hung Hong and Anthony Flint, Smart Growth Policies: An Evaluation of Programs and Outcomes, (Cambridge: Lincoln Institute of Land Policy, 2009) 13.

¹¹ Richard W. England, "Property Tax Reform and Smart Growth." Land Lines (2004): 10.

¹² Seong-Hoon Cho, "Moderating Urban Sprawl through Land Value Taxation," American Agricultural Economics Association (2008): 2.

contaminated lands such as brownfields, can include extra construction costs and risk. These extra risks encourage developers to build in outer ring or suburban greenfield areas. Unfortunately, from society's point of view, the opposite scenario is wanted; the most desirable outcome is the cleanup and development of existing urban areas. Redirecting development into these existing urban areas helps create more accessible, diverse communities and preserves open space.¹³

Market based incentives, like a land value tax, can be used to direct development away from suburbs and toward urban areas. The market can be a better tool than regulations in curbing sprawl. For example, restrictive zoning laws can encourage developers to build in the suburbs. Similar restrictions effect buying decisions of the public as well. Economic, political and cultural factors need to work together to reduce sprawl. The market can be used as a tool by policy makers to obtain the goals of reduced sprawl, sustainable growth, and an increase in affordable housing.¹⁴

Studies of LVT applied in rural areas have produced mixed results. Studies that have looked strictly at farms in PA and how a land value tax would affect them “show evidence that suggests that the split-rate tax policy, especially with a heavy reduction of millage rate on building values, would significantly enhance incentives for the continuation and expansion of a viable, efficient, and sustainable agriculture in Pennsylvania and anywhere else.”¹⁵

¹³ Todd Litman, “Smart Growth Reforms Changing Planning, Regulatory and Fiscal Practices to Support More Efficient Land Use”, Victoria Transport Policy Institute (4 June 2010): 49.

¹⁴ Ansje Miller and Brian Parkinson, “Market-based policies for reducing sprawl: a critical overview,” (2001) <<http://www.urbantools.org/policy-papers/sprawl>>: 4.

¹⁵ Kenneth Wenzel, Land-Value Taxation: The Equitable and Efficient Source of Public

An opposing theory challenges the view that a land value tax is an anti-sprawl tax and suggests that, under certain conditions, the land value tax has no more effect on urban sprawl than does the traditional property tax. This theory states that the tax increases on land and tax decreases on building are too insignificant to have any meaningful impact. These increases or decreases in property taxes, when weighed against the other factors a developer takes into account when making a decision to build, are relatively insignificant and therefore unlikely to affect development decisions. Other factors, such as the market and prices of materials, will take precedence in these decisions.¹⁶

(a) How an LVT directs development

To illustrate the argument in favor of can LVT support infill development, consider the following hypothetical example. Figure 3 is a representation of a typical empty lot that could be in any city or borough. The assessed value on this lot is \$8360. The property tax per year on this lot at a typical 17 mill tax rate, which is 1.7%, is \$142 a year. That comes out to about \$12 a month. For \$12 a month the owner of this lot can hold it for 15 or 20 years, there is no financial incentive to sell. If this lot is held by a speculator that is very likely what will happen to it. A speculator holds a lot in the hope of at some point in the future some type of capital improvement, such as a transit or trolley line, will be put in the area. Other capital improvements that can cause significant increases in property value could include a hospital looking to relocate or a university looking to expand. If this happens, the owner of this lot can sell it for five or 10 times the

Finance, (M.E. Sharpe, 1999): 266.

¹⁶ Andrejs Skaburskis, "The Consequence of Taxing Land Value," Journal of Planning Literature 10; 3 (1995): 3.

amount they paid for it. If this lot was bought for \$8000 they could sell it for \$40,000 or \$50,000.

Figure 3



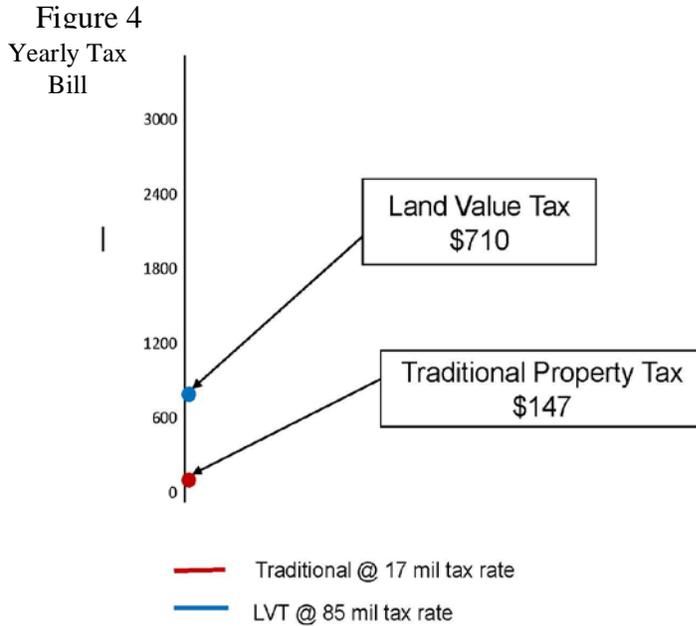
Assessed Value
\$8360

17 mil tax rate
\$142 a year

Unfortunately, the only person benefiting from this arrangement is the lot owner. Neither the neighborhood nor community receives any benefits. For the neighborhood and community to benefit, the lot owner would need to develop the lot or sell to someone who would develop it.

Figure 4 illustrates how a land value tax encourages our first Smart Growth objective of being infill directed. The graph shows that with a traditional 17 mill tax rate the taxes on this lot are \$147 a year. If this municipality enacts a land value tax, what would happen to the taxes on this lot? A typical land value tax on land is 85 mills which is 8.5%. At that tax rate the taxes on this piece of property would go to \$710 a year. That is close to 10% of the assessment value. With this yearly tax bill this property owner will not want to hold on to this land for 15 or 20 years. The higher yearly tax bill not only

increases the holding cost but increases the risk, as long as it is undeveloped, of this lot being a profitable investment. This is an example of how a land value tax encourages infill development, by discouraging owners of these infill lots from holding them out of the market.



2. Compact and dense

Building compact and dense is a major component of Smart Growth strategies. “A major objective of Smart Growth policies is to alter the spatial distribution of population and employment, principally by increasing the density and intensity of development, promoting compactness, and slowing the sprawling of development to rural and undeveloped areas.”¹⁷ Building densely allows for more effective public transportation, mixed use and walkable neighborhoods, and less suburban sprawl. With LVT the owner

¹⁷ Ingram 9.

has a strong incentive to build densely. This is based on the premise that developers generally want to build with higher density since there is higher profit potential. The tax encourages 'appropriate' development, which is development that can maximize the usefulness of buildings on the appropriate site.¹⁸ In urban areas this means building upward, putting more building on smaller lots.

Building densely has other benefits besides profits for the developer. It is an incentive, to not only develop infill areas, but also to replace older, blighted or under used buildings in an urban area. "Reducing the tax burden on improvements would facilitate revitalization and the replacement of obsolete buildings in older central cities. Property owners, responding to the financial inducement to reduce the land-to-building value ratio, would build more intensively on vacant and underutilized sites. The cumulative effect over time and space would be to increase property values, and thus the tax base, where that is most needed."¹⁹

Others argue that there is no reliable evidence for the capitalization effect which proponents believe would reduce land prices. They believe there is some evidence for a small incentive effect to development from removing the tax on buildings. However, they think that this development would only occur in areas already able to attract capital investment.²⁰

¹⁸ Jeff Wuensch, Frank Kelly, and Thomas Hamilton, "Land Value Taxation Views, Concepts and Methods: A Primer," Lincoln Institute of Land Policy (2000): 4.

¹⁹ Thomas Gihring, "Incentive Property Taxation: A Potential Tool for Urban Growth Management." Journal of the American Planning Association 65,1; ProQuest Direct Complete (Winter 1999): 63-64.

²⁰ M.D. Wyatt, "A Critical View of Land Value Taxation as a Progressive Strategy for Urban Revitalization, Rational Land Use, and Tax Relief," Review of Radical Political Economics 26(1) (1994): 18-19.

(a) How an LVT promotes compact and dense development

Continuing our example from the previous section, Figure 5 illustrates how a land value tax creates compactness and density. In this graph, since a land value tax was brought in, the owner of the lot decides to sell the land to a developer who is going to build a residential unit. How does a land value tax help us reach our next objective of Smart Growth of being compact and dense? The graph from the previous section that shows the two tax rates on just the land is modified. Since a developer now has the land and is going to build on it we will add a scale for building value. A line will be added at the \$150,000 mark to represent the new building the developer constructs. What will happen to the property tax with a land value tax? As can be seen from the horizontal line, there is no change since the tax is on the land and not the buildings. However, as the sloping line illustrates, with the traditional property tax, where the tax is on both land and buildings, the tax rises to \$2720.

Figure 5

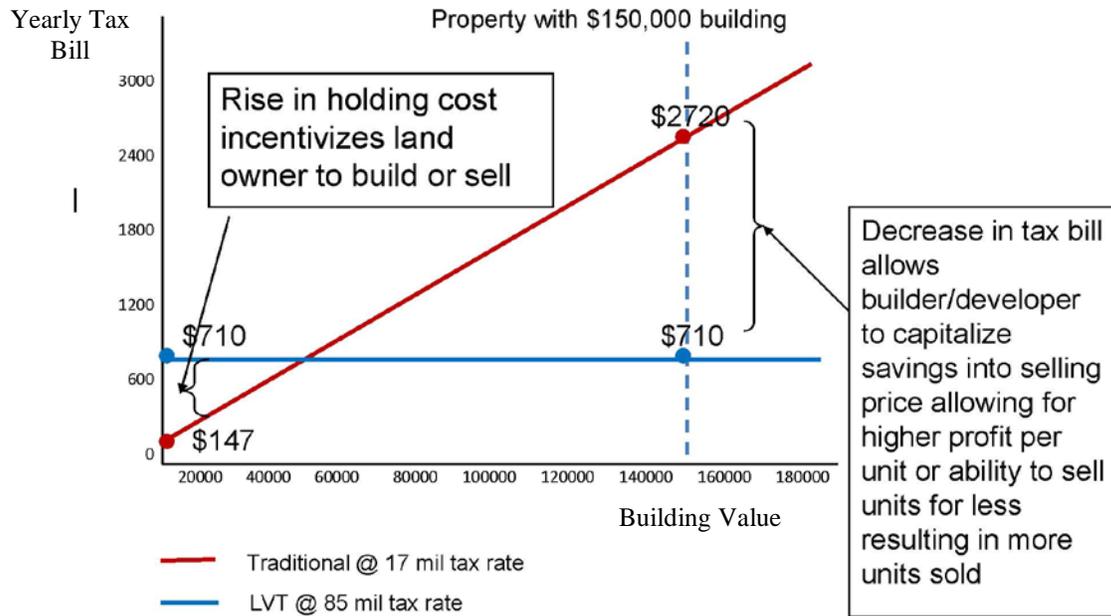


Figure 5 shows the incentive to build due to rising holding costs. It also illustrates that the decrease in tax bill will allow the builder or developer to capitalize the savings into the selling price allowing for higher profit per unit or the ability to sell units for less resulting in more units sold. This is very similar to a standard tax abatement given to developers for certain projects. Put more simply, there is a financial incentive for the builder to increase building density while decreasing lot size. If you are increasing building density while decreasing lot size, that is building compact and dense. This graph illustrates the core concept of a land value tax and how it supports Smart Growth development.

3. Affordable housing

A land value tax helps with affordable housing in two direct ways. The first is it

reduces the selling price of buildable land. As explained above, this is because land is fixed in supply. If builders can acquire land cheaper, in a competitive environment, this allows them to sell for less while still maintaining equivalent profit margins.

The second way LVT promotes affordable housing relates to the mortgage threshold to qualify for a home mortgage. Most bank mortgages combine the property tax and homeowners insurance in the monthly payment. Since LVT generally lowers the total property tax on well maintained buildings, this results in a lower monthly mortgage payment (as an example, in 2007 the Center for the Study of Economics did a study on the effect land value taxation has had on the city of Titusville, Pennsylvania, which adopted LVT in 1990. The study found that with an LVT 72% of residential properties now have smaller tax bills than they would have with a traditional property tax)²¹. In turn this brings more eligible people into the prospective homeowner pool. Sellers in the housing market are able to reduce home prices without a loss in their capital gains.

The ability of a land value tax to promote affordable housing is not totally agreed upon. Some authors believe that a land value tax is neutral at best in promoting affordable housing. They think that other programs such as regional fair-share programs, enforcement of fair housing laws, and preservation of existing affordable housing stock are needed to ensure affordable housing. Some studies have shown a land value tax on its own may actually be harmful to affordable housing objectives by replacing affordable housing stock with more lucrative development.²² In terms of the distribution of wealth, LVT may not only fail in correcting existing inequities, but it is likely also to exacerbate

²¹ “Recent Implementation Studies (2007 – 2010) Titusville,” Center for the Study of Economics, <<http://www.urbantools.org/research-and-studies/recent-implementation-studies-2007-2008>>

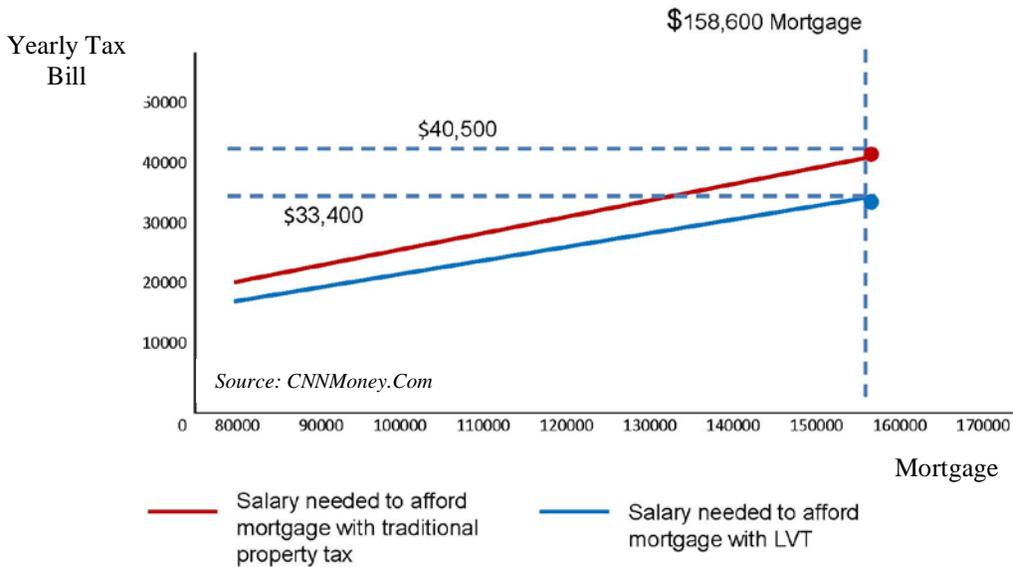
²² Betty Weiss, “Smart Growth and Neighborhoods.” APA Publication (5/1/2001): 21.

the concentration of wealth. The larger the LVT rate is made in an effort to have some land use impact, the more negative the results may be in terms of social equity.²³

(a) How a land value tax encourages affordable housing

Continuing with the \$150,000 house with the \$8000 piece of property from the previous example, if a homebuyer is looking to obtain a \$158,000 mortgage, what yearly salary would they need to qualify for this mortgage given both the traditional property tax and a land value tax? As mentioned above, this is also a mortgage that has the insurance and property tax payment rolled into it, which most lower income and middle income loans do. Looking at figure 6 below, with a traditional property tax the yearly salary needed to qualify for this loan is \$40,500. With a land value tax the yearly salary needed to qualify for this mortgage that has the property tax bill and insurance rolled into it is \$33,400.

Figure 6



²³ Wyatt 18-19.

This is a significant difference. With the land value tax, salary requirements to qualify for a loan decrease 17%. In supporting the Smart Growth objective of affordable housing, what a land value tax will do is help lower the monthly payment for many mortgages when the mortgages have the property tax bill rolled into it.

A land value tax supports affordable housing not only from the demand side, but from the supply side as well. Construction of multifamily and rental housing can be profitable for a builder or developer. Municipalities that successfully promote incentives for affordable housing are going to produce more multi-family and rental units, which are the core of affordable housing.²⁴ Affordable housing is not just beneficial for the tenants. These sites have the potential to provide a mix of housing opportunities, job opportunities, shopping opportunities and recreational opportunities all of which contribute to the formation of a community.²⁵ Tax incentives for affordable housing have a farther reaching effect than just making housing cheaper.

It is important to remember that housing is not only about affordability; quality is also important whether low income or middle income housing. One of the problems of the current property tax structure is it rewards absentee landlords who allow their rental properties to fall into a deteriorated condition. Financially speaking, this makes ‘slum housing’ or ‘slum land lording’ a highly profitable form of real estate investment.²⁶ LVT

²⁴ Ingram 24.

²⁵ Nicolaus Tideman, Professor of Economics, Virginia Polytechnic Institute and State University. “The Role of Taxes in Promoting Development on Derelict Land” <<http://www.urbantools.org/policy-papers/blight-and-development>>: 1.

²⁶ Bails 187.

can help alleviate this quality problem. With a traditional property tax, if the landlord makes any improvements, they are reassessed and their tax bill will increase. Conversely, if they allow their building to deteriorate, they will ask for a reassessment and their tax bill will decrease. While there is no direct financial incentive for landlords to maintain their property with an LVT, there is also not the financial incentive to purposely allow their properties to fall into disrepair. Landlords would not be rewarded for ignoring their property.²⁷

4. Create distinctive and vibrant communities

Creating distinctive, vibrant communities depends on encouraging the current neighborhood populace to take an interest and have pride in their neighborhood. Distinctive, vibrant communities often have the characteristics of traditional neighborhoods. There is a feeling of community among the residents. Neighbors know each other and there is a sense of a common goal in local matters. There is a commitment to neighborhood association. Most residents feel a connection to these types of neighborhoods and often wish to remain there. With a traditional property tax, if a neighborhood resident puts an addition on their home, they would see an increase in their property tax bill due to the improvement. With a land value tax, there would be less of an effect on the tax bill because the tax is on land and not on improvements.

With a traditional property tax if someone invests money in their home, or makes improvements on it, that person will pay a larger tax increase than with a land value tax.

²⁷ E. P. Tanzer, "The Effect on Housing Quality of Reducing the Structure Tax Rate." *Journal of Urban Economics* 17(3): 305-318 (1985): 305.

This not only keeps people from making large investments in their home, it is a disincentive to apply for a building permit to make small changes, costing the government money and possibly introducing safety issues since there is no inspection of work completed. With a land value tax, if people can invest in their houses while paying fewer taxes, they are more likely to do this. This in turn creates pride in the neighborhood and stability, since people that invest in their homes are more likely to remain there.

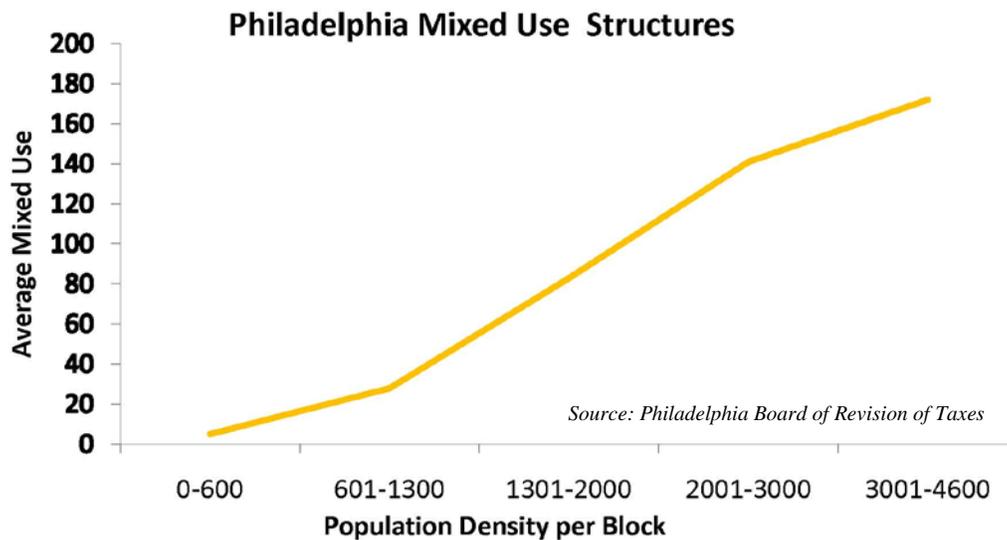
A second example of traditional property taxes being detrimental to neighborhood pride is in the area of rehabbing derelict homes. Many homes in older neighborhoods are attractive to younger professionals due to the architecture and character of these buildings. The business model of modern construction makes it difficult to reproduce homes or buildings with the same craftsmanship and attention to detail that can be found in these older homes and commercial buildings. Unfortunately, many of these fine older buildings have fallen into disrepair or have been abandoned. If someone wants to invest \$100,000 or more in renovating one of these older homes or buildings, the taxes on that property will increase dramatically. With a land value tax, home renovators can invest, live in the home and not be punished as severely for these actions with a large tax bill. Using a land value tax allows investment in neighborhoods without the corresponding large increase in property taxes, increasing the likelihood of more investment, and thereby allowing for the rehabilitation of many of these older buildings.

5. Create mixed use and walkable neighborhoods

A land value tax affects our last Smart Growth objective of being mixed-use and walkable by increasing the population density that generally draws retail. When we talk

about mixed-use and walkable we generally mean that there are retail stores that are within a short distance of living accommodations. An example of the relationship between density and retail or mixed-use can be seen in Philadelphia (figure 7). In Philadelphia as density increases the average number of mixed-use buildings per block increases. At 600 people per block there are zero mixed-use buildings, while at 4600 people per block there are about 170 mixed-use buildings. This is more of a common sense observation than an analysis. In an area that has large amounts of foot traffic, walkable retail and service industries will have the volume available to ensure adequate business.

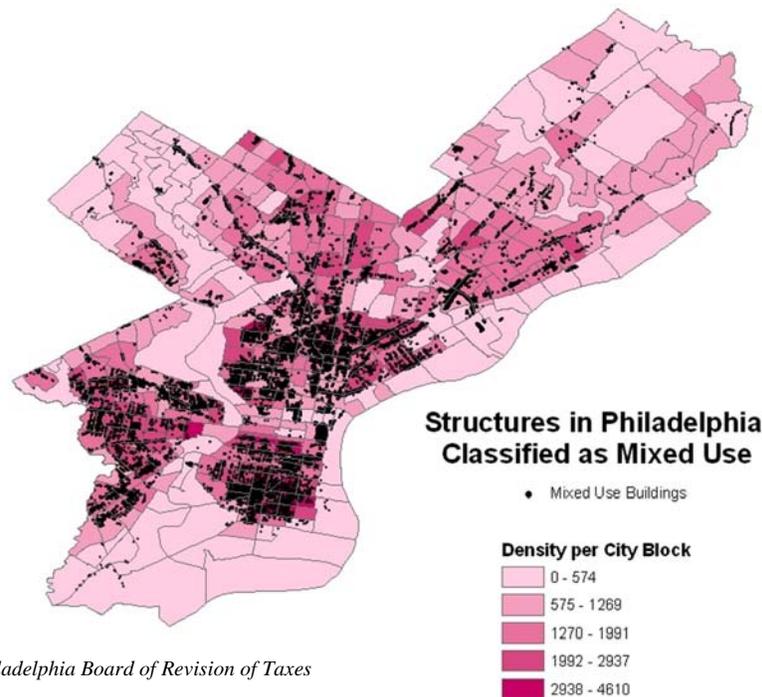
Figure 7



A second example is shown in figure 8. This map shows spatially how the largest concentration of mixed use buildings is found in the highest density areas of Philadelphia. In most cases in retail, it is the local demographics that determine the success of the business. While this map shows a correlation between density and mixed use, it cannot explain if or how one causes the other. Knowing that location decisions for retail

businesses are subsequent to customer dwelling decisions, it can be surmised that the density of the population is the determining factor in drawing mixed use retail. This gives the order of precedence in creating mixed use neighborhoods to developing higher residential densities and, with proper zoning, allowing the market to incorporate the retail businesses into that area.²⁸

Figure 8



Source: Philadelphia Board of Revision of Taxes

B. Transit Oriented Development

The second main objective of Smart Growth development relates to transportation.

An area where the role of LVT is being explored is in its role in promoting transportation

²⁸ Dr. Albert E. Myles, "Understanding Your Trade Area: Implications for Retail Analysis," Mississippi State University, Pub 2321 (2003).

options and supporting transit oriented development (TOD). Studies done on LVT's ability to promote transportation options revolve around the concept of land value capture, that land values are affected by government investment in public infrastructure. This is what causes most increases in value of private land holdings and is not the result of anything the landowners do themselves. The concept is that if the public, through their taxes, are creating wealth, then they should reap the benefits of this increased wealth. This captured value would pay for the capital improvements that the citizens, as a group, would enjoy the benefits of. LVT, since it is a land tax, is also a land value capture tool.

There are many advantages to transit oriented development. It has been shown to reduce traffic congestion, promote affordable housing, and create more efficient urban environments. The greatest beneficiary of TOD's is the real estate market surrounding transit facilities. Studies by Robert Cervero and Michael Duncan of the University of California, Berkeley have shown capitalization benefits of twenty three percent for a typical commercial parcel near a TOD and more than one hundred and twenty percent for commercial land in business district within a quarter mile of a commuter rail station. These studies are important to commercial developers and lenders as well as rail transit agencies that need to answer questions on assumed negative impacts associated with being near rail. These studies can also help in designing creative financing, such as value capture programs.²⁹

Unfortunately, with a traditional property tax, one of the benefits not taken advantage of is the ability of the transit system to pay for itself. Tax policy can be a major factor for

²⁹ Robert Cervero and Michael Duncan, "Rail Transit's Value-Added: Effects of Proximity to Light and Commuter Rail Transit on Commercial Land Values in Santa Clara County, California," Urban Land Institute National Association of Realtors (June 2001): 1.

transportation funding. Since transportation systems are a result of public investment, the increase in land value, should be captured and returned to the public from where the investment came. Taxed in this way, there would be less dependence on Federal, State, and Regional funding that is derived from income taxes. These taxes could then be used for other purposes. LVT is one of the methods available that can capture these values to be used to finance urban mass transit systems. “The tax in this case creates an incentive for households to locate in high accessibility urban areas, thus increasing their use of public transport services. Value capture taxation aims to create a financial tool capable of sponsoring public transport.”³⁰

In earlier times, pedestrian walking distances, streetcars and trains created the pattern of the early suburbs. This type of development pattern did not create the need for the massive public investment in infrastructure that is needed today. Now, the automobile has allowed new development to be spread out and without structure across the countryside, increasing the need for infrastructure investment dramatically.³¹ One of the main goals of Smart Growth proponents is to reverse or eliminate this trend. Expanding transport options, lowering transport pricing, and making transit nodes more attractive lessens single occupant car travel, lessens congestion, and increases trips by transit, biking, and walking.³² With a land value tax the rise in property values around a transportation hub can be captured to pay for the project or can be reinvested in further Smart Growth transportation projects. “Because American society needs to find new means to finance

³⁰ Francesca Medda, “Land Value Tax as an Investment Mechanism for Public Transport Assets,” UCLA (2009): 1.

³¹ Andres Duany, Jeff Speck and Mike Lydon, The Smart Growth Manual, (McGraw-Hill Professional, 2009) 3.1.

³² Ingram 58.

transportation capital investment, particularly public transit, value capture offers an opportunity essentially painless to participants, to achieve these goals”³³

C. LVT and the Environment

Many present tax and land use policies encourage consumption of land for low density uses, pushing back the boundaries of rural areas and encouraging urban sprawl. Sprawl has the effect of eliminating productive farming land while ignoring the benefits of urban life such as interpersonal contact, cooperation, and exchange.³⁴ LVT slows sprawl by encouraging density. Lowering the tax on structures will encourage more structures to be built on a given land area so the same population can be housed in a smaller area.

Other environmental benefits of a land value tax are, as with transit oriented development, it is a land value capture tool that can be used to finance open space and green projects such as parks. LVT’s use as a land value capture tool can be compared to tax increment financing where the financing comes from the projects themselves, rather than the general taxpayer.³⁵ This land value capture can be used to finance community projects or to support environmental projects that are important to the community.

When directed properly, tax policy is a valuable tool in preventing sprawl. Tax policies such as land value taxation need to be directed properly so they do not impede

³³ Batt, William. “Value Capture As A Public Finance Tool”
<<http://www.urbantools.org/policy-papers/transportation>>: 2.

³⁴ Bails 189.

³⁵ John L. Crompton, Impact of parks and open space on property values and the property tax base, (Ashburn, Va.: National Recreation and Park Association, 2000) 22.

other resources of sprawl prevention, such as land conservation. As with most strategies to protect the environment, the prevention of sprawl and protection of open space using tools such as land conservation and LVT must be planned and carried out comprehensively. Linkages between various Smart Growth policies, both legislative like land conservation, and financial like tax policy, are essential for the success of environmental protection.³⁶

II. LVT and Fiscal Impacts

In the current economic environment it is important to look at how any policy change will affect the revenues and expenditures of government. When looking at policy changes, such as LVT, attention must be paid to how the new policy changes the government's revenue streams and how much it costs the government to finance the program.

Smart Growth concentrates development in areas with existing infrastructure and pre-existing services. This provides major saving over development in greenfield areas that need new services installed. Since Smart Growth programs concentrate economic activity in areas that are already developed and try to control growth in undeveloped and rural areas, there is a major effect on fiscal revenues and expenditures. Questions remain as to what extent revenues from developed areas help pay for expenditures, and how the balance of revenues and expenditures compares between Smart Growth and other areas.³⁷

In order to ensure that over time revenue rises proportionately with additional

³⁶ Ingram 15.

³⁷ Ingram 28.

construction, frequent and accurate assessments need to be done so the increased land value can be used to offset the decrease in tax revenue from building. Under assessment or lack of timely assessment would lead to uncollected tax revenue which could strain public resources. As construction increases, land value in those areas will increase. The capture of this increased land value is necessary to pay for the extra public service responsibilities the municipality will sustain.

LVT brings efficiency factors to resource use and distribution. In a study done in Minneapolis, MN on the commercial sector, land values were the greatest barrier to cost-effective development of properties.³⁸ With a possible reduction of land prices from a land value tax, commercial investment would be deemed more likely if this barrier were eliminated.

A land value tax does not need any investment from the local government. It can be used to effectively stimulate downtown revitalization without the necessity of capital flow from public coffers. Conventional property tax increases, wage and occupational taxes, and special sales taxes are a deterrent to businesses locating in downtown areas. A land value tax can help mitigate the negative impact of other taxes without a loss of revenue from these other sources.³⁹

Since neighboring towns often compete against each other for development, only one town having an LVT in a region could cause neighboring towns to lose development

³⁸ Mark Haveman, "Evaluating the Feasibility and Burden Shifting Impacts of a State Land Value Tax on Commercial and Industrial Property." Lincoln Institute of Land Policy (January 2004): 21.

³⁹ Thomas Shepstone, "Land Value Tax: A Planning Tool?" <<http://www.urbantools.org/policy-papers/blight-and-development/Land%20Tax%20and%20Planning2005.doc/view>>: 4.

opportunities. Regionally speaking this would not improve the area since you are just moving development from one area to another. This is a similar situation as happens in economic development in which municipalities in the same region compete for relocation of a business. Regionally speaking this is simply dividing the 'pie' in a different manner rather than increasing the size of the total pie. To avoid this it may be preferable to promote LVT on a regional basis. This happened in Southwestern Pennsylvania where McKeesport enacted a land value tax in 1980. McKeesport had apparent success with this change so the neighboring towns of Duquesne (1985) and Clairton (1989) adopted the land value tax as well.

Administratively, implementing a land value tax is fairly straightforward and simple. Almost all taxing jurisdictions value land and improvements separately; so the methodologies to value land and improvements separately are already in place. A version of a pure land tax could be implemented by simply excluding the value of improvements from the tax base. To implement a split-rate version of a land tax, a jurisdiction could simply apply a lower tax rate to the separate value of improvements.⁴⁰ The cost to do this would be relatively insignificant given most other major policy changes. Costs involved would be labor in changing forms and software and other administrative expenses. There would be no 'growing of government' since a land value tax does not necessitate any additional labor in its management than what is common for a traditional property tax.

⁴⁰ Dye 154-155.

III. Issues with a Land Value Tax

Studies have described the benefits of a land value tax. This brings up the question of, if land value taxation is such a good idea, why haven't more jurisdictions adopted it? The answer to this question is related to the following four key issues:

Taxation of unrealized capital gains: The property tax in general is an unpopular tax, largely because it is a tax on wealth rather than current cash flow. The property's value increases raising the tax on it, but the owner does not receive this benefit until the property is sold. In the meantime they still need to pay the higher taxes out of their monthly income.

Land value assessment and rate setting: Land value taxation requires accurate land assessments, which can be more difficult than assessments of total property value. It also requires a more complex rate-setting process that is outside the normal procedure for assessors. With a traditional property tax the total is the important number and how it is divided is unimportant. With a land value tax, the division is very important.

Too much development: Without proper zoning, land value taxation can result in side effects in the form of too much dense development or failure to preserve valuable buildings or sites. Bad appraisals can heighten this problem.

Winners and losers: Changing from a property tax to a land value tax creates winners and losers and therefore raises concerns about fairness. This can contribute to political confrontations between those who support and those who oppose land value taxation.

Lack of understanding: Finally, and perhaps most importantly, the land value tax and its benefits are not well understood by elected officials and citizens at large.⁴¹

⁴¹ Dye 195-196.

Other concerns include the market, which is the main factor in determining if construction is economically profitable or not and whether a developer will build or not. There may be little or no demand for new or renovated buildings, meaning that lowering the tax rate on buildings will have little or no effect on the amount of development. It will, however, cause the land owners to feel that the property tax is particularly burdensome. If the land value tax is adopted with the unrealistic hope of developing an area that has no market potential, the only thing a switch from a property tax to a land value tax does is redistribute tax burdens without any efficiency gains.⁴² What this means is you can influence the market, you cannot dictate to it. There are other factors involved: the market, political will, community buy in, the macro economy, etc.

Lastly, one of the problems with broad research is there are often large data sets looked at that are extraordinarily broad, with much differentiation that are averaged together to come up with one answer. In reality there may be several answers. There are also factors that are held out of the study or that are ignored. This is what the economists call *ceteris paribus*, which is a Latin phrase that translates approximately to "holding other things constant" or "all other things being equal". The term is used as shorthand for indicating the effect of one economic variable on another, holding constant all other variables that may affect the second variable. Since some studies are looked at in this way, the conclusion reached is a general answer that shows the tool looked at will work in most towns. However, sometimes a town is not average. It appears that while LVT may be perfect for one town, another may have features that make LVT a bad fit.

The important point to remember is that all towns are different; you need to do a study. Most towns will benefit from LVT but some won't. You need to look at the impact on each municipality individually to determine the effectiveness of any tax structure changes. In the next

⁴² Dye 207.

section, the issues of implementing a land value tax system are explored.

Part 3 – Implementing a Land Value Tax

I. LVT and Zoning Regulations

The broad goals and objectives of Smart Growth are accomplished through the implementation of local land use ordinances. Land value taxation is an economic incentive to Smart Growth while zoning regulations are the legislative framework of Smart Growth. The previous section dealt with how LVT would function in a typical situation. Here, the other factors involved in how well LVT performs, specifically zoning and regulations, will be examined. These factors need to be addressed in any LVT analysis. The following section looks at which zoning and regulations best complement an LVT tax structure. Since LVT and zoning must work together, the zoning code must have ordinances that are consistent with the economic incentives of Smart Growth. Before any economic incentive can be enacted that encourage development in a Smart Growth manner, the laws and regulations must allow development in a Smart Growth manner.⁴³

There are many zoning and regulatory strategies. Not all of them support Smart Growth objectives and in extension a land value tax. Basic questions as to density, setbacks, use codes, and height restrictions can all have a major impact as to the success of a land value tax in supporting Smart Growth objectives. We will look at zoning, ordinances, and the regulatory environment to see what regulations support LVT and Smart Growth and which will increase the probability of LVT being successful.

⁴³ John Nolon and Patricia Salkin, Land Use in a Nut Shell, (St Paul, MN:Thomson/West, 2006) 197.

A. Zoning

The most widely used tool for achieving Smart Growth is the local zoning law.

Through zoning, new development can be restricted to specific areas, and additional density incentives can be offered for areas where appropriate. Zoning can also control the amount of parking required to be built with new development, and can be used to designate land to be set aside for parks and other community amenities. While other tools used by planners, such as sub-division regulations, are important, zoning is one of the more flexible land use tools available to planners.

For a land value tax to be effective there are several congruent factors that are important. Zoning that is supportive and complementary to the goals of Smart Growth need to be in place. Lacking the proper zoning, there are no economic incentives to shape development available that will be effective. Giving a developer a profit incentive to build in a planned manner has no benefits if the law disallows building in this manner.

Enacting LVT to accomplish Smart Growth objectives requires a zoning plan that is supportive of Smart Growth objectives. This means zoning that supports compact, mixed use, walkable, distinctive communities, high density, and ranges of housing opportunities; all while preserving open space, parks, and environmentally sensitive areas. In addition, it means zoning that is sensible, easily understood, and easily administered.

An important requirement for Smart Growth zoning is flexibility, the ability to adapt to the variations of Smart Growth. Flexibility also means the ability to adapt not just to community requirements, but to developer requirements. The following seven zoning types, from the Conservation Law Foundation & Vermont Forum on Sprawl and John

Nolan and Patricia Salkin's "Land Use in a Nut Shell," fit this description. Depending on the local context, some or all may be appropriate to include.

(1) Inclusionary zoning

Inclusionary zoning is used to create affordable housing. It simply dictates that a certain percentage of housing in an area needs to be affordable. LVT would be beneficial to this type of zoning since a land value tax encourages density and lowers qualification limits for homebuyers.⁴⁴

(2) Overlay districts

Overlay districts are areas with uniform requirements that are superimposed over one or more zoning districts.⁴⁵ An overlay district is a specialized use, so LVT would have no effect on it. Since an overlay district is a flexible zoning technique that allows a municipality either to encourage or to discourage development in certain areas, this type of zoning could be used to protect areas from the intense development brought about by LVT.⁴⁶

(3) Cluster zoning

Cluster zoning allows a municipality to have development directed to just a portion of a parcel and the rest remain undeveloped open space. These are often used to reduce the

⁴⁴ Conservation Law Foundation & Vermont Forum on Sprawl, "Community Rules: A New England Guide to Smart Growth Strategies," (2002): 77.

⁴⁵ Conservation 78.

⁴⁶ Nolan 218.

cost of housing, to preserve environmental feature, to reserve land for recreational purposes, or to preserve open space.⁴⁷ Cluster zoning would work well with LVT since density is one of the main factors LVT encourages.

(4) Performance zoning

Performance zoning regulates development not by using traditional dimensional and use standards but by reference to performance standards that measure the impact of a development on a particular site and area.⁴⁸ This type of zoning encourage mixed uses, provided that their impacts do not violate previously established standards (e.g., for noise, traffic, signage, etc.).⁴⁹ LVT is a good fit for this type of zoning; many of the objectives are the same.

(5) Floating zones

A floating zone permits uses—such as an office complex, a research laboratory, or multi-family housing—that the community wants to encourage.⁵⁰ A land value tax would be successful here. It would help encourage development of popular community investments.

⁴⁷ Nolon 214.

⁴⁸ Nolon 217-218.

⁴⁹ Conservation 79.

⁵⁰ Nolon 222-223.

(6) Traditional neighborhood zoning

Traditional Neighborhood Development (TND) allows for the development of mixed-use neighborhoods where housing types are varied, retail and commercial services are available within walking distance of residences, public green space is provided, visual and recreational amenities exist nearby and pedestrian and bicycle travel is actively encouraged.⁵¹ This zoning type would complement a land value tax. Their focus on mixed use and varied housing types would work in parallel to achieve both objectives.

(7) Planned unit development

Planned unit development (PUD) zoning provisions permit large lots to be developed in a more flexible manner than is allowed by the underlying zoning. PUD ordinances typically leave the underlying zoning in place and offer an alternative to landowners to develop the site in accordance with the PUD provisions.⁵² This type of zoning allows for great flexibility. It would allow the community greater control over what was built while still allowing for flexibility and creativity from the developer.

B. Comprehensive nature of Smart Growth planning

“To accomplish smart growth, government must take two related actions. The first is the designation of discrete geographical areas into which private market growth pressures are directed. The second is the designation of other areas for recreation, conservation, and

⁵¹ Nolon 225-227.

⁵² Nolon 228.

environmental protection.”⁵³

All of these zoning types, by themselves or in combination, are supportive of many of smart growth’s objectives. The list is not meant to be comprehensive and there are other zoning strategies, including more traditional zoning, which can be used to support LVT and smart growth. It should also be mentioned that LVT is not dependent on these zoning types. Other zoning strategies can be used; they may not be as effective in promoting Smart Growth objectives as the ones mentioned. A land value tax is not a stand-alone tool. For proper development to take place, other tools in the development process need to be integrated into the system. Developers must be able to form reasonable expectations regarding future market conditions and development environments. It should also be remembered that the public’s opinion on growth are likely to affect future development more than other factors.⁵⁴

As mentioned earlier, Smart Growth is comprehensive. Comprehensive planning is what makes Smart Growth work, but it is also what makes it complicated and difficult to achieve. One of the main obstacles in realizing this comprehensiveness is the separate responsibilities of the different departments involved in city government. It is difficult to get these separate actors to work in concert. Often the priorities of one are not the priorities of the other. In order to be successful, however, that is what must happen. The plans that will work the best and be the most effective are those that integrate and include all the separate department and areas of land use - economic, zoning, and regulatory.

⁵³ Nolon 197.

⁵⁴ Ibid.

II. How LVT Fits In with Other Economic Remedies

LVT is not the only economic remedy available that can be used to support Smart Growth development. Other more established remedies include tax abatements, tax increment financing (TIF's), and business improvement districts (BID's). These alternative remedies are more focused and not as broad reaching as LVT. Because of this, they can be used as an addition to LVT where it is desired that development be concentrated to a specific area in a municipality, such as the main street or central business district. These complements to LVT are listed below.

A. Abatements

Tax abatement is a tool used by local government to attract private investment and job creation by exempting all or a portion of the new or increased assessed value resulting from new investment from the property tax roll. In most cases the granting of tax abatements will reduce the amount of property taxes paid by the owner over the full abatement period. A land value tax, by nature, is a type of tax abatement on structures. The difference between the two is a standard abatement is directed to a smaller area than an LVT and its application is usually restricted to larger businesses.

B. Tax Increment Financing (TIF)

TIF's are primarily used to pay for public investments or improvements (i.e., water and sewer lines, streets, lighting, parking lots, land procurement, etc.) needed to attract economic development or retain businesses that want to expand. A TIF keeps the assessed valuation of all parcels in a designated area (the TIF district) from increasing.

Property taxes levied on this frozen tax base then continue to accumulate. The accumulated taxes from the increases in assessed values (the tax increment) can then be used to retire any debt the TIF authority acquired from the public investment or to encourage future growth in the district. When using TIF, a local government identifies an area within which it pledges to use all increases in property tax revenues generated from new development to support infrastructure improvements.⁵⁵ TIF's, like abatements, are generally directed toward a specific area that is being developed. They differ from a land value tax in that the accrued revenue is reserved for specific uses.

C. Business Improvement Districts (BID's)

A business improvement district is like a special-purpose zoning or taxing area, but it is organized by the businesses. It gains legal form through a majority of the businesses voting for its existence, after which it must be enacted by ordinance. The taxes are then collected by the municipality. These funds can be added to by securing public grants and can be used for a variety of local improvement purposes such as cleanup, enhanced pedestrian and transportation projects, heavier police presence, marketing programs, and building façade improvements.⁵⁶ Business improvement districts are a unique complement to a land value tax. In a business improvement district, the taxes are paid by property owners of the district and the revenue is invested in that district.

⁵⁵ Joyce Man and Mark Rosentraub, "Tax Increment Financing: Municipal Adoption and Effects On Property Value Growth," Public Finance Review 26; 523 (1998): 523-525.

⁵⁶ Edward Blakely and Nancey Green Leigh, Planning Local Economic Development, (Thousands Oaks, CA: SAGE Publications Inc., 2010) 243.

D. How an LVT compares with other incentives

A land value tax is not a standalone concept but can be combined with other economic incentive programs. Using a combination of economic incentives with LVT as the base can have strategic advantages. A land value tax is a general tax that covers an entire taxing district. Abatements, TIFs and BIDs are targeted to precise areas and certain businesses. BID's usually help small businesses leverage resources against large retail and shopping malls. Depending on the priorities for the district, a land value tax can be used in combination with other incentive programs for greater effect.

Abatements, TIFs, and BIDs have negative aspects associated with them that are not found with a land value tax. Abatements are only temporary, most not lasting longer than ten years. Once this period is up, the business has a strong incentive to relocate, which often happens. LVT is permanent so businesses are encouraged to stay. If expansion or growth is wanted, the business has a financial reason to stay in the area. TIF's and abatements are often targeted to bigger business. Small businesses have to pay the full tax burden. For many communities the small business is the main supplier of jobs and revenue. A land value tax supports the small businesses as well as the large. This makes it fairer and more inclusive.

III. State Enabling Legislation

In many states it is questionable whether it is legal or not for a municipality to institute a land value tax. It is necessary for a municipality to have legislative authority from the state to have this tax. Property tax laws are written into state constitutions. Most states are Dillon's rule states where state law has preeminence over local government, so

municipalities are limited to how they can enact property tax laws. State governments generally have the legal federal authority to tax real property. To allow a municipality to enact a land value tax the state must either have enabling legislation in the constitution authorizing a tax on real property, or through a provision, establish the general taxation powers of the state.⁵⁷ A land value tax is implemented at the municipal level. In all circumstances in the U.S., the state has to have legislation in their constitution or codes allowing a municipality the flexibility in their tax law to implement an LVT. For states that do not have this flexibility in their tax laws, they would need to petition the state and receive legislation to allow for this type of property tax.⁵⁸

There are clauses in many state constitutions requiring tax laws be applied in a uniform manner. This may cause a problem since with LVT land is taxed at a higher rate than the buildings on that land.⁵⁹ Non-uniformity clauses in the state constitution can prohibit a municipality from instituting a land value tax. Adoption of exemption and classification provisions can be used to fix many of these constitutional issues.⁶⁰

The legality of implementing a land value tax in the varying states is not clear. As Richard Coe wrote when addressing the question of what legal obstacles a state may face when trying to do this “the answer is a resounding, ‘it depends’.”⁶¹ . In those states, like Pennsylvania where the tax has been used for decades, there is no question as to its

⁵⁷ Dye 131.

⁵⁸ Dye 23.

⁵⁹ Dye 23.

⁶⁰ Dye 24.

⁶¹ Dye 155.

legality. Other states that have not had a land value tax but have a constitution allowing it would have to institute it and see if it is challenged. Those states that have strict uniformity clauses would need a change or amendment to their constitution. These would be the most difficult states to adopt a land value tax.

No matter how difficult the barriers to legalizing a land value tax, any state can pass a constitutional amendment allowing for LVT. Some lawyers think there could be a challenge based on the equal protection clause in the US constitution, but most experts agree it is not likely that this would be upheld.⁶² For any state, passing a constitutional amendment would be a solution to any of the problems or issues involved in legalizing a land value tax in the state. The difficult part of passing a constitutional amendment would be convincing the public that a land value tax is that important.⁶³

⁶² Dye 138-139.

⁶³ Dye 156-157.

Part 4 - Conclusion

A. How a land value tax support Smart Growth

A land value tax helps promote and support principal Smart Growth objectives. A land value tax promotes the objective of infill development by creating a disincentive to hold empty lots. This is the result of the increased holding cost from the higher taxes, freeing lots for building. Since land is fixed in supply this has a tendency to lower the selling price, bringing the price more into line with its true market value.

Second, it promotes compactness and density by producing more efficient consolidated units with an incentive to build upward with more units. This is caused by the increased tax on land combined with the decreased tax on buildings resulting in the economic incentive to construct more building on less land.

Third, it helps with affordable housing since lower incomes can qualify for a loan. By decreasing the property tax, LVT lowers the monthly payment required by banks when property taxes and insurance are part of the payment. Mortgage calculators show the decrease in yearly income needed to qualify for a mortgage.

Fourth, it helps make communities more distinctive while instilling pride in neighborhoods by allowing investment in homes with smaller tax increases. Homeowners can build additions, improve their houses, or renovate run down dwellings without being punished with as large a tax increase.

A land value tax makes neighborhoods more mixed-use and walkable since density draws stores and retail. It also supports transit oriented development through its ability to act as a land value capture tool. Using land value capture allows project expenses to be

paid for through the capture of the resulting rise in land values. And lastly, while not as effective as other program in protecting the environment, it has been shown that with proper zoning and regulations, LVT does not reduce open space or impact the environment negatively.

Much of the literature agrees with the view that a land value tax supports the objectives of smart growth. When compared to a traditional property tax it has been found that LVT has distinctive economic benefits and, when combined with proper zoning and regulation, complements Smart Growth objectives. Studies have shown evidence of LVT channeling housing and building into urban centers. This helps areas become more public transit and pedestrian oriented with walkable neighborhoods and livable communities.

The most compelling arguments against LVT involved the difficulty politically in enacting a land value tax. Some authors believe that private and public sector responses to a land value tax would be relatively hostile. These authors believe the theory is correct behind a land value tax and that it would accomplish all it claims to. Their doubts are whether or not politically it would be possible.⁶⁴

While the data is not as robust as would be preferred, there does seem to be a strong argument for land value tax implementation in municipalities interested in Smart Growth development and that land value taxation does support the objectives of smart growth. If a land value tax can be implemented in a greater number of municipalities, more data will be available to better understand the effects of LVT on a municipality and how effective it is in supporting the objectives of smart growth.

⁶⁴ P. S. Kochanowski, "Site Value Taxation in a Declining City," American Journal of Economics and Sociology 50(1): 15-58 (1991): 55.

B. Planners and economics

In the last couple years there has been a major shift in the economy. Investment in building and construction has dropped dramatically. During the building boom planners across the country needed to focus on uncontrolled development on previously pristine farmland and woodland. Today in many areas, stimulating development has overtaken the containment of sprawl as the primary focus. The focus has changed from overheated growth to the opposite problem of stagnant and shrinking growth. This change in strategy has resulted in a change in the tactics of planners. Where controlling growth involves legislative and regulatory tactics, stimulating growth involves economic and fiscal tactics.

Unfortunately, planners often aren't that knowledgeable (or aren't as involved in) economic and fiscal decisions as they should be. This leads to a lower level of knowledge on the subject. In this economic climate, those issues need to be addressed and planners need to have a better understanding of economic issues. Planners too often act as if land planning is not related to land economics. They have a tendency to believe that they can control land economics with planning, when in most cases just the opposite is true. Planners need to become more knowledgeable in land economics and taxation, using that knowledge to support elected officials and their departments in devising plans that support the public's needs while doing so in a fiscally responsible manner. The land value tax is a tool that has the potential to be a predictable source of revenue for public needs while being a fair and inexpensive process to administer.⁶⁵

Once planners recognize the value of fiscal policy in promoting their goals, another

⁶⁵ Shepstone 3-4.

tool will be at their disposal. Policies can be put in place so that when development does begin to occur again, it can be readily directed to the areas preferred by the community.

C. A land value tax works

Every town is distinctive and needs to customize their plans and programs to their unique needs. LVT has the ability to suit those town's unique needs. Its strongest points are; it has a record of success where implemented, it involves minimal costs to administer, it can be phased in over time and at various split tax rates, and it can be employed with and complement most other planning programs

A land value tax can be used with main street programs, elm street programs, tax increment financing, abatements, vacant property registration, and land banks. It can complement suggested best practices such as those proposed in the Pennsylvania Revitalization Desktop Guide. It can be used with open space initiatives and agricultural preservation programs. LVT works at all levels of government and private enterprise, from low income to higher income, and from small business to corporations. This is why LVT is unique when compared to other incentive programs. Most other programs are limited and narrower in focus.

The concept that LVT is a powerful tool for the implementation of Smart Growth strategies is fairly easy to see and defend. It is supported by data from cities that have a land value tax as well as case studies and models. It's being straightforward and easy to implement help make it intuitive and not difficult to understand.

A common criticism of planners is that in their pursuit of Smart Growth objectives, economic or tax solutions are only superficially addressed. With planners when essential

economic issues are addressed, they are done so in a shallow, periphery manner.

Attention to economic concerns should include consideration of economic development, job generation, and in creating land use demand. Planners must more deeply understand how tax policy drives land decisions, job generation which affects adequate housing, and how tax policy can be used to plan for, build, and finance infrastructure in a timely and cost effective manner.⁶⁶

For planners, the hard part may be in understanding the new economic realities. The importance of knowing where the money is coming from, and how this is a leading factor in project approval. Having confidence in the ability of a land value tax in promoting good planning and Smart Growth objectives should be easy. The main impediment may be the difficulty in educating those in government, planning, as well as the public on those benefits. If this can be accomplished, states like Pennsylvania that have enabling legislation can make a land value tax a cornerstone of urban governance, while states that need constitutional amendments to enact LVT can begin the legislative procedures to get a land value tax implemented, prior to its use in the cities that will benefit.

⁶⁶ Meck A-9.

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