Want Affordable Housing? Look to the Land!

May 17, 2016: Written by Rick Rybeck, Director, Just Economics, LLC

Revised May 1, 2020*

* This was originally posted to Habitat for Humanity's "Solid Ground" campaign blog. In March 2020, the Solid Ground website was decommissioned. I have re-created the article here. I have updated a few terms to make them more comprehensible. "Value capture" has been replaced by "land value return and recycling."

Downtown Harrisburg, PA in 1982 (left) and 2007 (right)

In addition to food, water and air, an essential part of life is having a place to live. In spite of great advances in technology, we cannot live a purely "virtual" existence -- we need real places to grow our food, work, play, and most importantly, live.

When we think of housing, we often think about buildings. What are they made of? How big are they? Are they well-maintained? But we don't always think about the land that these homes sit on.

That land is a key element of building, and a major factor in price. You've likely seen houses of similar size, appearance and quality, that sell for vastly different prices. The difference is usually not because the building materials cost that much more in one community compared to the other. Most of that difference is due to the price of land in different communities and different neighborhoods.

So what determines the price of land? Some neighborhoods might be close to a good school. Some homes are close to employment centers. In short, access to jobs, education, shopping, entertainment and essential public goods and services (transportation, water, sewer, police and fire protection, etc.) makes land more valuable.

The role of access highlights an important distinction between the value of a house and the value of land underneath a house. The house has value based on the labor and material used to create, improve and maintain the house. Land beneath the house, however, has value based on what the surrounding community has done to make a particular location a good place to live.

Under most property tax models, publicly-created land value isn't widely shared. When a community builds and operates a good school, a water and sewer system, or a good transportation system, only a tiny portion of that community-created land value is returned to the community through taxes. The

lion's share of that value ends up as a windfall to whoever is lucky enough to own the best-served land. Such windfalls are the fuel for land speculation. ("Speculation" is buying land not to use it but in the hope of selling it later at a higher price.) The ability of private landowners to profit from public infrastructure investments can encourage corruption and discourage development or housing improvements. Most importantly, holding or hoarding land for future appreciation creates an artificial shortage of land available for development today. This artificial scarcity of developable land results in real increases in land prices, particularly near prime sites close to good schools, jobs and transportation facilities.

The inflated price of urban land pushes development – particularly affordable development – away from prime sites to cheaper, more remote sites lacking these amenities. In many parts of the world, this process creates urban sprawl – low density, discontinuous development. High prices may also result in informal settlements where people squat on marginal land that lacks basic public services.

This flight, from prime urban sites to sprawl or informal settlements, is detrimental to the environment. It impairs agriculture and conservation. It also cripples city budgets because public goods and services must be spread across a much wider area than if development were more compact. It deprives residents and businesses of essential public services.

Fortunately, some communities have discovered a remedy.

Traditionally, a property tax is a single tax rate applied to the combined value of land and any buildings on the land. This approach fails to account for the fact that taxes have different impacts on the price of buildings and the price of land. The tax on buildings is a cost of production. This tax is imposed when a building is constructed or improved, and again each and every year thereafter that such improvements add value to that piece of land. This increase in the cost of producing and maintaining houses results in lower housing production and higher housing prices.

Land, on the other hand, is not produced and its supply is fixed. Taxing land value does not reduce the quantity of land, but it does reduce the benefits of land ownership, and therefore reduces the price that people will pay to own land.

In order to reduce the cost of housing and the land underneath, governments should look beyond the traditional property tax model. Some communities have enhanced housing affordability through the use of "**land value return and recycling**." This is accomplished by reducing the property tax rate on privately-created building values and increasing the tax rate on publicly-created land values. Without any additional spending or any loss in revenue, this tax shift allows communities to reduce the price of both houses and land. The lower tax rate on buildings makes them cheaper to build, improve and maintain. The higher tax rate on land reduces the profits from land speculation, which keeps land prices more affordable. Further, revenue from land value return can be recycled for public purposes, making public infrastructure more financially self-sustaining.

This approach could be called a "universal tax abatement" because it would reduce taxes for all buildings. In addition to keeping housing affordable, it also encourages more intense development of high-value land near urban infrastructure amenities, such as public transit, water and sewage. This results in more compact cities where walking, cycling and transit are more efficient and affordable. This tax model encourages more construction, improvement and maintenance of buildings, thereby

increasing employment. And, by reducing sprawl, this approach helps preserve rural areas for agriculture, conservation and recreation. More compact development also reduces the wasteful duplication of (and expense for) urban infrastructure, thereby reducing tax burdens.

Land value return and recycling is already in use in a variety of cities around the world, including in high-density, high-population cities like Hong Kong, and in smaller cities such as Harrisburg, Pennsylvania (pictured). The approach has been adopted by entire countries as well. In Denmark, for example, land value return helped preserve family farms. Japan and Taiwan used it to transition from rural economies into industrial powerhouses.

This policy reform, by itself, will not solve all our urban problems. But by lowering prices for land and housing, we can help create more prosperous and sustainable cities that are more harmonious with nearby rural areas.

Rick Rybeck is the Director and Founder of Just Economics, LLC, an organization dedicated to assisting communities in promoting job creation, affordable housing, transportation efficiency and sustainable economic development.