

LAND PLANNING AND THE PROPERTY TAX

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Summary by Editor:

Since present types of local property tax laws and assessment procedures often frustrate the real estate market and private renewal, one promising approach would be to change from a building-based tax to a land-based tax. Not only would this free up the market, it would also give public planners more leverage in guiding private development, thus expanding their effective powers of implementation.

Land planners concern themselves with the relations among the uses to which independent private owners put their land. These private owners mostly seek to maximize their individual net welfare after taxes. Since taxes are a large fraction of all costs, after-tax welfare is quite different from before-tax welfare. So public land planners seeking to influence private landowners must perforce be tax planners.

Land planners generally have been tax planners in at least a passive sense: their expectation of private response to public initiative has been based on experience, which in turn reflects landowners' tax avoidance. Some planners have grumbled at individual tax avoidance, as though it were immoral and should go away-not a very realistic approach.

Others have sweepingly condemned the entire market mechanism - a "rush to judgment" that might be tempered when we consider to what extent the malfunction of the market results from avoidance of ineptly imposed tax costs. Still others have supported land underassessment to relieve the pressure to develop suburban land-without, I believe, adequately considering that unused land lies among used parcels and disrupts their symbiotic interactions, which are the heart of public land planning and the essence of urban civilization.

Yet others have foundered by expecting private landowners to respond to, and fill in, the empty niches in grand plans

much more rapidly than the Great American Land Speculator is wont to do.

To be most effective, land planners must become positive tax planners. Collectively, they need to support national reform of the income tax as it bears on land development. Our theme here is what they can do locally through property tax laws and assessment procedures. Tax reform can help the market help the planner. What is good for the market is generally good for planning. Land planning amends and guides the market-it is not at war with the market. On the contrary, effective public land planning presupposes a well oiled land market.

Planners and the Land Market The planner, through his influence on zoning, street layout and other public constraints, presents each landowner with a sort of environmental challenge: he hopes the landowner will respond constructively. The planner provides avenues of linkage by which landowners may relate to one another: he hopes they will use those avenues. The market motivates them.

On the whole, the highest use of a site is that which most relates to and complements uses on other sites. This is what cities are all about. Planners are often preoccupied with minimizing conflicts between neighbors, which calls for minor departures from the most lucrative use; but conflicts must not blind us to the overriding value of symbiosis among neighbors. This is the first concern of land planning; it is also the first concern of the self-helping landowner.

The worst nuisance a central landowner can commit is passive withdrawal of his land from the life of the city-right where it gets in everyone's way. The market, if he listens, tells him to participate instead. Taxation may be used to nudge the market a little this way or that, but the first concern of tax reform is to unleash the market to do its constructive work. Anecdotally

Capital and people compactly grouped, and with good mutual access provided by quality planning, interact synergistically to produce a large surplus above cost. The whole is greater than the sum of its parts: that is

synergism." Planning and the market work together to maximize synergism.

Another function of the land market is in the development of new areas, or redevelopment when new uses succeed old, to synchronize interdependent private investments that interact synergistically to produce a total community. Thus as a city expands, high land values at the perimeter put simultaneous pressure on all owners there to convert to urban use.

were this mechanism in good working order, planners could extend city services to compact increments of land, initially sizing utility lines and streets for ultimate demand, secure in the knowledge that the ultimate demand would be there in short order. Private builders could orient their plans to a more certain future, minimizing transition costs of, for example, shifting from wells and septic tanks to public water and sewers. Every private improvement could be less self-sufficient and more oriented to the prospect of a total community.

But the market is not in good working order. Taxation intercedes in every land use decision. Every piece of land is periodically mobile among uses-when there is some "sacrament" in its life, such as demolition and construction, sale, subdivision, or assembly.

It is then in press among competing buyers, uses, densities, timings, parcel sizes, and so on. In every such press, taxation biases the choice in favor of the lighter taxed use. The real estate tax on building thus always favors old over new; gas stations over apartments; junk yards over factories; parking lots over parking structures; high income residences over low (high income residences are usually less intensive because of larger lots in neighborhoods of higher land value); billboards over offices; unused over improved land; waiting over acting.

This bias has half-destroyed the market as an arbiter among competing land uses, and an agency promoting urban synergism. It has lowered the density, retarded renewal, and broken up integral linkages of the central city, fostering in their place random scattering of new buildings at the outskirts.

It has so far impaired the city's function of linking small independent industrial firms as to bear large responsibility for today's galloping merger movement in which a key word is-synergism! Firms seek through merger and vertical integration the access to services, labor, and supplies which in a well ordered city they could get from independent firms through the market.

Tax Base Redefinition I do not propose that we eliminate taxes. The public needs money. I do submit that it is not necessary for real estate taxes to impair the market. The method is to modify the definition of the tax base.

It is not new that we can foster a particular thing by subsidizing it, or just leaving it alone when other things are taxed. It *is* new to note there is a way to tax something and not damage it. We can even tax something and, by taxing, foster and promote it.

Tax capital and you drive it away; tax land and you drive it into use. The technique is to redefine the real estate tax base as land value alone. Value at any time is what the land if bare would sell for. It is value in the best alternative use, the economists' "opportunity cost." It is independent of present use or ownership. It changes year by year, usually gradually as demands and neighborhoods change, or as anticipated public improvements, long since foreseen and discounted into values, are completed. It is very dependent on the things that planners plan and is in large part the product of good planning and implementation of planning Alfred Marshall called it "the public value of land," in reference to its origin.

A proper assessment of land changes in step with the outside determinants, ignoring the specific response that individual landowners make to the environmental challenge. They are taxed not for improving their opportunities, but for having and holding them; not for what they do themselves, but for the good things that planners do for them.

Private Renewal Problems The real estate tax modified in this way would help planners with many problems that now seem intractable and foreboding. I will focus on one, the problem of slow urban renewal. Few would deny that the market has failed to renew our cities fast enough. For this the real estate tax, bearing differentially on new buildings, must shoulder much of the blame.

The economical time for an individual to clear and renew land is when the current cash flow from existing or "defender" use ceases to yield a fair return on the "scrap value" of the site in the most eligible succeeding use (the value of future income less the present value of future costs).

The land-based tax is neutral in this decision, because it is unmoved by renewal: It is the same on the defender as the challenger. The building-based tax is unneutral because it rockets upward when new succeeds old. It weakens the challenger vis-à-vis the defender, by the amount of tax increase. Not only is the new building valued higher than the old: often assessors seize this occasion to reassess the land upwards, adding to the bias against renewal.

The general qualitative direction of the bias is clear - I have said that before. Quantitatively, the number of years during which building taxes retard site renewal depends, among other things, on how the cash flow from old buildings drops off. If it plummets steeply, then renewal dates are preordained by nontax factors, and tax policy is unimportant. If it tails off gradually, a substantial tax bias against new buildings retards the renewal of each site regarded individually; and of neighborhoods and school districts even more, as the nonrenewal of each site robs neighboring sites of their renewability, and suppresses competition from new buildings which would pull tenants from old defenders.

A number of time series showing historical income experience of commercial buildings have been compiled and published by Leo Grebler, Fred Case, and Louis Winnick.² I have deflated them for price level changes. They are much

affected by cycles of depression and war. The general time pattern and period of dropoff is clear enough, however. Real income from old buildings dwindles away slowly over many decades, in spite of depreciation and obsolescence. There is no sharp cutoff, no predestined date of demolition determined by technology or taste. Even when an old building has gone vacant, it may come back. After world war II, real income of many buildings rose sharply.

Another source of data is the Institute of Real Estate Management "Experience Exchange" among members of the N.A.R.E.B. In 1967, their 1,069 respondents reported on operating ratios (total expenses including real estate taxes divided by total actual collections) for apartment buildings classified by age groups. For elevator apartments the ratio rose gently from 45 percent for 1961-66 birthdays to 59 percent for all buildings over 47 years old, that is, pre-1920.4 For low-rise apartments it was from 41 percent to 58 percent; for garden apartments from 40 percent to 48 percent. In other words, almost half the gross collections from old apartments represents net income to the owner. A powerful factor helping hold down these operating ratios is that real estate tax expenses keep falling as a building ages.

Measured in years, therefore, the fiscal deterrent to urban renewal—the threat of increased taxes on new buildings—retards by decades renewal of the individual urban site. I could give you a precise number of years, using Milwaukee's present real tax rate of 4.0 percent; but it would be a false precision, since it would be based on the individual site in isolation. Let us look at the extended effects on neighborhoods.

New Building Impacts The renewal of one site speeds the renewal of nearby sites in at least three ways. First, it raises the renewal or challenger value of nearby land. One new building gives heart to potential builders of others, who naturally prefer new buildings for neighbors. Slum environs can virtually destroy the renewal value of land—a problem often noted. One or a few sound new buildings as inspiration can support supplementary and complementary renewal round about.

The new GM building on 5th Avenue is reported by *Fortune* to have doubled floor space rentals across the street. Once a new, neighborhood or city or region gets well started, renewal snowballs because people like to locate near their customers, contacts, suppliers, workers, and friends.

This, of course, raises the negative possibility that new buildings strengthen adjacent defender values as well as challenger values. There are frequent complaints that successful urban renewal projects, for example, raise the cost of nearby land for the next project. However, these higher land "costs" are merely *asking* prices and may be based on higher anticipated challenger values, plus the knowledge that federal funds are on tap to buy. They do not in general represent higher defender cash flow nearly as much as challenger values.

The reason is that new buildings pull tenants from old, in general weakening defenders. This is the second way that renewal reinforces itself. It is especially true when the new buildings are at higher density than what they replace—something which building taxes also discourage—and represent net new supply. Where tenants have a choice they move to newer quarters. The oldest defender filters down to be demolished. Its successor then pulls tenants from others, repeating the cycle. In the right conditions the reverberations from one new structure resound through several rounds of induced renewal.

Milwaukee's progress during the last eight years represents the ramifying effects that may flow from one new building. Through a series of historical accidents and legal technicalities, Wisconsin had an assessment freeze law that proved unconstitutional after being used essentially just once, in 1960, for the Marine Plaza—a high rise office and bank building. It was the first downtown building of consequence in thirty years. It pulled tenants from other buildings, forcing a wave of remodeling and renewal, still in progress, which has changed the face of downtown Milwaukee. By general account, this one new competitor set off the chain reaction. There is a multiplier the like of which few other economic processes approach. Perhaps the time was unusually ripe, but that is mere hypothesis. The facts are there, and they speak volumes.

It is not that this one stroke alone was enough. The ripples are dying out, long before the job is done, but the point is if one original cause can ramify so far, even though every induced new building was fully taxed, twenty original causes would transform a city, if every induced new building were to be tax free.

A third way that renewal reinforces itself is through the higher income that it brings. Renewal means capital inflow, construction payrolls, material sales, new jobs, and so on. This pushes up local income levels. Now new buildings are "superior goods." The higher the local income, the greater the premium paid for new over old floor space, and the stronger are challengers relative to defenders.

So neighborhood and aggregate effects multiply the good done by each new building; conversely, of course, they multiply the damage from the present tax policy, which defers renewal.

But neighborhood effects are not the whole of the story of multiplied effects from taxing challengers more than defenders. Consider that most building is done on borrowed money. We live in a world of credit ratings, cash flows, front money, cash squeezes, and leverage -- matters basic in financing business, but too often underweighed in economic analysis. A tax on new buildings, coupled with low taxes on old, weakens the credit of challengers and strengthens that of defenders. It adds to challengers' needs for front money and reduces defenders' needs for any money at all.

A tax on new buildings is at its maximum in the early years, the time of tightest cash squeeze. A high property tax rate today may take 30 percent of gross income from a new building. If other expenses take 30 percent, that is three-sevenths of the net operating income. If the entrepreneur is highly leveraged--and today, that is standard--most of the rest of net operating income goes to debt service. The net cash remaining for the entrepreneur then, especially during the early cash squeeze, is doubly leveraged, so a small rise in building taxes can wipe him out.

His credit rating in turn is leveraged by the prospects for his equity position. It is a familiar fact that a small rise of mortgage rates causes a large drop in building. Loanable funds rush out of building, not just because borrowers balk at higher rates, but because lenders lower everyone's credit rating because of lower equity income. Real estate taxes on new buildings add to costs in the same way as interest rates - that is, they are a fixed percent of value. A 3 percent-of-true-value property tax rate hits new building with the impact of a rise of mortgage rates from 4 percent to 7 percent; except that the real estate tax is worse because the tax rate applies to the whole value, while mortgage rates apply only to the debt. The tax not only defers renewal by its simple direct impact, but additionally by its leveraged effect on entrepreneur net cash flow and thence on credit ratings.

So it is powerful medicine to convert the real estate tax base to the site value basis. My current study comparing challenger and defender values in Milwaukee County is finding that a small rise of challenger values over defender values would cause 20 percent of the central city area to be renewed forthwith; and that the large change resulting from a full exemption of buildings from real estate tax would cause some 50 percent to be renewed - if the labor and money could be found to do it. Again, these results would be magnified by consideration of the neighborhood effects previously described.

They would be magnified again by consideration of the positive effect of cash squeeze on defenders. So far I have written only of exempting new buildings, but the land basis of real estate taxation does more than that. It raises taxes on defenders. The result is a potent cash squeeze effect. Today's real estate tax puts the squeeze on buildings. The proposed land tax puts it on defenders, holdouts, and preemptors of land.

So powerful is the medicine that, once it is understood, opposition may be expected, not from those who say it will not work, but from those who fear it will work too well: destroy historical antiquities, flood the market,

jeopardize collateral values, lower rents, change the character of neighborhoods, sacrifice tradition to progress, overstimulate the economy, encourage immigration, spoil the labor, change voting patterns, weaken old ethnic ties, and generally frighten those who dislike change and abundance. There is also a concern for the welfare cases who inhabit old buildings and may have relocation problems. This is not the place to answer all those points; nor is this the place to answer those who would not have us do any good thing locally without first tracing its possible effects on the equilibrium of the whole world. They should reread *Candide*. But I do have a few words of conciliation and challenge for planners who might be concerned that the proposal to unleash the full force of the free market is also a proposal to substitute the market for planners.

Challenges for Planners The unleashed market can solve some problems that now divert planners. It can bring urban renewal; group complementary land uses; promote low income housing; contain sprawl; attract an economic base; and weed out the worst generators of fiscal net deficits—old buildings. But on the whole, the land tax proposal implies more need for planners. Indeed, it gives planning so much more force and leadership as to make one ask whether planners are prepared to meet the challenge. Let us enumerate the ways that land value taxation supports and presupposes good public planning.

1. It gives planners a positive tool for influencing private land use, where now they largely have powers to say "Nay." when they designate an area for development, direct routes and utilities in it, and zone it for new use—up go land taxes, cash-squeezing the landowner into early attention to his new opportunities. Further, since high-use zoning is exploited quickly, there need be no great surplus scattered about, as it is today. It remains tight and retains its power to shape land use. This is also true for advantageous locations along public roads—which incidentally cost much more to produce than zoning, and if they are produced in surplus because half are unexploited (again as today), they require the most egregious waste of public capital.

Some may even regard land taxation as a form of tyranny by planners over landowners. But note the limits to the planner's power. He does not direct a landowner to put his land to a specific use. Nor is there usually just one "highest and best" use of a given site, to which every landowner will be forced. Thriving cities are not characterized by monoculture and monotony, but by variety, constant change, and complementation. Whatever is the highest use in a neighborhood, say elevator apartments, is supplied in abundance until the need for another one is no greater than the need for some complement like a grocery store or parking structure. At any time an equilibrium generally prevails and affords each landowner several options. Within limits he may "do his own thing."

The land tax does not turn the planner into an overcentralized administrator or petty tyrant dictating specifics when he should be delegating authority. Rather, it sets a generalized performance standard, cutting off options beyond a certain degree of slothfulness and disregard for the public cost of giving land its latent value, but leaving wide latitude for individual discretion.

2. The land tax gives public investment great leverage over private investment. Today it is the reverse. Within limits, public roads, regulated utilities, the mailman, and school bus will follow you wherever you choose to locate. The regional planning commission uses traffic counts to plan bigger roads, following the lead of private émigrés. These outreaching roads often seem to follow wealth and power.

The land tax lets public planners take the initiative if they will. The city extends roads and sewers a reasonable way and then raises taxes on the land. The cash squeeze says: "Bring me roofs to match my roadways."

We have seen that individual buildings in new neighborhoods need synchronization because of synergistic interdependence. When the community of small independent entrepreneurs lacks synchronization, it is hard put to compete with giant developers of integrated centers and whole towns, who centrally control entire new communities. To compete, the public needs a community synchronizer. This the land tax affords. The planner does not try to play every instrument in the orchestra, but the land tax lets him set the tempo.

But how this puts the conductor on his mettle! The man with the baton had better set the right beat, for everyone knows who he is. From an objective view of administration, of course, that is very good. It may give stage fright to a profession still a stranger to the podium. Are planners ready?

3. The land tax gives planners some leverage over tax assessors. Now, assessors are preoccupied assessing building values. Then, they would assess site potential, the thing planners play such a role in determining.

4. Synchronized expansion lets planners plan for open space. Today, open space is a transitory byproduct of land speculation. In transition zones we undersize parks because there is so much open land and so few people. The private open space cannot be entered and supplies only visual amenities, and often not even that. When the landowner is ready for cash, the space is closed and a new load, often an overload, thrown on public land.

The land tax system lets transition be quick and orderly. Knowing the ultimate density, the planner can provide parks in optimal measured amounts and sizes so that settlement is not crowded, but unsprawled. By using tax pressure to assure early compact use of land between open spaces, he justifies the investment in open land and relieves the pressure to invade it. The public planner can work open space into an integrated pattern, just as large private developers can (and sometimes do) now.

With such power in hand, planners might even retain economists to measure the benefits and costs of open space. It is high time we introduce rational management and optimization into a topic now too freighted with hoarding, alarmism, sentimentality, camouflaged race prejudice, opportunistic tax-dodging and uncritical nature-worship.

5. The land tax system shortens the period between site renewals. Every site renewal is another occasion to plan, and to plan ambitiously, excitingly, not just for rehabilitation but from the ground up. The public planner can go further. He can synchronize demolitions and replot the ground itself, something we had better get around to more often if our older city layouts are to avoid utter obsolescence.

6. The land tax system helps free planners from the constraint of "French equity." I allude to the concept of equity, characteristically French, that every man's share of land should be made equal, regardless of social cost, that the object of the institution of property is not good land use but distributive equity. In city planning that means what you do for Jacques' land you must also do for Pierre's.

Efficiency, on the other hand, calls for neighborhood specialization and differentiation, with high values for some and low for others. The land tax uses the fiscal and monetary mechanism to compensate the losers from the gains of the winners. Those who get the high unit values also get the high tax *bills-not* because of what they do for themselves, but for what the city planner does for them. Thus liberated from the tyranny of pettiness, the planners can relocate things and maximize net urban welfare on a much grander scale than now.

Equally important, the land tax gives city councils a better chance to be honest. Lincoln Steffens once remarked that the troublemaker in the Garden of Eden was not Eve, nor yet the serpent-but the apple! Taxing land values serves to dehydrate the apples of unearned increment which city councils dispense; and for which land developers vie when they contribute to campaigns, lobby, and otherwise influence officials. Keying the land tax to the provision of value-creating public works tempers the landowner's appetite by having him pay for his apples. The planner can now put priorities in the capital budget with a clearer conscience and less fear of pressure.

7. Finally, the land tax system leads to demand for a greater variety of community facilities because it gives people better mutual access. It reduces the self-sufficiency of individual landowners. It obviates vertical integration by individual firms. It increases interdependence. It fosters more linkages of all kinds: social, commercial, industrial, political,

cultural. It puts more load on the linkage mechanism—the sector of the city that planners plan.

To be sure, it greatly shortens the linkage network because orderly, unsprawled settlement lets people live closer, reducing the travel required for any given degree of linkage. Furthermore, it untaxes elevators and utility cores in private buildings and so lets private capital develop the third dimension of the linkage network, reducing the need for public capital. But the public capital released from lengthening the street grid and the planning talent liberated from this single-minded preoccupation has higher and varied uses. They can: replan interior areas and central lines; dean up air and water; perfect mass transit; sewer septic-tank suburbs and enlarge inadequate central lines; relocate buildings and lines to maximize synergistic gains from linkages; build a community house, a central mall and plaza, a Tivoli Gardens, a trade fair, an auditorium, stadium, art center, zoo, gymnasium, pool, theatre, marina, museum, library, playgrounds, park facilities, and so on without end.

Reviewing these seven challenges for planners, I must plead innocent of plotting their obsolescence and disemployment. Rather, I am moved to ask, with the Joseph Schlitz Brewing Company, "How much boldness can you handle?"

Author's Note: This is a revised version of a workshop paper presented at the 1968 Conference of the American Institute of Planners in Pittsburgh.

NOTES

1For more detail on this see my "Property Taxes and the Frequency of Urban Renewal," *Proceedings* of the 57th National Tax Conference, Pittsburgh, Pennsylvania, September 14-17, 1967, pp. 272-85.

2Leo Grebler, *Experience in Urban Real Estate Investment* (New York: Columbia University Press, 1955); Fred Case, *Los Angeles Real Estate; A Study of Investment Experience* (Los Angeles: Real Estate Research Program, Graduate School of Business Administration, Division of Research, University of California, 1960); and Louis Winnick, *Rental Housing: Opportunities for Private Investment* (New York: McGraw-Hill, 1958).

3My study of the detail and trend adjustments will be published next spring.

4Institute of Real Estate Management, *Apartment Building Income Expense Analysis* (Chicago: IREM of the NAREB, 1967).

J. of the American Inst. of Planners, May, 1969, pp.178-83