Reprinted from **The Annals** of the American Academy of Political and Social Science,
Philadelphia, March, 1930.
Publication No. 2371.

The Operation of the Graded Tax Law in Pittsburgh

By Thomas C. McMahon
Chief Assessor of the City of Pittsburgh, Pittsburgh, Pennsylvania

WHAT is known as the graded tax law on buildings for cities of the second class in the State of Pennsylvania was enacted in 1913, and began to function in 1914. On January 1, 1925, the law became fully effective. Therefore, the graded tax law should be considered as something that we have had in actual operation only since 1925.

The system of assessing real estate for taxation purposes in the city of Pittsburgh does not differ materially from the assessment system in force in other large cities throughout the country. Land and buildings are assessed separately, as in New York, Boston, Cleveland, Detroit, and other large cities. The graded tax plan does not involve any discrimination in our treatment of land and buildings, in so far as appraising the value for taxation purposes is concerned. It is entirely a matter of fixing separate tax rates. The Department of Assessors furnishes the total assessed valuation of land and the total assessed valuation of buildings to the City Council. After the amount of the city budget is known, the City Council determines the tax rates for city purposes. The Council fixes two separate rates, one rate to apply to land and the other rate to apply to buildings. The building tax rate, according to the law, must be one-half of the land tax rate. Pittsburgh, therefore, does not really have a tax on real estate as that term is generally understood in speaking of taxation in American cities. In place of a general real estate tax, there is a land tax and a building tax, and while it is possible to arrive at the average real estate tax for the city as a whole we do not speak in terms of a real estate tax. The average would, of course, differ in almost every individual case, depending entirely upon the relative value of the land and of the building in each individual assessment. But, there is absolute uniformity in the taxation of all land and in that of all buildings. Pittsburgh levies no tax whatever on personal property, machinery, and so forth, standing alone, among the large cities of the United States, in this respect.

Increased Building Construction

It is my judgment that the full effects of the graded tax plan have not yet been attained, nor will they be attained until a fuller use is made of all the land within the city of Pittsburgh. In the downtown business district, there has been a greater amount of building in the "Golden Triangle" during the past six years than during a period of fifteen years previous to that time. Due to economic conditions, land formerly used for blast furnaces and rolling mills is now utilized for warehouses and light manufacturing buildings, the latter being several stories in height. In property used for housing purposes a most notable change has taken place. The number of single dwellings, duplexes, and apartments erected during the past six years has been greater than those erected in twice that length of time during any previous period in the history of Pittsburgh. Housing construction has progressed to such an extent that land suitable for such development is becoming very scarce. Many of the large estates, where formerly a building of palatial dimensions occupied a large tract of land, have been taken over by developers who have laid out the acreage in fair-sized lots and have erected residences thereon. These three classes of property, i.e., high-grade business property, industrial property, and housing property, have been benefited by a lighter burden of taxation under the graded tax plan than they would have if the flat tax rate system had been in force. In the years to come, when further development takes place, a full realization of the benefits of the graded tax system will be found. We can say, at least, that the man who does something is not being penalized by having a heavy tax burden placed on the buildings which he has erected, no matter for what purpose.

No claim is made that the graded tax law effects a saving in taxation to the community as a whole. A certain amount of revenue must be obtained to defray the expenses of the city government. The allocating of this cost of government is made, however, in a different manner from that employed in other American cities, with the result that certain properties are contributing a smaller amount to the cost of government while other properties are contributing more. Classifying again the three types of real estate, i.e., business, manufacturing, and residential properties, we find with regard to business properties that those where the site is highly developed are paying less in taxes under the Pittsburgh plan than they would pay under the flat-rate system. In those cases where the land and building values are about equal, the tax is approximately the same as it would be under the old flat-rate system. In the case of those properties improved with buildings of lesser values than those of the sites, a greater amount is paid in taxes under the graded tax than would be collected under the flat-rate system. The majority of business properties in the downtown district are in the latter class, owing to the very high land values prevailing in the "Golden Triangle." These high land values are the creation of all the people in the community who, while living away from the business district, do business in that section and thus make it valuable for business purposes. The site value is what pays the largest proportion of the taxes in any business district in Pittsburgh, and this value is better able to pay the taxes than are the improvements. In a great majority of the cases the site receives an annual increment, while the structure thereon suffers an annual depreciation. We find outstanding examples of increased land values in some of our prominent corners in Pittsburgh.

INCREASE IN LAND VALUES

The Park Building occupies a site one hundred and twenty by one hundred and fifteen feet, on the northwest corner of Fifth Avenue and Smithfield Street. The lot was purchased by Mr. Park from the United States Government in 1893, at a cost of $433,000. Recently a reported appraisal on this lot was $2,750,000, an increment of $2,316,500. This increase in value is not the result of any individual effort, but is a result of the activities of the entire community.

On the southwest corner of Fifth Avenue and Smithfield Street there is located a lot twenty by sixty feet. In February, 1895, this lot was appraised by three of Pittsburgh's leading real estate brokers. The appraisal was made for the Orphan's Court in a partition proceeding. A value of $81,720 was placed on the property, land,

and building. Today this lot is leased for $30,000 per year, net. The building is owned by the tenant. The capitalized value of the lot is $600,000, or an increment of $518,280 in thirty-four years.

On the southeast corner of Fifth Avenue and Wood Street is a lot sixty by forty-eight feet, which was sold in December, 1863, by Henry Sterling to Zodock L. Eisner, for the sum of $28,500. In May, 1929, the Eisner estate sold this property to the United Cigar Company for $850,000, an increase of $821,500. The new owners removed a very old six-story building from the lot and erected thereon a three-story building.

On the southwest corner of Fifth Avenue and Wood Street the Goehring estate owns a lot sixty by forty feet. This property has been in the Goehring family for many years. In December, 1897, an heir sold a one-eighth interest for $18,000, or $144,000 for the full value of the property, as appraised at that time. The estimated value of the property today is $750,000. The increment is $606,000 in thirty-two years.

The Jenkins Arcade property, located in Liberty Avenue, Fifth Avenue, Penn Avenue, and Stanwix Street, was assembled, between 1884 and 1889, by the present owners. They paid $244,500 for the parcels, comprising a site of 46,350 square feet. The present-day value is $3,800,000, in the opinion of local real estate experts. In forty years the community has increased the value $3,556,000, or fifteen times the original purchase price. The parcel is occupied by a seven-story office building. It is one of the best paying properties in Pittsburgh.

The "Golden Triangle" is not the only place where these enormous community-created values exist. Five miles from the center of the business section is the East Liberty district, a high-grade residential neighborhood. The East Liberty business center is in Penn Avenue, between Highland and Center Avenues.

On the northeast corner of Penn and Highland Avenues is a lot with a thirty-seven foot frontage on Penn Avenue, and one hundred and fifteen feet on Highland Avenue. A chain cigar store company recently paid $425,000 for this lot. The very old two-story building occupying the lot has little value. G. G. Rauhauser, in 1883, paid $5,000 for the property, the lot being forty-three by one hundred and fifteen feet. The city of Pittsburgh widened Highland Avenue, taking a width of six feet along Highland Avenue, paying well for the privilege. Forty-five years before the time of selling, the Rauhauser heirs received an increment of $420,000 over the purchase price of the property, or eighty-five times the price paid by their father.

On the southwest corner of Penn and Center Avenues is located the City Deposit Bank, a one-story building. Thirty years ago the present owners paid $18,000 for a lot fifty feet on Penn Avenue, averaging one hundred and five feet through to Center Avenue. Today this site is conservatively valued at $350,000, or an increase of $332,000. The value today is twenty times the price paid in 1898.

Adjoining the City Deposit Bank on the west side is the Thomas Moreland property. In 1884, Thomas Moreland, Sr., purchased one hundred and seven feet on Penn Avenue, having an average depth of two hundred and ten feet, for the sum of $18,600. The property is leasing today on a basis of $750,000. The people doing business in the East Liberty district have increased the value of this property $731,000, or forty times the original purchase price. This site is occupied by a three-story building.

The properties referred to here are examples used by opponents of the graded tax law in an attempt to prove the unfairness of the law when applied to this class of properties.

With the exception of the Park lot, the buildings on these properties are from two to six stories in height.

Skyscrapers, i.e., the portion of the building above the second or third story, show a very low return on the investment; and where a return above normal is shown for a skyscraper, it comes from the ground floor rentals. A vast majority of the best paying business sites in the city of Pittsburgh have buildings that do not exceed four or five stories. It is my contention that the tax levied on business properties is unfair, where the burden is placed on the property that is highly developed by having a tall building erected thereon, for the overhead expenses of these buildings, together with annual depreciation, very often leave but a small return on the invested capital.

An important feature of the Pittsburgh plan of taxation is that the business man who pays a heavier share of taxes on his land is exempt from any personal property taxes whatsoever for city purposes. Industry is similarly exempt.

Industrial Property

Industrial property in the city of Pittsburgh is undergoing a change. The rolling mills and blast furnaces are seeking locations outside the city, where the opportunity for expansion is better. As previously mentioned, land formerly occupied by such mills and furnaces is now being used by warehouses and light manufacturing buildings. While, in some cases, these properties pay a heavier tax under the Pittsburgh plan than they would under a flat rate, many of the properties are paying less in taxes, due to the fact that the building value is greater than the land value. Industrial property in Pittsburgh is benefited by the Pittsburgh tax plan because we do not tax machinery, raw material, or finished products, upon which, in many communities throughout the country, the manufacturer is required to pay taxes.

A noticeable effect of the graded tax plan is that which we find in the case of industrial property which has been held at a selling price far in excess of that which a manufacturer would be justified in paying for a suitable site. Such property has since been placed on the market at a much lower selling price than was asked previous to the full operation of the graded tax plan, and numerous sites have been sold at a dollar and a half to two dollars per square foot which were previously held at four to five dollars per square foot.

Opponents of the graded tax plan have stated at times that the plan is not proving of benefit in the way of reducing land values, but rather that an increase in land values has taken place. In support of their contention, they refer to increases in assessments of industrial properties in Pittsburgh between 1913 and 1928. These increases in the assessed valuation of land actually represent a revision of incorrect assessments made in 1916, and the fact is that some of these industrial properties have actually sold for less than the assessment in 1927–1928, with the result that a revision of the assessments downward has since been made to correspond with these sales.

It is my judgment that ninety-five per cent of the housing properties in Pittsburgh are benefited through tax savings by the graded tax plan. A complete analysis was made of a typical home-owning ward, and in this

ward out of a total of 3,272 owners of improved properties it was found that 3,250 pay from thirty per cent to five per cent less in taxes by reason of the graded tax plan. It is my conviction that these are the properties that should receive the greatest consideration because the land values of this type of property remain stable, whereas building values suffer an annual depreciation. The wealth invested is gradually decreasing, while these same people are helping to create the increased wealth in the form of land values in the business section of the city.

In all fairness, I wish to say that I make no claim that the graded tax plan has been responsible for all the increased building operations in Pittsburgh, but I would rather say that the building operations have been a natural development in the growth of the community. I do maintain, however, that the owners of the properties that have been well improved have a lighter tax to pay under the Pittsburgh plan than they would have under the old flat-rate system. This belief is based upon the number of inquiries that have come to me from those wanting to know what their taxes would be if they built a home in a certain district, as compared with what their taxes would be on a similar home built outside the city in one of the adjoining boroughs. In such cases, the tax estimates made by me almost invariably resulted in the inquirer's building within the city of Pittsburgh.

With regard to rents, it is my contention, based on an actual survey made in fourteen of the large cities of the country, that no fair comparison can be made between housing conditions in Pittsburgh and those in other cities. Properties compared as to type of construction, location of the properties, and the facilities afforded, vary so greatly in the different cities that a common denominator cannot be used such as is necessary to arrive at a proper conclusion as to the rate per room or the rate per apartment or house.

I do not claim that the graded tax plan has had any particular effect on rentals in Pittsburgh. Abnormal conditions have existed in renting properties for housing purposes during and since the war, but it is only fair to draw the conclusion that, all things being equal, when a landlord pays a lower tax through the graded tax plan it should result in a lower rental, as the owner can then afford to rent for less.

Pittsburgh cannot be compared with many other cities with respect to tax rates, due to the fact that our entire tax revenue is derived from real estate, while many other cities have a revenue from personal property and public utility taxes equivalent to thirty per cent of their entire revenue. Neither of these sources of revenue is available in Pittsburgh.

Taxpayers Favorable to Graded Tax Plan

Since the graded tax plan has been fully effective, I have been in close touch with the situation, due to my position as Chief Assessor of the city of Pittsburgh. So far as I can learn, no serious objection is offered to the present tax plan. The taxpayers of the community as a whole seem to have accepted the graded tax plan, and it has been, and is today, strongly endorsed editorially by all the daily newspapers. Furthermore, every member of the City Council, the men who determine our tax rates, is on record in favor of the present Pittsburgh tax plan which, as explained above, has as its two principal features the graded tax and the exemption from taxation of personal property, machinery, and so forth.

The best answer to the charge that the graded tax plan is a menace to the growth and welfare of the community is to be found in the fact that Pittsburgh has had its most remarkable development in the Pittsburgh district since 1924, when the graded tax plan came into full operation. The United States Steel Corporation is spending in the Pittsburgh district $100,000,000 in expansion and improvements. During 1927–1928, the amount of building operations, wherein the buildings cost $100,000 or more, amounted to $100,000,000. The three great trunk lines entering Pittsburgh, i.e., the Pennsylvania Railroad, the New York Central Railroad, and the Baltimore and Ohio Railroad, are spending more than $80,000,000 in terminal expansion and improvements. Allegheny County, in 1928, started public improvements amounting to $45,000,000. The city of Pittsburgh, between 1924 and 1928, spent $35,000,000 in public improvements. Two important public utilities, i.e., the Bell Telephone Company and the Allegheny Heating Company, have an improvement program of expansion under way wherein $25,000,000 is to be expended. In 1922, bank clearings in the city of Pittsburgh amounted to $6,800,000,000; in 1928 they were $9,450,000,000, or fifty per cent more than the city of Cleveland in that year, and three times the amount of the city of Cincinnati. These two cities are in the same Federal Reserve district as the city of Pittsburgh.

After a careful study of conditions in the Pittsburgh district, I am thoroughly convinced that Pittsburgh's tax plan aids that city in promoting progress.