Reforming the city's property tax

IN light of recent developments to plug a $100 million gap in the proposed city budget of $1.4 billion, the City Council has passed a $96 million tax package that includes a 15% increase in wage tax for city residents and a 4% increase in real estate tax. This gesture from council members is bound to bring about a concerted effort on the part of taxpayers to lobby for overdue tax reforms. With that in mind, Professor Steven Cord offers a simple change to improve the property tax system, a change which has brought results in other U.S. cities.

By Steven Cord

URBAN tax experts are giving increasing support to a property tax reform designed to:

- Reduce the costs of construction and rehabilitation.
- Invigorate our central business districts.
- Stop the urban sprawl into our clean-and-green countryside.
- Allow cities and school districts to raise revenue more easily.

The proposal is simple enough: instead of taxing land and building at the same millage rate (as we do now), tax land at a higher rate than buildings.

For example, McKeesport now taxes land at 9% and buildings at 2%. Pittsburgh taxes land at 15.15% mills and buildings at 2.7%. If a city or school district needs more revenue from the property tax, it can raise the millage on land only, rather than on both land and buildings. Or they can gradually phase out the property tax on buildings altogether over a period of 10 years and end up taxing land only.

How can a simple change like that improve our cities? is the obvious question.

(1) It will reduce the costs of construction and rehabilitation. The property tax on buildings adds considerably to those costs, much more than most people are aware of. If we reduce (eventually abolish) the building tax, then construction and rehabilitation costs will also be reduced, and reduced considerably.

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Suppose you want to build a $100,000 building in Philadelphia, for instance. The property tax in the city is 7.175%, but since assessments are officially 53.4% of market value, then the effective tax rate is 3.83% (7.175% times 53.4%). Thus you would pay $3,830 each year in taxes on your new building. The current mortgage rate is about 13%, so you would expect to make about $13,000 a year on your building investment. You would make markedly more without the building tax. In fact, your current taxes are almost 30% of the current expected income of your property (3.83% divided by 13%). What a deterrent to new construction such a tax is!

If someone suggested a city tax of 30% on real estate income, would you support it? Yet that is what the current property tax on buildings amounts to. Do you favor that?

By un-taxing buildings, we considerably reduce their cost. This alone can spur a healthy construction boom.

Let a property owner improve his building and his property tax goes up. But if we tax land instead, then we can remove this major obstacle to rehabilitation while maintaining city revenues.

But in addition, by taxing land more heavily, we require it to be used efficiently, as determined by the market at any given time (within zoning limitations, of course). The more we tax land, the more efficiently and fully it would be used, for who would keep land out of use, or in only partial use, if he had to pay a higher tax on its value?

When we tax products of labor, we discourage their production, but when we tax land, we encourage production!

Rural land not needed for development will remain underdeveloped, but the land value tax will require valuable urban land to be used efficiently, and it will be easier to do so if buildings are un-taxed—a carrot-and-stick approach.

(2) This reform will invigorate our central business districts. It will promote the construction of apartment buildings near the downtown stores, which need walk-in traffic to prosper.

It will spur the rehabilitation of our blighted commercial districts. One building owner might not want to rehabilitate his building if he's located in a blighted downtown area; but if all the owners in the area are spurred into renewal, then renewal becomes profitable for all owners.

There are ample facts to support this expectation. Numerous studies show that in New Zealand, Australia and South Africa, cities which start to tax only land values experience marked construction increases, and those increases are uniformly greater than their similar but non-land-value-taxing neighbors. In South Africa, cities taxing only land values experience more construction than those cities which tax land values more than buildings, but the latter cities out-construct cities which tax land and buildings at the same rate.

We needn't, however, depend only on far-away places for verification of the economic boost that can come from a building-to-land tax shift. Take Pittsburgh, for example.

In that city, the tax rate on land was boosted steadily after 1979 so that now that rate stands at 15.15%, with building assessments being taxed at only 2.7%. Furthermore, in 1979, three-year property tax exemptions were granted to new construction (but not to the underlying land value). What happened was that new construction in 1979-81 jumped four-fold over 1976-78. Office buildings sprung up like mushrooms after a spring rain. No doubt, other factors also helped cause the construction burst but it is reassuring to note that Pittsburgh's experience accords with that of New Zealand, Australia and South Africa.

Take Scranton as another case in point. After it nearly doubled its land tax rate in 1980 and granted a 10-year property tax exemption to new construction, the value of new construction during 1980-81 increased 22% over 1977-79—this in the face of a howling construction depression. Nearby Wilkes-Barre, which taxes land and buildings at the same rate, experienced a 44% decrease in 1980-81 as compared to 1977-79.

Consider McKeesport, which in 1980 increased its land tax rate to 9%, decreased its building tax rate to 2%, and granted a three-year tax exemption to new construction. Building permit issuance increased 36% in 1980-81 as compared to 1977-79, whereas in adjacent Clairton and Duquesne, building permit issuance dropped 30% and 14% respectively in 1980-81 as compared to 1977-79.

Is there something here for Philadelphia to think about? No wonder a research study by the prestigious Urban Land Institute calls this property tax reform a "golden key to urban renewal-to the automatic regeneration of the city, and not at public expense."

(3) This is how to protect our unspoiled countryside. By taxing land more, buildings less, urban land will be used more efficiently; and the urge to spill and sprawl over the surrounding countryside would be considerably reduced.

Our population is expanding, and some encroachment on the fringe is inevitable; the younger generation has to live somewhere. But inefficient sprawl is an enemy which could be stopped by taxing land more heavily.

In New Zealand, the city of Wellington taxes land values which Auckland doesn't. Both cities are geographically similar, but Auckland's sprawl is noticeably greater than Wellington's.

Isn't it about time we protected our countryside?

(4) Cities and school districts can raise revenue more easily. Homeowners pay less in taxes when we tax land at a higher rate (after all, we're un-taxing their buildings,which is the major part of their investment). The tax is therefore mildly progressive—in accord with ability to pay. And it is for this reason that cities and school districts can raise revenue with the least harm to most taxpayers.

It is obviously easier to get more revenue from a tax (as on land) which will help rather than hinder the local economy.

The experts, from Ralph Nader of the U.S. Chamber of Commerce, urge this lower millage on buildings, higher millage on land. The reform has been successful where tried and is slowly spreading. It has attraction for those who are concerned about our urban unemployed.

When the government builds roads, schools and hospitals, land values jump. Shouldn't the government tax what it creates—land values—more than what individuals produce—income and buildings? □

Readers wishing more information about the two-rate tax can get in touch with the author at the Center for the Study of Economics, 580 N. Sixth Street, Indiana, Pa. 15701. Or readers could contact George Collins, Director of the Henry George School, 413 S. Tenth Street, Philadelphia, Pa. 19147.

Focus

metropolitan philadelphia's business newsweekly

WEDNESDAY, JUNE 1, 1983