The Value of Land and Its Assessment

By Gilbert M. Tucker

There is fast-growing interest in the proposal to end taxation of real estate improvements and levy only on land values. Pennsylvania has passed, almost unanimously, a permissive act making this possible: the cities of Maryland are urging a similar law and there are signs of interest in New York and New England. What constitutes land value and how it should be assessed is a live question and merits attention, for value is a tricky word and as applied to land, has peculiar meaning. Generally, in the case of ordinary commodities, value, and its expression in price, is determined by sales: but, in the case of land, there are many more rental transactions than sales, and value and price are often gauged in terms of rent rather than of sale.

Rental price and sales price are mutually inter-related, but sometimes there is little direct connection between the rent which a piece of land commands and the price asked at sale. One might say that land which will rent for $100 a year is worth $2000 if money is worth 5 per cent, but this is not always a correct assumption. In a thriving, growing city land is seldom leased except for the purpose of building, and such leases generally run for a long period of years. If there is expectation of growth and progress no landlord will give a long-term lease, on the basis of today's rents. Generally the rent will be based as much on future expectations as on present values, or provision will be made for periodic adjustments in rent to conform to changed conditions. On the other hand, sometimes land is leased for short periods at a rental ridiculously low, as illustrated by a city lot leased for purely temporary purposes. The owner, anticipating a great increase in value, was loath to sell or to give a long term lease, but rather than have the land stand idle, he was willing to lease it at a low price, for the time being, so it would yield some income while he was waiting to garner his anticipated "unearned increment".

We talk glibly about landowners, but no one owns land absolutely outright. Pollock, the distinguished jurist, says, "It is commonly supposed that land belongs to its owners in the same way as money or a watch. This is not the theory of English law. No absolute ownership of land is recognized in our law books, except in the Crown." Blackstone sums it up tersely: "It is a received and undeniable principle of law that all lands in England are held immediately by the King"; and Williams, in "Real Property," says, "The first thing the student has to get rid of is the idea of absolute ownership; such an idea is quite unknown in English law." In America, the Constitution of New York declares, "The people in their right of sovereignty are deemed to possess the original and ultimate property in and to all lands within the jurisdiction of the state", and similar provisions are found in the constitutions of many states. This peculiarity of land ownership, although universally recognized by students, is often forgotten, and yet, it is evidenced in innumerable ways. The fact that land is practically always taxed shows that the authorities have a claim on it, and the right of eminent domain is another recognition of the supreme title of the people.

Limited Ownership Vested in Titleholder

WHEN WE TALK about the value of the land we generally lose all sight of the prior claim of all the people and consider only the value of the equity of the titleholder. In the case of sale, the price is paid, not for full and perfect title, but for that limited ownership which is vested in the titleholder. This is all that he can transfer and it is always secondary to the supreme claim of the State. For example: in one city the tax rate and the prevailing interest rate are approximately equal, about 4½ per cent. If the holder of a piece of land pays $900 a year for tenure, we can say that the property is worth $20,000, arrived at by capitalizing gross income at the prevailing rate of interest. However, though this amount is paid by the tenant, one-half must be turned over to the tax collector, so actually ownership is divided equally between city and titleholder, each deriving an income of $450. Capitalizing the net income enjoyed by the titleholder puts the "value" of the land at $10,000 and that is what it is assessed at normally, for it represents all the value which he can sell. Accustomed to thinking in terms of sales price and market value, we mistake this for the true, full value, ignoring the equity of taxing authorities.

The shares of ownership of the city and of the titleholder depend upon the ratio of taxes to net income. In our example there is an equal division, but should the tax rate go to 6 per cent the city would get $600 and the owner only $300, so two-thirds of the value would be lodged in the city, only one-third remaining with the titleholder; and, should the tax go to 9 per cent, all the value would be taken by the city; no equity would be left to the owner and the value of the title would shrink to zero, although the tenant still pays $900 a year. *What the tenant pays* *is the true index of the real value, and though the equity of the titleholder would disappear and sales value would be wiped out, the lot would nevertheless be worth just as much as before,* but the value would all be vested in the city.

This illustrates a universal fallacy in assessing land values. We mistakenly assess the value, in utter disregard of the values lodged in the tax authorities, basing assessment only on the value held by the titleholder, which is all he can sell, and the gauge of market price.

This is a very practical point when it comes to questions of levying a higher tax on land. It is difficult in our present blindness to work out a basis for levying such a tax because, as we increase the tax, the value, as we assess it, continually shrinks. We should assess all land at its true value, *including both the equity left to the titleholder and the claim of the taxing authority.* Doing this, we will have a just basis for the taxation of land. In this there is no departure from our practice in taxing other things; the income tax is levied on gross income and not on what is left of the income after paying tax. Therefore, to arrive at a just system of taxation of land values, *we should base taxation on the rental which property will command—the amount which the tenant is willing to pay, regardless of whether it goes to the city in taxes, or is divided with the titleholder.*

At the present time there is growing sentiment favoring the higher taxing of land values, or, more correctly, the collection of ground rent, and reduction, or complete ending, of the levy on buildings. Such a policy is sound by every standard, but a difficulty which has long stood in the way of this reform has been the question of the method of assessing land values, because, as the tax increases, value—if it expresses only the value to the titleholder—shrinks. The answer is to assess land at its true value as indicated by the rent it will command. If we prefer we can simply assess ground rent and take that—or most of it—for the support of government, but it may be well to compute capitalized value for purposes other than for taxation. In some states it is important as a limit on bonded indebtedness; it may affect distribution of state funds, and it is sometimes the basis of state taxation. To compute this capitalized value, rent should be capitalized at the current tax rate, because this is the rate of return to the city.

Some Issues in Shifting the Tax Base

A PROPOSAL TO SHIFT TAXATION from building values to site values raises some questions. Primarily it is felt to be hard on the landowner. But, think a moment! Practically, city land earns little or nothing, unless a building is erected upon it. Oh yes, there are exceptions: when a circus comes to town the vacant lot may earn some money, and sometimes it will bring in a fair return for parking, but generally most of the land in the city shows a profit only when built upon. It is not the land that yields a return but the building. Land may be likened to a tool. A good machine tool may be a real asset, but the tool by itself, is useless: it takes a man to run it. So it is with land! City land itself produces practically nothing, and yields a return only when put to use, and generally, that means building.

The collection of ground rents is nearly always coupled with exemption of improvement values and this exemption will add tremendously to the value of land. We then have something of a paradox: as we increase the tax on land, sales price and value to the titleholder will shrink; but, if we simultaneously decrease the tax on buildings, land values may rise. Studies in countries where this program is in force show that sometimes the first effect of a change of this sort is to increase, not only true land value, but even value expressed in sales price. To illustrate what may happen, in one city a splendidly located lot was in forfeiture for tax delinquency, its value to the owner apparently wiped out. Suddenly the lot appeared desirable for a building which would be tax exempt, and it sold at a good figure. It was only a tax situation which had killed the former sales value of this lot and, unquestionably, it would have been speedily restored by a program of general tax exemption.

We also have frequently a situation of which the following is an actual example. In a new development there are fifty lots resulting from a premature subdivision. On three of these, new houses have been erected and they are so heavily taxed that no one else will build. There is absolutely no sale for the lots, taxed about $16 per year and all in forfeiture with all value to the titleholder wiped out. In this city, doubling the tax on land would compensate for exemption of all improvement values so, under such a proposal, the tax on these lots would jump to twice the present uncollectable tax. This would bring the tax on sites to $32 but what would this signify if a $12,000 house which would today be taxed about $500 a year, were freed from all taxation! These lots, under such a program, and with housing conditions as they are in this city today, would unquestionably meet with a ready sale, and the unfortunate speculator, now soon to be cleaned out, would be saved. However, these conditions are rather exceptional and they are transitory in character. We must admit that, if we continue to collect a larger proportion of the ground rent until we finally collect it all, the sales value of the land will theoretically drop to zero, but the *use value* would be greatly enhanced if, correlated with this change, we exempt in increasing proportion, and finally make tax-free, all buildings.

This principle may be illustrated by a comparison. Today we tax automobiles by purchase tax, license tax, and a tax on many accessories. It might seem that the motorist would gain by abolition of these taxes. But suppose for them we substitute a heavy tax on the mileage driven by every car. Would there be an advantage to the motorist if the total amount collected by the government were the same? It would be as broad as it is long, but it would bear very hard on some people and it would restrict the use of cars and reduce their practical value. To tax the use of a thing is quite as injurious as to tax the thing itself, because it is the use which yields a profit and a satisfaction to the owner.

Benefits from a Change in Tax Policy

SINCE ALL THAT WE HAVE is obtained from the land, everything taken for the support of government must be derived either from a levy on land or on the use to which it is put. If we tax the land itself we bring it into use, for no one will hold it idle, and we shall increase production, add to the wealth of the community, and raise the standard of living. If we tax the use to which it is put we shall subsidize idleness and discourage all production. Clearly it is more to our interest to encourage production and stimulate industry rather than give encouragement to land gambling and parasitism. Should a few monopolize land and hold it idle, exploiting the dispossessed, or should it belong to those who will use it and make it contribute to the well-being and prosperity of the community?

Such a change in tax methods would bring benefit to nearly every class. The real estate operator would gain enormously because the builder, the operator, the broker and all involved in real estate derive their profit from the use of land. It is, however, essential that the method of assessing land be changed, as discussed above, for the law often provides that assessments shall be on the basis of sales or market value. The change proposed would raise the value of land, as found on our assessment books, to nearer the correct figure. It would be well to instruct assessors as to what constitutes true land value, and to encourage them to put a larger proportion of assessed value against site and a smaller proportion against buildings.

In many cities it is evident that land is under-assessed and buildings over-assessed. Years ago, research showed that in our larger cities land values, even as today assessed, generally equal approximately the population of the city multiplied by one thousand, but that was many years ago when prices were far lower and our money had not been devalued. Today population might well be multiplied by two or even three thousand. Of course these are not absolute figures; in growing boomtowns there will be the speculative element that will tend to inflate values. In backward towns, losing population, land values may be proportionately lower. But it is a rough indication of what the land value in cities should be. Generally, assessed land values are far lower and explanation for this under-assessment lies in the fact that, owing to heavy taxation of improvements, it is often impossible to make landholding profitable.

If improvements are untaxed, an impetus will immediately be given to the increase in the value of land: land will be able to carry increasing levies and without hardship to the owner, who will be more than compensated by the gains from untaxed improvements and use.

Albany, N. Y.

The Sea as an Economic Resource

FISHERMEN from the twenty-one countries that lead in annual fish catches bring ashore from the sea more than 13 million tons of fish a year, according to data collected by the United Nations Food and Agricultural Organization. The size of these catches is indicated by the statistics for 1951: Japan, 3.8 million tons; the United States, 2.6 million tons; Norway, 1.8 million tons and Great Britain, 1 million tons.

Canada has increased her catch from 500,000 tons a year, pre-war, to 660,000. Denmark's catch has increased phenomenally from 96,000 tons to 292,000. Iceland's catch rose from 274,000 tons to 368,000; Sweden's from 143,000 to 200,000.

Only a relatively small proportion of the catch is processed. In 1951 some 375,000 tons were frozen, 780,000 tons salted, 650,000 tons canned. Fish meal production accounted for a relatively large amount of the catch; output of meal was some 740,000 tons.

The sea is a valuable resource to the countries that have access to it. As the figures show, it is a primary source of foodstuffs of the most valuable kind. But it is also a source of minerals and it is often a highway to and from the markets of the world. There are some who believe that its riches have hardly been tapped.

W. L.