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URBAN REVITALIZATION

LIMITATIONS AND OPPORTUNITIES FOR THE LENDER

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INTRODUCTION

The nation's major metropolitan areas are plagued, despite major government and private reinvestment programs undertaken, with continuing urban decay. Having been largely absent from many inner-city neighborhoods for several decades, the financial community has been under significant pressure to redirect lending and investment activity into these areas of our cities.

Despite the acknowledged "disinvestment" by most regional and larger financial institutions, there has been no evidence of a conscious strategy designed to eliminate presence in declining neighborhoods. Rather, a process of "unconscious redlining" has resulted in areas where economic conditions discourage private investment. Certain neighborhoods have, over many years, become plagued with high levels of blighted housing, abandoned structures, business flight, joblessness and poor public facilities. Consequently, within these areas a diminishing number of business and consumer applicants for loans possess significant collateral or credit history to meet normal underwriting criteria. Yet a failure to invest dooms such areas to even further decline.

Can this cycle of decay be broken? What public actions would lead to a healthier investment climate in our inner-city neighborhoods? This analysis attempts to analyze the causes and outline essential elements for the cure.

CITIES AS MAGNETS FOR THE POOR

The Great Depression touched off a massive migration of unskilled rural workers into the nation's industrial centers. City governments became overwhelmed by the problems of overcrowding and the ever-growing demand for public services. Not until the late 1960s did Federal spending in the cities bring a real measure of financial support for social programs. Unfortunately, Federal programs only served to attract even more migrants even when there were minimal prospects for employment.

At the same time, a countermigration from the cities to the suburbs began. Federal aid for housing, roads and other public investments heavily favored suburban growth. Private and public investment were siphoned from the older cities into new and ever-distant communities. Outmigrants from the central cities were predominantly higher educated and possessed the skills which bring higher earnings. Not only did industry follow (in some measure to capture this new pool of labor talent) but technological advances and the expansion of light manufacturing found the suburban environment more advantageous. Major retailers also began abandoning the central city for suburban shopping centers and the new suburban buying power.

Housing stocks in the nation's older cities have been worsening for many years. Most dwellings in older inner-city neighborhoods are more than fifty years old and require substantial modernization in heating, plumbing and electrical systems. As outmigration occurred, large urban homes were often purchased by investors and divided into apartment units. And, as low income renters replaced owner-occupiers housing maintenance declined. Accelerated depreciation and other aspects of the tax structure permitted investors to gain maximum income while their property deteriorated in physical condition. Market values followed the drop in the income levels of residents, further removing any incentive for adequate maintenance or rehabilitation by property owners. A large number of absentee owners, after milking the property for maximum profit, simply abandoned their properties.

A socially-conscious government responded by using public funds to construct and operate public and publicly-subsidized housing. The experience of such programs is often disheartening. Housing projects, particularly those which are high-density and isolated from constructive community influences, suffer from a concentration of problems associated with poverty. Spending for public housing programs must address issues related to the overall neighborhood environment if any success is to be achieved.

NATIONAL AND INTERNATIONAL FACTORS

The post-war resurgence of European and Asian economies and the industrialization of developing nations confronted America with a degree of competition in domestic and world markets for which we were ill-prepared.

Massive deficit spending in Vietnam, the Mideast oil crisis and generally misguided fiscal policies led to chronic inflation, a soaring national debt and serious recessions at home and abroad. In response to the imposition by government of higher and higher taxes, the middle and upper income groups went to the ballot box in great numbers to vote against excessive government spending. These days costly social programs are no longer willingly financed by the nation's taxpayers.

Another important factor has been the shift from an industrial to a service-oriented economy, which has compounded the impact of outmigration on the ability of local governments to raise revenue. As the local tax base has been reduced by retarded economies, lower revenues have forced cutbacks in city services and facilities. This has occurred during a period of rapidly increasing dependency on government for basic human services.

A CHANGE OF FOCUS

With the reduced likelihood that federal programs will come to the rescue of the large cities, greater emphasis is needed on what cities can do to help themselves. Economic growth is clearly critical. In the case of housing, for example, the availability of residential mortgage loans is directly linked with the need for steady employment. Rental housing, too, is a profitable investment only if the neighborhood provides employment for tenants. Often downplayed by official studies, the presence of job-creating economic growth is absolutely essential to the revitalization of the city's blighted neighborhoods.

EXISTING PUBLIC STRATEGIES: SITE ACQUISITIONS AND TAX ABATEMENT

Many cities have founded public "development corporations" that attempt to attract new industry, especially high technology business. One of the primary elements in this strategy has been a site acquisition program. Land suitable for commercial-industrial development is purchased by the city (funded by the sale of tax-free municipal/industrial development bonds), then resold to businesses agreeing to locate in the city at a price often less than 25 percent of market value. Additionally, new firms are normally exempted from city real estate taxes for a stated period of time.

Such land cost write-downs and tax abatements are undoubtedly attractive to new firms. However, these new businesses require local services and facilities. The increased economic activity generated by the new firms must be sufficient to pay for such services as well as the subsidies given. At times, the land and tax "bait" may cost the city more than the "catch" is worth. It should also be noted that the costs of attracting new business are borne largely by older, existing businesses, which must then compete on unequal terms (the payment of higher taxes, for one) with the newcomers. One consequence is that older marginal firms may be forced out of business and their employees left unemployed.

Ways must be found for bringing down land costs and tax costs for <u>all</u> productive elements in the community -- older firms as well as the new. Helping existing firms in a city to thrive and expand is often more cost effective than trying to lure firms from other places. Companies being sought after by competing cities sometimes put extravagant prices on their locational decisions. A vital and growing economy acts as a magnet for business.

THE CRUCIAL ROLE OF TAXES

Economists are uniform in agreement that the greater the tax burden on production, the less production there will be. Most of the emphasis in this discussion has related to federal taxes, but overtaxing production is an equally serious problem at the local level.

Local revenue is raised primarily from taxes on individual and business income, on retail sales and on real estate. Income and sales taxes are clearly burdens on production. The real estate tax also taxes production insofar as it falls on improvements such as homes, office buildings, factories and equipment. On the other hand, insofar as the real estate tax falls on land, it is <u>not</u> a tax on production. The quantity of land in existence is fixed and not produced by people. No change in tax policy will raise or lower the amount of land in a city.

Because of the uniqueness of land as a fixed quantity, a pro-production and pro-employment tax structure at the local level should be fashioned to reduce taxes placed on income, sales and the improvement component of real estate. For this reason, it also makes more sense to collect a much greater proportion of local taxes from land values than any other sources.

A CLOSER LOOK AT LAND TAXES

Taxes are rarely given credit for reducing prices. If there were a tax that would bring more land onto the market at reasonable prices, that would encourage the production of more and better housing, reduce construction costs and generate more jobs, it should stir excitement among those concerned with a city's social and economic climate. Economists such as the University of California's Mason Gaffney, Columbia University's C. Lowell Harriss and New York University's Dick Netzer all believe a tax on land values is such a tax.

Historically, the tax on land value has been linked with the tax on buildings as part of the much-maligned property tax. As a result the virtues of the land tax have been largely obscured. Consistently heavy taxes on improvements reduce the incentive to build and to maintain. To reverse the economics of the real estate tax, we ideally should gradually reduce the building tax while increasing the land tax until, say, within five or ten years the real estate tax will be levied on land values alone, with all improvements fully and permanently tax exempt.

As a result of infrequent and archaic assessment practices, present property taxes on land throughout the nation are relatively nominal and constitute a low annual holding cost for owners. Imposition of a higher rate of taxation on land (even when underassessed) reduces profit from speculative holdings and causes owners to release more land onto the market. As noted above, the absolute quantity of land remains constant, but the greater supply of land made available for development will tend to bring land prices down. Real estate developers can attest that land prices are an increasingly large component of housing costs. Reductions in land prices will be reflected in a reduced cost of housing for the consumer. Substitution of the land tax for the tax on improvements will, for most homeowners, further reduce their housing costs. Having established the land tax and exempting improvements, higher assessments -- that amount to tax penalties -- will no longer follow the completion of a new dwelling unit or rehabilitation of an old one.

THE LAND TAX AND BUSINESS PROPERTIES

Under a land value tax, with no tax on improvements, a capital-intensive office building is taxed no more than a parking lot using an identically-valued site. Owners of high quality buildings enjoy sizeable tax reductions. Owners of bare or underused sites get a "tax push" to put their land to appropriate use, or to sell the land to someone who will.

LAND BANKING

Land banking, the practice of buying up sites for future use, would be more costly under market conditions subject to a land value tax. But it would no longer be necessary. Developers usually inventory more parcels than they need in order to avoid losing a large share of their profits to land speculators. A high enough land tax will make speculation unprofitable; therefore, the land market will experience less hoarding and developers will find attractive sites at reasonable prices when they are ready to build.

A NEW ECONOMIC EQUATION

Economic development promoters should note that the land tax creates an environment of low land costs and low taxes on production -- not only for the occasional new firm entering the community but for all firms, new or old, large or small. Special benefits are avoided which help a favored few at the expense of the bulk of businesses that have contributed to the economy for years or even generations. The land tax exempts all buildings and generates no tax increase for modernization. An increase in jobs would flow from the new construction generated by removing the tax from buildings and taxing land values more. First to benefit would be the construction industry and its employees and suppliers. Those who produce and sell furnishings and equipment would be next in line. And, finally, employment would be generated as the new buildings are used to produce goods and services.

REVITALIZING DETERIORATING NEIGHBORHOODS

Disinvestment has been presented in this analysis as the result, not the cause, of neighborhood decay. The evidence strongly suggests that the tax system followed in our cities -- with its heavy burdens on production and construction -- stands in the way of efforts to revive older neighborhoods. The real estate tax as it now operates, with low taxes on land values and high building taxes, is a blighting influence that must be dealt with if renewal is to occur.

According to specialists such as Professors Harriss, Netzer and Gaffney, shifting to a land value tax would significantly help reverse the conditions which have led to urban blight and high structural unemployment.

The financial community must respond to the challenges faced by profitable investment in the inner-city. It would be well advised to support constructive tax reform as part of an economic development strategy. This represents a market-centered rather than a subsidy approach, under which benefits would accrue not only to blighted areas but to cities as a whole.

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