A TAX REFORM THAT FIGHTS SPRAWL

Low-density, discontinuous land use development, known as "sprawl," contributes to many of the ills that plague our society. Property tax reform can create economic incentives to reverse this trend, thereby encouraging the use of transit while conserving energy and open space.

Sprawl inhibits the use of transit which thus necessitates auto travel, which in turn contributes to air pollution. Energy and time are wasted in traffic jams, reducing productivity and increasing stress. Health is endangered from pollution and automobile accidents. Per capita infrastructure costs are high because roads, sewers, etc. must be extended through sparsely occupied areas. Undeveloped areas are too small and too scattered to support meaningful conservation uses or agriculture.

The Clean Air Act mandates the achievement of ambient air quality standards. Recent scientific studies show that merely reducing the number of vehicle miles travelled does not provide a commensurate reduction in pollution due to the preponderance of emissions that occur when vehicles are started and those which occur even when vehicles are idle. Therefore, Congestion Mitigation and Air Quality funds available might be spent most profitably on traffic demand management to reduce the number of vehicle trips.

Perhaps the most effective way to accomplish this objective is to encourage the development of housing in close proximity to jobs, schools, recreation and shopping. Compact, mixed-use development not only allows people to walk or bike to their destinations, but it also enhances the efficiency of mass transit.

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

All too often, land near public infrastructure at "Point A" (like a subway station or major road intersection) remains vacant or grossly underutilized because a land owner is waiting for a price in excess of what space users will pay today. This drives developers to seek cheaper sites, farther away from public infrastructure at "Point B."

Once this cheaper land is developed and inhabited, the occupants of this area create political pressure to extend the infrastructure from "A" to "B." Once this occurs, land prices at "B" rise, choking off development there, (even though additional

capacity exists) and driving developers and users farther away to "Point C."

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

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

The other part of the property tax is a tax on the value of land. Land is not a product of human labor. Because a tax on land cannot be avoided by producing less land, or by moving land from one jurisdiction to another, a tax on land values is not a cost of production but functions as a fee for land use.

Landowners who underutilize valuable land sites with speculative intent contribute to sprawl and the costly, inefficient use of infrastructure. But a land value based property tax reverses the incentive for land speculation. This type of user fee system curbs speculation and resultant sprawl by lowering land prices and thus encouraging infill development and better utilization of sites, infrastructure, and public transit.

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

With a land value based property tax the greatest economic imperative to develop land exists adjacent to existing infrastructure and amenities. At the same time, a reduction in the tax rate applied to building values makes that development more profitable and further encourages compact, energy efficient urban design. The greater utilization of land adjacent to existing infrastructure reduces the demand for development in outlying areas.

A significant amount of vacant and underutilized land exists within most urban areas. With this form of property tax, new development would tend to occur within the existing urbanized area, rather than outside it.

Pittsburgh is the largest city in the United States that taxes land values more heavily than building values. Until the late 1970s, Pittsburgh taxed land values at twice the rate on building values. At that time Pittsburgh increased the tax on

land, leaving the building tax the same. Today, Pittsburgh taxes land values at a rate between five and six times more than the tax rate on building values.

In spite of the severe depression in steel and related industries that was occuring during this time, residential and office development within Pittsburgh grew substantially. Contrary to national trends, development within the city limits exceeded development in the suburbs. Pittsburgh is a high quality of life city on several indicators and an average priced home is still affordable to the average income household.

Today 15 Pennsylvania cities tax land values higher than building values (Fig. 1). Harrisburg shifted to the two-rate approach in 1974 and now taxes land values at a rate four times that of buildings. Once considered the second most distressed city in the United States, Harrisburg has sustained an economic resurgence that has garnered national acclaim. Harrisburg has twice won the top United States community honor as All-American City, along with the top state recognition from the state Chamber of Business and Industry as Outstanding Community in Pennsylvania.

Regarding Harrisburg's implementation of this policy, Mayor Stephen Reed has written that:

"The City of Harrisburg continues in the view that a land value taxation system, which places a much higher tax rate on land than on improvements, is an important incentive for the highest and best use of land in already developed communities, such as cities.

In our central business district, for example, our two-tiered tax rate policy has specifically encouraged vertical development, meaning highrise construction, as opposed to lowrise or horizontal development that seems to permeate suburban communities and which utilizes much more land than is necessary."[2]

Here are a few of the improvements mentioned in the Harrisburg literature[3]:

* The number of vacant structures, over 4200 in 1982, is today less than 500.

* With a resident population of 53,000, there are 4,700 more city residents today employed full-time than in 1982.

* The crime rate has dropped 22.5% since 1981

* The fire rate has decreased 51% since 1982.

* Extensive infrastructure improvements guarantee long-term reliability and capacity for water, sewer, trash disposal and collection and other essential services with rates among the lowest in the region.

Both theoretical models and practical experience lead to the conclusion that this approach to property tax reform can provide economic incentives to help reverse urban sprawl and to restore and revitalize our cities.

Political feasibility is indicated in a study comparing the traditional property tax to a split-rate property tax[4]. This study showed a reduction in the tax burden on most residential and neighborhood business properties. Vacant lots and surface parking lots experienced tax increases. In Harrisburg, over 90% of the property owners saved money over what they would pay with the traditional property tax.

Compact development, by utilizing existing infrastructure, conserves natural and financial resources and encourages walking, cycling, and public transit. Of course, zoning and other community land use controls should be coordinated to insure appropriate development and the establishment of public open space within the urban area.

Land derives its value from the desirability of its surroundings (location). Increasing taxes on land discourages speculation and returns to the public economic values that are largely created by public expenditures in the first place.[5] A building, on the other hand, derives its value from the owner's work in constructing and maintaining it. Reducing taxes on buildings reduces the cost of housing and home maintenance.

Together, these tax changes promote the clustering of development adjacent to existing infrastructure, reducing development pressure on outlying areas and discouraging urban sprawl. A split-rate tax helps harmonize economic incentives with public policy objectives for affordable housing, urban economic development and environmental protection.

This approach also constitutes a traffic demand management strategy that will reduce the need for auto trips. It satisfies several of the factors that must be considered in the development of both metropolitan and state Transportation Improvement Plans.

The split-rate tax can be designed to raise the same revenue as the traditional property tax. However, sources of funding for research and implementation of the transition to a split-rate tax could come from a variety of sources including the Congestion Mitigation and Air Quality Improvement Program (CMAQ), and planning funds under both the National Highway System Program, the Surface Transportation Program and the Federal Transit Act Amendments.

[1] Joseph DiMasi, "The Effects of Site Value Taxation in an Urban Area: A General Equilibrium Computational Approach," *National Tax Journal*, vol. 40, December, 1987

[2] Letter of Mayor Stephen Reed of Harrisburg to Patrick Toomey of Allentown, October 5, 1994.

[3] *Harrisburg - An Economic Profile*, back cover page of this 96-page publication available at the City Government Center, 10 N. Second Street, Harrisburg, PA 17101-1678, Tel.(717)255-3040.

[4] "Real Property Tax Rates for Tax Year 1992," published by the Pro-Housing Property Tax Coalition, June 21, 1991.

[5] "Value capture," as described here, is enumerated in *ISTEA* as an innovative financing technique to be included in Long-Range Plans and state Transportation Improvement Plans. See sections 134(g)(2)(B) and 134(h)(2)(B).

FIGURE 1

Fifteen Pennsylvania Cities are Now Two-Rate

from Incentive Taxation, April, 1995 Phone: (410)740-1177

CITY	Land Rate	Building Rate	One-Rate	Population	Two-Rate Since	% of Tax Rev. From Land	$ Per Yr. Saved By Bldgs.
Aliquippa S.D.	163.00	11.000	0.0442	13,374	1993	80.55%	$2,115,366
Aliquippa	79.00	7.000	0.0227	13,374	1988	75.92%	$1,001,915
Clairton	100.00	21.050	0.0366	9,656	1989	53.72%	$300,193
Coatesville	50.15	25.000	0.0303	11,038	1991	33.90%	$70,521
Connellsville	113.50	17.500	0.0304	9,229	1992	50.10%	$384,508
DuBois	51.00	13.000	0.0193	8,286	1991	43.96%	$31,180
Duquesne	80.00	38.000	0.0463	8,845	1985	34.04%	$134,182
Harrisburg	32.25	10.750	0.0142	52,376	1975	36.05%	$2,533,689
Lock Haven	31.10	10.273	0.0175	9,230	1991	61.84%	$117,963
McKeesport	100.00	19.000	0.0364	26,016	1980	59.04%	$865,637
New Castle	87.28	22.030	0.0338	28,334	1982	46.58%	$1,192,131
Oil City	85.50	26.800	0.0378	11,949	1989	42.45%	$478,190
Pittsburgh	184.50	32.000	0.0609	369,379	1913	57.42%	$73,739,859
Scranton	66.00	12.000	0.0261	81,805	1913	65.96%	$3,997,371
Titusville	61.34	15.00	0.0200	6,434	1990	32.97%	$308,773
Washington	177.24	17.660	0.0482	15,791	1985	70.38%	$1,495,562
						TOTAL	$88,767,040

Rates for F[illegible] Year 1995

For more information contact:

Rick Rybeck
c/o Honorable Hilda Mason
Council of the District of Columbia
Washington, DC 20004
(202)724-8064

Alanna Hartzok
PA Fair Tax Coalition
123 South Second Street
Chambersburg, PA 17201
(717)263-2820