Avoiding Mis-Givings: Recycling Community-Created Land Values for Affordability, Sustainability, and Equity

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"Givings" are the result of community actions that enhance the value of privately owned land. These "givings" are windfalls to landowners and are the fuel for land speculation. Land speculation produces nothing of value. However, it does create artificial scarcities of developable land (particularly near prime sites with infrastructure amenities) and leads to actual increases in land prices at these locations. This increases the cost of residential and commercial development, reducing housing affordability and employment. High land prices in prime locations push development to cheaper (but more remote and less productive) sites. The resulting urban sprawl requires the duplication of expensive infrastructure facilities in relatively low-density areas. This creates high per capita tax burdens and impairs fiscal sustainability. This article will review these impacts of "givings" and explore the opportunity for land value return and recycling to promote more affordable, sustainable, and equitable development.

I. "Givings" and "Takings"

The Fifth Amendment to the U.S. Constitution limits government taking of private property. Such takings are subject to "due process," must be undertaken for a "public use," and must provide "just compensation"

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to the owner.[1] A computer search for "takings" reveals many references to the Fifth Amendment, numerous statutes, regulations, cases, and commentaries. However, a similar search for "givings" yields much less. Of note is an article, "Givings" by Abraham Bell and Gideon Parchomovsky that discusses "givings" as the mirror image of "takings."[2] Indeed, they are "two sides of the same coin."[3] Bell and Parchomovsky stress that "a government that compensates for takings should also assess charges for givings . . . [and] . . . the animating concerns of takings jurisprudence—fairness and efficiency—apply with equal force to givings and demand a givings doctrine."[4]

Bell and Parchomovsky note that uncompensated takings would be both unfair and inefficient. It would be unfair to "forc[e] some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[5] It would be inefficient because, without just compensation, there would be no effort to ensure that the public benefits exceeded the compensatory costs. Similarly, the positive externalities associated with "givings" are unfair because many people (taxpayers) are forced to subsidize benefits that are primarily bestowed on only a few property owners. And positive externalities can also lead to economic inefficiency. Uncompensated givings allow beneficiaries to hoard land that would otherwise have to be employed productively. The analysis below will show that "land hoarding" contributes to urban sprawl, environmental degradation, unemployment, unaffordable housing, infrastructure duplication, and fiscal strain that may ultimately lead to governmental insolvency.[6]

1. The Fifth Amendment to the U.S. Constitution reads, in part, "No person shall . . . be deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation." https://constitution.findlaw.com/amendment5.html.

2. Abraham Bell & Gideon Parchomovsky, *Givings*, 111 Yale L.J. 547 (2001), *available at* https://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=4571&context=ylj.

3. *Id.* at 563.

4. *Id.* at 577–78.

5. *Id.* at 554 (citing Armstrong v. United States, 364 U.S. 40, 49 (1960)).

6. A number of cities have lost population while continuing to expand at the urban fringe, thereby leaving fewer people to pay for more infrastructure. Examples include Detroit, Cleveland, and Buffalo. *See* Alan Mallach, Facing the Urban Challenge: The Federal Government and America's Older Distressed Cities 8 (2010); *see also* Charles Marohn, The Growth Ponzi Scheme Part 2 (June 16, 2011), https://www.strongtowns.org/journal/2011/6/14/the-growth-ponzi-scheme-part-2.html; Leigh Gallagher, *The Suburbs Will Die: One Man's Fight to Save The American Dream*, Time (July 28, 2014), http://time.com/3031079/suburbs-will-die-sprawl . Marohn estimates that property taxes return between four and sixty-five cents for every dollar of future liability incurred. *See also* Walter Rybeck, Re-Solving the Economic Puzzle 146–48 (2011); James A. Kushner, *Affordable Housing in the Time of Global Climate Change*, 42Urb. Law. 207

A. The Infrastructure Conundrum

Typically, local governments use their authority and tax revenues to create infrastructure to facilitate and support development. But if infrastructure is well-designed and well-executed, land prices and rents near the infrastructure rise. This increase represents a windfall gain to owners of well-served sites.[7] Yet, neither the Constitution nor statutes mandate that private landowners compensate the public sector for such beneficence. State and local property taxes will typically recapture only ten to twenty percent of this benefit, leaving the lion's share to private landowners.[8]

(2010)/43 Urb. Law.179 (2011) (crediting real estate speculation as a significant cause of the 2007 financial meltdown).

7. Are increases in land value windfalls or appropriate returns to "real estate investors," compensating them for investment risks? First, buying and selling land are often referred to as "real estate investment." But "investment" in an economic sense is foregoing consumption to create goods that are not themselves consumed, but are used to create other goods or services in the future. *See Investment*, Wikipedia, https://en.wikipedia.org/wiki/Investment_(macroeconomics). This definition contrasts "economic investment" in capital goods (housing, machinery, etc) to "financial investment," which is simply the holding of any asset for the purpose of future appreciation. When land is merely purchased, nothing is created. Therefore, the purchase of land is not "investment" in an economic sense. Second, we have been taught that capitalism rewards risk. Buying land is risky because the value of the land can decrease. So why should people who buy land not be rewarded? Buying lottery tickets and betting on horse races are risky. But these activities are not "investment" because they produce nothing. These activities are merely gambling. The essence of capitalism is not rewarding risk-taking per se, but rewarding productive risk-taking. If somebody builds a building and they fail to recover a profit, society ends up with a building that could be of some use to somebody. But if we hold a lottery, we merely redistribute money from losers to winners, and no new net wealth is created. Thus, it is important to distinguish between two types of behavior—economic investment and gambling. Both entail risk. But gambling creates nothing that was not already there. Buying and selling land in the hopes of making a profit is not "economic investment," it is "gambling." And if the gamble succeeds, it is based on appropriating value created by others and not by the "investor." Thus land speculation is a parasitic activity. George Washington Plunkitt, a Tammany Hall official, spoke about public officials who, knowing where infrastructure expansions would occur, would buy land in advance of these projects and then reap the rewards. He referred to this as "honest graft." *See George Washington Plunkitt*, Panarchy (2000–2017), https://www.panarchy.org/plunkitt/graft.1905.html. But do land speculators benefit society by preserving vacant land for future development? When a need for more intense use of a site arises, existing buildings are often expanded. If the need for more intense use is significant enough, buildings are torn down and completely rebuilt. Thus, vacant land is not necessary to facilitate future development.

8. The part of the traditional property tax that is applied to publicly created land value will return only a small portion of this windfall. Property tax rates vary from place to place, but typically they range between 1% and 2% of value. *See* Alan Mallach, The Divided City: Poverty and Prosperity in Urban America 164 (2018). Assuming a typical property tax rate of 1% to 2% of value paid annually, a net present value (NPV) calculation in a low-inflation environment shows the NPV of these payments as roughly

Very significant consequences arise from this lack of reciprocity. The ability of landowners to appropriate publicly created land values serves as the fuel for land speculation. Land speculation is the purchase of land, not for the purpose of using it, but for the purpose of obtaining a higher sales price in the future.[9] Buying land and holding it for future appreciation means that less land is available for development today. This artificial scarcity of developable land results in actual price increases—primarily at prime sites near urban infrastructure amenities.[10] As prices of prime sites escalate, more owners of these sites are induced to favor speculation over utilization, driving land prices even higher.

High land prices near infrastructure amenities (like centers of urban transportation networks, transit stations, good schools, parks, etc.) push development to cheaper (but more remote and less productive) sites.[11] When these remote areas are occupied, residents and businesses find that they lack necessary infrastructure and demand its extension to these areas.[12] When infrastructure is extended, the cycle repeats with rising land prices choking off development at that location and chasing it even farther away. [13]

between 10% and 20%. Thus, 80% to 90% of publicly created land values end up as windfall gains to private landowners.

9. *Plunkitt*, *supra* note 7. Mr. Plunkitt explains how knowledge of where new infrastructure will be placed allows a public official to buy that land in advance of the project and then reap the rewards later. According to Plunkitt, there's no harm to the public because the price of land would rise as a result of the new infrastructure regardless of who owns it. *Id.*

10. Richard K. Green, *Nine Causes of Sprawl*, Ill. Real Estate Letter (U. Ill.-Urbana-Champaign), Fall 1999, at 12 (land assembly holdouts).

11. *Id.* at 10 (noting high land prices in city centers pushing development towards cheaper peripheral sites); *see also* Todd Litman, *Analysis of Public Policies that Unintentionally Encourage Sprawl*, Global Commission on the Economy and the Climate 1–3 (Mar. 2015), https://newclimateeconomy.report/workingpapers/wp-content/uploads/sites/5/2016/04/public-policies-encourage-sprawl-nce-report.pdf (describing sprawl impairing economic productivity).

12. In the 1990s, America Online (AOL) was expanding rapidly and quickly outgrew three office buildings in Fairfax County, a suburb of Washington, DC. AOL wanted to have all its employees in one place. It could have located its headquarters in the District of Columbia or in any of the close-in suburbs to maximize access to the labor pool by taking advantage of the existing roadway and transit networks. Instead, AOL developed a campus in Loudoun County, more than thirty miles from Washington, DC. Shortly after the move, employees and then AOL complained about the inadequate road network in the area. AOL bought cheap exurban land. The land was cheap because it lacked infrastructure. AOL's call for Loudoun County to improve the roadway network is an example of how private development seeks public infrastructure subsidies. *See* Michael Laris, *Loudoun, AOL Split Over Slow Growth: Tech Giant's Attack Upsets Supervisors*, Wash. Post, July 29, 2001, at C1.

13. Public sector subsidization of new development is identified as a factor that encourages sprawl. *See* Useful Community Development, https://www.useful

The "infrastructure conundrum" describes a situation whereby the infrastructure created to facilitate development inflates land prices, and this chases development away from the infrastructure. Communities run after new development with more infrastructure, but never catch up. The resulting sprawl destroys farmland, increases impervious surfaces that degrade streams and rivers, increases dependency on single-occupant vehicles for travel, thereby increasing energy consumption and pollution along with traffic injuries and deaths.[14] New infrastructure on the urban fringe can pull private investment away from central neighborhoods, which become blighted. Municipal budgets are stretched thin due to the duplication of expensive infrastructure across metropolitan areas where densities are too low to maintain that infrastructure without excessive tax burdens.[15]

B. No Good Deed Goes Unpunished

The same economic externalities that lead to the "infrastructure conundrum" also create an environment in which "no good deed goes unpunished." Communities may attempt to assist distressed neighborhoods through improvements to schools, transportation, public safety, etc. If these efforts are successful, land prices and rents rise, displacing the intended beneficiaries and enriching already affluent landowners, exacerbating income inequality.[16] This "no good deed goes unpunished" environ-

-community-development.org/causes-of-urban-sprawl.html. Rapid suburban development (sprawl) whereby the public sector subsidized new development is credited with fueling the movement toward development impact fees. *See* Paul A. Tiburzi, *Impact Fees In Maryland*, 17 U. Balt. L. Rev. 502 (1988), *available at* http://scholarworks.law.ubalt.edu/ublr/vol17/iss3/4.

14. For more information about the fiscal and environmental costs of sprawl, see Todd Litman, *Understanding Smart Growth Savings: What We Know About Public Infrastructure and Service Cost Savings, and How They Are Misrepresented by Critics*, Victoria Transp. Pol'y Inst. (Apr. 25, 2013), http://www.vtpi.org/sg_save.pdf*; see also* Transp. Res. Bd., Transit Cooperative Research Program (TCRP) Report 74: Costs of Sprawl (2000); Real Estate Res. Corp., The Costs of Sprawl (1974). These reports show that sprawl can increase the cost of infrastructure by between ten and forty percent. *See also* Clinton-Gore Administration, Building Livable Communities (2000); Robert Burchell et al., Federal Transportation Administration, Costs of Sprawl—Revisited, Transit Cooperative Research Program (1997). Compact development also leads to substantial energy savings for both buildings and transportation. See Jonathan Rose Cos., U.S. EPA, Location Efficiency and Housing Type—Boiling It Down to BTUs (2011), at www.epa.gov/smartgrowth/pdf/location_efficiency_BTU.pdf .

15. This paragraph recapitulates what was said earlier. *See* Charles Marohn, *The Growth Ponzi Scheme*, Strong Towns (June 2011), https://www.strongtowns.org/the-growth-ponzi-scheme.

16. Winston Churchill addressed Parliament in 1909 telling a story about a working class neighborhood where many workers had to pay a bridge toll to get to work. Londoners felt bad about this and asked the government to "free" the bridge. It did so. Shortly thereafter, rents in this neighborhood increased by the amount of the foregone toll. Workers were no better off than before if they used the bridge. They were worse

ment creates frustration. Governments are blamed for lack of investment in low-income neighborhoods *and* for too much investment if these efforts lead to the displacement of low-income households.

The infrastructure conundrum and the unintended consequences of anti-poverty efforts can be remedied, at least in part, by returning community-created land values to the public sector and recycling them for operation and maintenance of public goods and services. This taps an often-overlooked source of revenue, allowing for reductions in taxation of privately created building values. Lower taxes on building values makes buildings cheaper to construct, improve, and maintain.[17] Surprisingly, higher taxes or fees on land values help keep land prices more affordable as well because the price of land is based on the expected benefits of ownership. Increasing taxes on land value reduce the expected benefits of ownership, thereby reducing its price.[18] Thus, shifting taxes off of building

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off if they did not use the bridge because their rents went up anyway. *Winston Churchill Said It All Better Than We Can*, Land Value Taxation Campaign (Feb. 14, 2010), http://www.landvaluetax.org/current-affairs-comment/winston-churchill-said-it-all-better-then-we-can.html. Involuntary displacement is wrenching and traumatic for families. In most of the country, it manifests itself as "demolition by neglect." This is the predominant form of involuntary displacement in rust-belt cities where factory closings and job losses undermine their economic foundation. This was the predominant form of displacement in Washington, DC, until it became one of the few places in the country to have a robust job market, particularly for high-tech and intellectual workers. Then gentrification took hold, first in white working class neighborhoods in Ward 3 and then moving east. In some neighborhoods (like Shaw), demolition by neglect had removed most of the low-income and working-class Black families before the affluent folks moved in. Although some people think that demolition by neglect and gentrification are totally different, they have a common foundation. That foundation is land speculation. For a discussion of gentrification, see Alan Mallach, The Divided City: Poverty and Prosperity in Urban America (2018); see also Margaret Reuss & Jerome Paige, *The Process of Neighborhood Revitalization and Its Implications for Public Policy: The Case of Washington, DC.*, (U.D.C., Dep't of Econ., Working Paper No. 7, 1979).

17. Paul A. Samuelson, Economics 387–88 (9th ed. 1973). A tax on something that is produced becomes a cost of production. (If there is no production, there is no tax.) Anytime the cost of production increases (all other things being the same), the quantity of goods being produced will decline because producers must initially absorb the tax (as consumers are not willing to pay higher prices just because the tax went up), and marginal producers go out of business. Then, because the quantity of goods declines, prices rise.

18. *Id.* at 562–64; *see also* Adam Smith, The Wealth of Nations 976 (1937). The price of land is based on purchasers' expectations of the benefits of land ownership. Increasing the tax on land, all other things being the same, causes the expected benefits of landownership to decline, thereby causing prospective purchasers to offer lower prices. Thus, a tax on land is not a cost of production. Land is not produced, and there will be just as much land after the tax is imposed as there was before. A tax on land is a cost of ownership. Increasing the cost of ownership reduces the price.

values and onto land values makes both buildings and land more affordable, without any new expenditures or any revenue losses.

Although it might be best politically to implement this tax shift in a revenue-neutral manner vis-à-vis the traditional property tax, such an implementation is likely to become revenue positive over time because vacant lots and boarded-up buildings will be revitalized with tax-generating residents or businesses. Furthermore, reducing vacant lots and boarded-up buildings can reduce expenditures associated with such properties related to arson and other crimes.

Returning a greater share of land value to the public sector that creates it also ensures greater equity to the extent that those who receive the largest benefits from public goods and services, as reflected in land values, pay in proportion to the benefits received. The most valuable land, near public infrastructure amenities, will pay the most in taxes. As an additional benefit, returning community-created land values encourages development. Because landowners cannot avoid land value return payments, they are motivated to generate income from which to pay them. The greatest incentive for development will occur on high-value sites, typically infill sites near existing public infrastructure amenities.

The first graphic illustrates how land values are created and distributed. There are three main points:

- Although most people pay for infrastructure through taxes,[19] increased land values tend to be very concentrated in and around those areas where infrastructure benefits occur. This dynamic redistributes wealth from the general public to the owners of prime sites. Thus, as noted by Nobel-winning economist Joseph Stiglitz, "givings" are contributing to the growing inequality in our society.[20]

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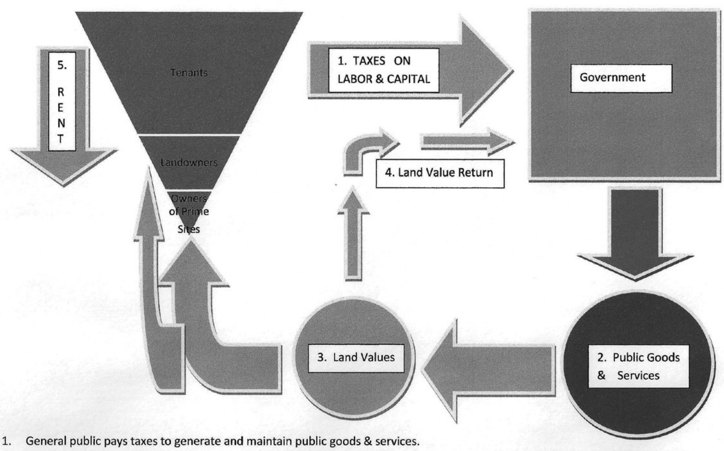
19. Infrastructure is typically paid for through federal, state, and local appropriations. The source of all these appropriations is various taxes. State and municipal bonds are also used to pay for infrastructure. But bonds are NOT a source of funds. They are merely a source of financing. Bonds are loans that are paid off by future taxes. In some cases, impact fees might also help pay for infrastructure. But impact fees are similar to taxes on improvements. They increase the cost of development, thereby reducing the amount of development that occurs and increasing the price of what remains by being passed through to the users.

20. *See US Should Adopt a Land Tax to Combat Inequality*, Bloomberg Bus. Rep. (Mar. 5, 2015), *available at* https://www.iol.co.za/business-report/opinion/us-should-adopt-a-land-tax-to-combat-inequality-1827238. This article reports on Nobel-winning economist Joseph Stiglitz's critique of Thomas Piketty's claim in *Capital in the Twenty First Century* that returns to capital are outpacing returns to labor. Stiglitz suggests that if land and housing are removed from the category of "capital," the returns to capital have been constant since the 1950s and are somewhat lower than they were at the turn of the twentieth century. Stiglitz suggests that it is important to distinguish between productive capital and land. He also suggests that a tax on land value would diminish inequality without the negative impacts on productivity that characterize many other types of taxes. *See*

- Some publicly-created land value is returned to the public sector through the property tax. But this typically amounts to only ten to twenty percent of the value created, leaving eighty to ninety percent as a windfall to private landowners.[21]
- Most taxpayers end up paying for infrastructure at least twice. First they pay in taxes. Then, if they want to take advantage of that infrastructure by locating their homes or businesses nearby, they must pay a premium price or rent to the landowner as well.

LAND VALUE CREATION & CONSEQUENCES



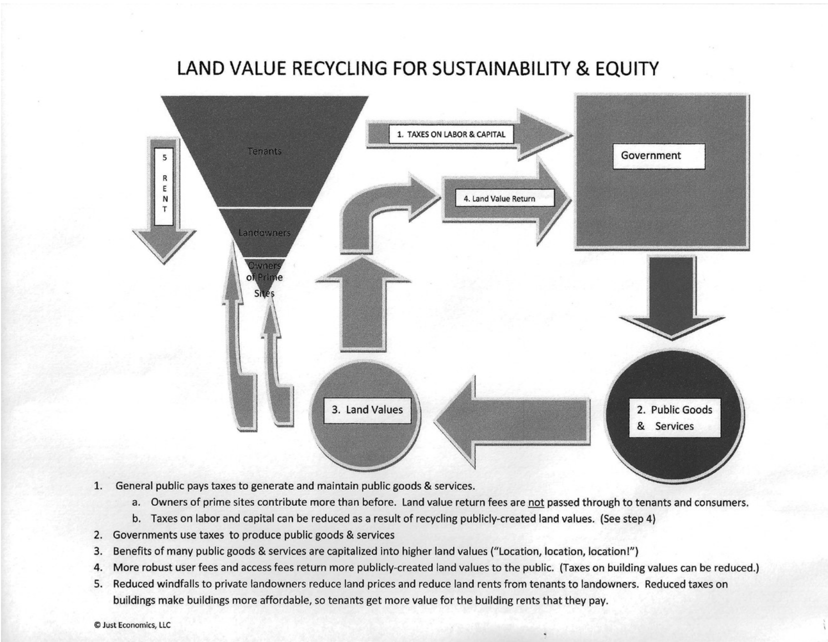
1. General public pays taxes to generate and maintain public goods & services.
   a. Owners of prime sites contribute less than others because most of their taxes are passed through to tenants and consumers.
2. Governments use taxes to produce public goods & services
3. Benefits of many public goods & services are capitalized into higher land values, mainly on prime sites. ("Location, location, location!")
4. Land Value Return: User fees plus access fees (land taxes). Typical property tax returns only 1% or 2% of publicly-created land value.
5. Most land values created by government are windfalls to owners of prime sites who charge premium rents to tenants for the right to access these public goods and services. NOTE: Tenants pay twice for government services. Once in taxes & again in land rent.

The second graphic illustrates what happens when a more significant share of publicly created land value is returned to the public sector and recycled to operate and maintain the public goods and services that created this value in the first place. As mentioned above, some degree of land value return and recycling (LVRR) exists almost everywhere, embedded within the traditional property tax. But, it is typically very weak. By making LVRR more robust, the profits from land speculation are reduced. This reduces speculative demand for land and helps reduce land price inflation as well. Because LVRR payments cannot be avoided (as it is impossible to

Joseph Stiglitz, The Price of Inequality (2012); Joseph Stiglitz, Rewriting the Rules for the American Economy (2016).

21. *See supra* note 8.

move a parcel of land from a high-tax to a low-tax jurisdiction), they actually encourage development of high-value sites to generate income from which to pay these fees. Because the demand for developed space is finite at any given time, expanding the supply of developed space on high-value sites near existing infrastructure helps reduce development pressure at the urban fringe, resulting in more compact development.[22]



II. Land Value Return and Recycling in Practice

The property tax applied to buildings is a cost of production that reduces supply and increases building prices. The property tax applied to land is a cost of ownership that has no impact on supply and reduces land prices. Although these divergent impacts of taxation on land and buildings are explained by fundamental economic principles, many people are unaware of this Jekyll and Hyde characteristic of the traditional property tax. Nonetheless, some communities have successfully implemented land value return and recycling policies with demonstrably beneficial outcomes.

22. Joseph DiMasi, *The Effects of Site Value Taxation in an Urban Area: A General Equilibrium Computational Approach*, 40 Nat'l Tax J. 577 (Dec. 1987). Using data from Boston, the distance from the central business district to the outer urban ring of the model contracted by more than half a mile when the current property tax was replaced by a split-rate tax that taxed land values at three times the rate on building values.

One of the earliest examples in the United States was the reconstruction of San Francisco after the devastating earthquake and fire of 1906. Without federal or state disaster assistance, San Francisco was quickly rebuilt as a vibrant and compact city. Prior to the disaster, records show that seventy-five percent of San Francisco's real estate tax base consisted of land value. In other words, either through assessment policy, tax rate policy or both, land was being taxed more heavily than buildings. Therefore, although the quake and fire destroyed many buildings, San Francisco's land (and most of its tax base) remained intact. Tax payments allowed San Francisco to rebuild its infrastructure and motivated landowners to restore income-producing buildings quickly.[23]

In 1913, Pittsburgh began to shift its property tax off of building values and onto land values. This shift was phased-in over five years after which the tax rate on buildings was one half the rate on land. This reform was undertaken at the behest of manufacturers who needed access to flat land for factories. Pittsburgh is very hilly, with some flat land along the rivers. But, in the early 1900s, this river-front land was controlled by a few owners who were demanding excessive prices. The higher tax applied to land values made it more difficult for these landowners to hold out for above-market prices. Thus, manufacturers obtained access to land at reasonable prices, transforming Pittsburgh into a vital manufacturing center.[24]

During the Great Depression, many major cities experienced reductions of twenty-five to fifty-eight percent in property assessments.[25] This decrease was the result of a nationwide real estate boom and bust in the late 1920s and compounded by the ensuing depression. But, during this time, Pittsburgh's assessments declined by only eleven percent.[26] In part, this happened because Pittsburgh's higher tax on land values discouraged land speculation. Thus Pittsburgh avoided the real estate boom and bust that plagued other cities.

In the 1960s, while jobs (and people) were fleeing the cities for the suburbs, Pittsburgh was an outlier, attracting more jobs than its suburbs.[27] During the 1970s, when faced with a budget shortfall, Pittsburgh increased its land tax (in lieu of a proposed increase in wage taxes). As Pittsburgh's

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23. Mason Gaffney, *New Life in Old Cities*, Robert Schalkenbach Found. 24–26 (2006), http://www.masongaffney.org/publications/2006_New_Life_in_Old_Cities.pdf. Mason Gaffney is a professor of economics at the University of California, Riverside.

24. Dan Sullivan, *Why Pittsburgh Real Estate Never Crashes: The Tax Reform That Stabilized a City's Economy*, Saving Communities (n.d.), http://savingcommunities.org/places/us/pa/al/pgh/nevercrashes.html.

25. Percy R. Williams, *Pittsburgh's Pioneering in Scientific Taxation*, republished as *The Pittsburgh Graded Tax Plan: Its History and Experience*, Robert Schalkenbach Found. n.59 (1963), http://savingcommunities.org/docs/williams.percy/gradedtax.html. Williams was Pittsburgh's Chief Assessor 1934–1942.

26. *Id*. n.59.

27. Robert C. Weaver, *The Suburbanization of America: Or the Shrinking of the Cities*, 9 Civ. Rts. Dig., Spring 1977, at 3, 9.

land tax grew to four times and then six times the rate applied to buildings, Pittsburgh experienced Renaissance II, an expansion of new corporate headquarters in its downtown.[28] When Pittsburgh's manufacturing industries automated and/or departed for overseas locations, Pittsburgh suffered. But it was more successful than most other rust-belt cities in making the transition to a service-based economy. A 1997 article for the National Tax Journal credits Pittsburgh's unusual property tax system as one reason for this success.[29]

In the late 1990s, Allegheny County underwent a court-ordered reassessment. The reassessment (which may have been flawed) resulted in large increases in land value assessments in affluent Pittsburgh neighborhoods, triggering complaints and objections. Pittsburgh could not afford to redo the assessments. Local politicians decided that returning to a traditional property tax (same rate applied to buildings and land) would be the easiest way to reduce taxes in the affluent neighborhoods. Most Pittsburgh taxpayers had little awareness about Pittsburgh's "split-rate" property tax. Even fewer were aware that it was instrumental in Pittsburgh's economic success. As a result, there was no organized constituency to demand its preservation, and Pittsburgh abandoned its split-rate property tax in 2001.[30]

Harrisburg, Pennsylvania, a manufacturing city, a transportation hub and the state capital, suffered from urban flight as did many other cities during the 1960s and 1970s. Making matters worse in 1972, Hurricane Agnes caused the Susquehanna River to flood, damaging Harrisburg's downtown. In the late 1970s, there were over 5,000 vacant and boarded-up properties in Harrisburg. In 1975, Harrisburg adopted the approach of taxing publicly created land values more heavily than privately-created building values. Over the next fifteen years, the number of vacant and boarded-up properties were reduced to a few hundred.[31] As recently as July, 2018, Harrisburg continues to employ this "split-rate" property tax with a rate of 30.97 mills on land and a rate of 5.16 mills on improvements.[32]

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28. *See Pittsburgh's Golden Triangle – 1983: Renaissance II*, Brookline Connection (2019), http://brooklineconnection.com/history/Facts/Point1983.html.

29. Wallace Oates & Robert M. Schwab, *The Impact of Urban Land Taxation: The Pittsburgh Experience*, 50 Nat'l Tax J. 1 (Mar. 1997).

30. Herbert Barry III, *Irrationally Indiscriminate Tax*, *Groundswell*, Common Ground, Mar.–Apr. 2001, at 5–7, https://commonground-usa.net/barry-herbert_irrationally-indiscriminate-tax-2001-mar-apr.pdf.

31. Nat'l Neighborhood Coal., Neighborhoods, Regions And Smart Growth Toolkit: The Smart Growth, Better Neighborhoods Action Guide (2003); Case Study: Two-Rate Tax in Harrisburg 26 (June 10, 2004), http://web.archive.org/web/20040610031846/www.neighborhoodcoalition.org/pdfs/content.pdf.

32. *With Property Tax Hike Threatened, How Does Harrisburg's Tax Rate Compare?*, Penn Live (July 11, 2018), https://www.pennlive.com/news/2018/07/with_big_property_tax_hike_loo.html. Harrisburg has been in a precarious financial situation since 2011. This arises not from its unusual property tax regime, but from its investment in a waste-to-energy incinerator that failed (and for which the City of Harrisburg was financially

Of course, when good things happen after the implementation of land value return and recycling, it is reasonable to wonder: "Would this improvement have happened without the reform?" Fortunately, in the mid 1970s, a situation arose that was very close to a "controlled experiment." Outside of Pittsburgh are three steel towns: McKeesport, Duquesne, and Clairton. They all have largely Eastern-European populations with steel-based economies. In the mid-1970s, they each had a closed factory, and each suffered from declining numbers of building permits year after year. McKeesport then adopted land value return and recycling by implementing a split-rate property tax with a lower tax on buildings and a higher tax on land. Shortly afterwards, building permits rose over several consecutive years. Economic theory predicts this result, but would it have happened anyway? In nearby Duquesne and Clairton, the number of building permits continued to decline. Noticing what happened in McKeesport, Duquesne and Clairton soon adopted land value return and recycling. Thereafter, building permits increased in those cities also.[33]

McKeesport, Duquesne, and Clairton remain distressed economically. Reforming the property tax did not cause the steel mills to return nor unemployment to disappear. But each of these cities is performing better than it would under the traditional property tax.

III. Legal Issues[34]

A. Takings

Although land value return and recycling is proposed to address a situation of uncompensated "givings," would there be any grounds for some property owners to claim that higher taxes based upon land value constitute a "taking" under the Fifth Amendment to the U.S. Constitution?

First, where property taxes are levied, they are typically levied against both the value land and the value improvements (buildings), if any. Thus some degree of LVRR is almost ubiquitous now. To the author's knowledge, there has never been a successful challenge against property taxation generally or the taxation of land value specifically, on the basis that such a tax constituted a "taking." Second, in most places where LVRR has been made more robust, it has been accompanied by reduced rates of taxation levied against the value of buildings. All other things being equal, reducing

liable) and from other corruption and fiscal mismanagement issues. *See Harrisburg, Pennsylvania,* Wikipedia, https://en.wikipedia.org/wiki/Harrisburg,_Pennsylvania#21st_century_fiscal_difficulties_and_receivership .

33. Steven Cord, Incentive Taxation (Oct. 1995), *cited in* Rick Rybeck & Walter Rybeck, *Break the Boom & Bust Cycle*, Pub. Mgmt. 7, 10 n.6 (Aug. 2012), https://www.justeconomicsllc.com/pdfs/ICMA-BreakBoom&BustCycle-Aug2012.pdf.

34. For another examination of legal and administrative issues, see Richard F. Dye & Richard W. England, *Assessing the Theory and Practice of Land Value Taxation*, Lincoln Inst. 23–25 (2010), https://www.lincolninst.edu/sites/default/files/pubfiles/assessing-theory-practice-land-value-taxation-full_0.pdf.

the tax on buildings tends to increase the price of land in such an area.[35] So it would be difficult to claim that LVRR constitutes an uncompensated taking when part of the reform actually increases land values.

Third, as mentioned previously, the value of land arises largely from the quality and quantity of public goods and services available at particular locations. Thus, payments based upon land value result in payments that are proportional to the public infrastructure benefits received. Thus payments based on land value are value given for value received. Such payments are more like a "fee" than a "tax." The distinction is that a fee is a payment directly related to a publicly provided benefit.[36] Taxes, on the other hand, are general payments in exchange for general benefits, with little direct connection between the taxes paid and the benefits received. Thus, the strong relationship between land value return payments and public benefits received would undercut any claim of uncompensated "taking."

B. *Uniformity*

Some state constitutions and property tax statutes require "uniformity." This means that all property in the same class must be treated equally. Would taxing land and buildings at different rates violate the uniformity requirement?

Some states separate residential, commercial, and industrial properties into distinct classes of property and apply either different assessment rates or different tax rates to each class.[37] These are referred to as "classified" property tax systems. To the best of the author's knowledge, most classified property tax systems meet a rational basis test for equal treatment of similar property.

In the 1970s and 1980s, several states identified economically distressed areas for the purpose of creating Enterprise Zones. Businesses and properties within these designated "enterprise zones" became eligible for reduced

35. Reducing the tax rate on buildings makes buildings cheaper to construct, improve, and maintain. To the extent that this reform is undertaken, buildings in the area where the improvement tax has been reduced will be more profitable than they had been and more profitable than comparable buildings in places with higher improvement taxes. As a result, if nothing else were done, land prices would increase in this area. Of course, the proposal is to simultaneously increase the tax on land values, which, as stated earlier, creates downward pressure on land prices. Because both changes would happen simultaneously, it is difficult to know what the net change in land prices would be without an in-depth study of local market conditions.

36. Transp. Res. Bd., Guidebook to Funding Transportation Through Land Value Return and Recycling 60 (Apr. 2018) (NCHRP Report #873), http://www.trb.org/Main/Blurbs/177574.aspx [hereinafter TRB Guidebook].

37. Daphne A. Kenyon, Real Property Tax Classification in Washington, DC 16 (Oct. 24, 2013), http://docs.wixstatic.com/ugd/ddda66_7e055c0324c7fa709eff78a44065f104.pdf. As of 2012, twenty-seven states employed "classified" property tax systems. *Id.*

levels of taxation, including reduced property tax rates in some cases.[38] To the best of the author's knowledge, states that established objective criteria for distressed areas and that linked lower tax rates in these areas to a policy objective for economic revitalization were successful in avoiding any legal nullification of the favorable tax treatment provided within the zones.

Based on common practices utilizing classified property taxes and enterprise zones, a legislative finding based on long-established economic principles that land and buildings are separate classes of property should meet the rational basis test and survive any challenge based on a lack of uniformity. And reducing the tax rate on improvements to make housing more affordable and to increase employment opportunities is likely to be seen as a legitimate public purpose. Since 1913, Pennsylvania has permitted jurisdictions to tax land and buildings at separate rates and no legal challenge has nullified this practice on grounds of uniformity—or any other legal principle.

C. *Statutory Prohibition*

Some states have statutes which prohibit land and buildings from being taxed at different rates. Maryland represents an interesting example.

In Maryland, the most fundamental law governing property tax assessments and rates is Article 15 of the Declaration of Rights:

> **Art. 15.** . . . [T]he General Assembly shall, by uniform rules, provide for the separate assessment, classification and sub-classification of land, improvements on land and personal property, as it may deem proper; and all taxes thereafter provided to be levied by the State for the support of the general State Government, and by the Counties and by the City of Baltimore for their respective purposes, shall be uniform within each class or sub-class of land, improvements on land and personal property which the respective taxing powers may have directed to be subjected to the tax levy. . . .[39]

Article 15 states that "land" and "improvements on land" are (or could be) separate classes of property. It also indicates that "sub-classes" of property can be created. Therefore, while both buildings and land should be assessed at their full fair market value, the Maryland Declaration of Rights appears to permit a split-rate property tax whereby a lower tax rate could be applied to privately created building values and a higher tax rate could be applied to publicly created land values.

Yet, the setting of property tax rates by counties and Baltimore City is further circumscribed by another statute. Maryland Tax-Property Code § 6-302 specifically prohibits Maryland counties (including Baltimore City) from levying more than one rate on all real property, whereas § 6-303 permits levying multiple rates for cities (except Baltimore).[40] If Baltimore

38. *See Enterprise zone*, Wikipedia, https://en.wikipedia.org/wiki/Urban_enterprise_zone.

39. Md. Const., art. 15.

40. *See* Md. Code Ann. Tax-Prop. § 6-303(c)(1).

City or a county in Maryland wished to implement land value return and recycling, an amendment to § 6-302 eliminating the prohibition would be required.[41] However, cities (except Baltimore) have property taxation powers and are able to tax land and buildings at separate rates.

Some states and counties present more difficult challenges. In 1978, California voters approved Proposition 13. Proposition 13, and similar laws enacted in other jurisdictions since that time, froze (or limited increases in) property assessments and/or rates. These laws often require super-majority votes to amend them or to exceed the limits they established. Approximately forty-two states employ some type of limitation on increases in assessments and/or rates.[42] These limitations represent the most significant impediment to the implementation of more robust land value return and recycling.

D. Assessments

The property tax assessment process is the foundation for fair and effective property taxation. It is essentially a reporting function to determine the location and amount of real property value. While the technicalities of assessment methodology are beyond the scope of this essay, there are some important things to understand. The market value of a property is not an exact figure, but a range.[43] And the two key metrics for assessments are accuracy and fairness. Ultimately, fairness is more important. If all the properties in a jurisdiction are worth between $190,000 and $210,000 and they are all assessed at $95,000 to $105,000, the assessments are inaccurate, but they are fair because the ratio of market value to assessed value is roughly the same for all properties.

When land value return and recycling is proposed,[44] it is not uncommon for some to say that this is fine in theory, but, in practice, because most properties contain both land and improvements, it is impossible to apportion the total property value between its land and improvements

41. Rosecroft Trotting & Pacing v. P.G. County, 471 A.2d 719 (Md.1984).

42. Transp. Res. Bd., *supra* note 36, at 59.

43. The market value of a property may be expressed as an exact dollar figure, but it is more accurate to express it as a range of values. In other words, if the same property were put up for auction week after week (assuming no change in population, demand for housing or general economic conditions), the winning bids are unlikely to be identical. However, the winning bids should cluster around each other. So while an assessment might state that a property is worth $200,000, it might be more appropriate to express the market value as a range between $190,000 and $210,000.

44. In 1978, only five jurisdictions in Pennsylvania taxed land and buildings at separate rates. Today, there are about fourteen such jurisdictions. *See* Zhou Yang, *The Effects of the Two-Rate Property Tax: What Can We Learn from the Pennsylvania Experience?* 12 tbl. 1 (Lincoln Inst. Land Pol'y Working Paper, 2014), https://www.lincolninst.edu/sites/default/files/pubfiles/yang_wp14zy1.pdf.

components.[45] This argument is bogus. Ordinary families shopping for homes will see similar houses selling for vastly different prices in different neighborhoods. They intuitively understand that this difference is related to differences between neighborhoods in terms of access to jobs, good schools, shopping, and transportation facilities and services. In other words, significant differences in the prices of similar homes are a reflection of different land prices. The fact that properties often include both buildings and land may complicate the effort to value land and buildings separately, but it can be done.[46] Today, assessment departments have access to computer-assisted mass appraisal (CAMA) software that, through multiple regression analysis, can accurately apportion value between land and buildings.[47]

As a reporting function, assessments do not determine how much taxes are due. In other words, a property might be assessed at $1 million. But, if the tax rate is zero, no tax is due. Thus, the ultimate determinant of taxes is the tax rate that will be applied to assessed values. And the setting of tax rates is a political function reserved for legislators. Because the property tax is unpopular[48] and because politicians want to shield themselves from

45. The District of Columbia Office of Tax and Revenue made this argument during the deliberations of the District's Tax Revision Commission in 2012. The author was employed by the Commission and heard this argument being made. It was remarkable as DC law mandates separate assessments for both land and building values. *See* D.C. Code § 47–821(a). Additionally, the District employs computer-assisted mass appraisal (CAMA) software which has the capability of apportioning total property value among its land and building components. *See also* Elaine S. Povich, *Can Extra Taxes on Vacant Land Cure City Blight?*, Pew Trusts (Mar. 7, 2017), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2017/03/07/can-extra-taxes-on-vacant-land-cure-city-blight. Unfortunately, the ability to assess land and building values is regularly undercut by people who should know better. For example, in this article, George McCarthy, president and CEO of the Lincoln Institute of Land Policy, a research group, has said, "You have to estimate the value of the land and the value of improvements separately. Places have a hard enough time estimating the value of the land and property together."

46. Andrew Haughwout, James Orr & David Bedoll, *The Price of Land in the New York Metropolitan Area*, 14 Current Issues in Econ.& Fin. (Federal Reserve Bank of New York), Apr./May 2008, https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci14-3.pdf.

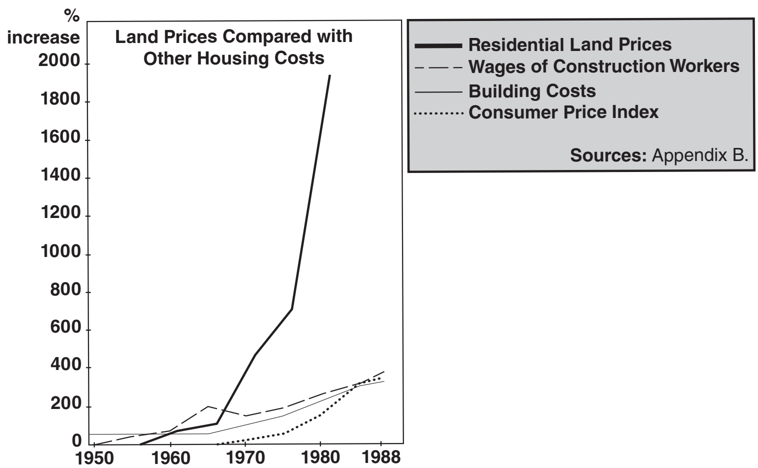
47. For information about assessment methodology and best practices, refer to the International Association of Assessing Officers (IAAO), https://www.iaao.org.

48. Property taxes are typically very unpopular. Aside from the fact that nobody likes to pay taxes, property taxes have some characteristics that make them particularly unpopular. First, it is typically paid in one or two lump-sum payments per year. For most employed people, estimated income taxes are deducted from take-home pay every pay period by employers. At the end of the year, taxpayers file income tax documents which typically show that they may owe a small amount or even get a refund. Imagine if we had to pay our total annual income tax in one or two payments? That would be very painful. Another factor that makes property taxes unpopular is that the portion of the tax

the ire of taxpayers, some politicians and some tax policy activists may blame assessors for high tax property tax liabilities instead.

IV. LVRR and Inclusionary Zoning

The preceding discussion may illuminate a key aspect of the country's affordable housing problem. Housing prices for similar homes can vary drastically from one city to another, or even within the same city from one neighborhood to another. Primarily, this is not because nails, lumber, plumbing, or even labor are that much more expensive in one place than the next. The primary cause for differences in housing prices is in the price of land. Therefore, our "affordable housing" crisis is more aptly described as an "affordable land" crisis.[49]



that falls on privately-created building values appears to be counter-productive. In other words, if property owners improve their property, the community punishes them with a higher tax. As mentioned in note 6 above, the economic impact of the property tax on improvements is equivalent to a one-time sales tax of between ten and twenty percent. That strikes many people as unfair and may render some improvements uneconomical.

Finally, property taxes are unpopular because increases in land value are beyond an owner's control. If land values increase, owners have not realized this value and do not necessarily have more income from which to pay the tax. Of course, if land values rise faster than inflation, politicians who set tax rates should lower the rates accordingly.

49. Walter Rybeck, Re-Solving the Economic Puzzle 194 (2011).

One recent response to the lack of affordable housing is inclusionary zoning. Inclusionary zoning ("IZ") is a legal mandate for the production of units to be sold at below-market prices in developments that exceed a specified threshold.[50] To be effective, IZ requires a hot real estate market. In other words, a spike in housing demand by relatively affluent households in a confined geographical area will lead to rising housing prices and windfall profits for owners of residential property. Some people think that this windfall could be used to cross- subsidize below-market units. Of course, this spike in housing prices is really a spike in land prices. If a housing developer acquires property after the rise in housing prices has occurred but prior to the enactment of an IZ requirement, then the inflated price of housing is baked into the price of the land acquired, and there's no "excess profit" for the developer.[51] Some IZ ordinances provide zoning density bonuses to offset the negative financial (and potentially confiscatory) impacts of the program.[52] But, if effective demand for housing is weak, there are no excess profits. Likewise, if effective demand is weak,

50. Obviously, if a developer builds one unit of housing, it cannot include both a market-rate and a below-market-rate unit. Therefore, inclusionary zoning ordinances establish a minimum development size that triggers a requirement to produce "affordable" units. Montgomery County, Maryland's "Moderately Priced Dwelling Unit program was started in 1974 and may have been the first "inclusionary zoning" ordinance in the United States. *See* https://www.montgomerycountymd.gov/DHCA/housing/singlefamily/mpdu/index.html. At the time of inception, the requirement applied to developments of fifty or more units. One has to wonder how many forty-nine-unit developments were permitted to avoid the requirements of this program. In more recent times, the threshold has been significantly reduced. *See*

http://www.montgomeryplanning.org/community/housing/frequently_asked_questions.shtm (noting minimum development size in Montgomery County, Maryland, of twenty units); *see also* https://dhcd.dc.gov/service/inclusionary-zoning-affordable-housing-program (noting development threshold in Washington, D.C., of ten units).

51. Some have argued that the inclusionary zoning (IZ) requirement—by making development more costly—results in lower land prices. See Emily Hamilton, *Is Inclusionary Zoning Creating Less Affordable Housing?*, Strong Towns (Apr. 11, 2018), https://www.strongtowns.org/journal/2018/4/10/is-inclusionary-zoning-creating-less-affordable-housing. In other words, a given parcel of land yields less profit from housing development after enactment of IZ requirements, and this outcome might cause developers to offer lower land prices. However, inclusionary zoning requirements typically apply only to developments above a certain threshold. So IZ might trigger smaller developments that are not subject to IZ requirements. Depending on the profit profiles of such development, there might not be any adverse impact on land prices.

52. Benjamin Schneider, *CityLab University: Inclusionary Zoning*, CityLab (July 17, 2018), https://www.citylab.com/equity/2018/07/citylab-university-inclusionary-zoning/565181. IZ has been challenged as an unconstitutional regulatory taking in some jurisdictions. Most courts have upheld IZ. *See, e.g.*, Cal. Bldg. Indus. Ass'n v. City of San Jose, 351 P.3d 974 (Cal. 2015); *see* Tim Iglesias, *Inclusionary Zoning Affirmed:* California Building Industry Association v. City of San Jose, 24 J. Affordable Hous. & Cmty. Dev. L. 409 (2016).

granting bonus density will not yield an economic return that could be used to compensate developers for providing below-market units. Homes in rust-belt cities are typically much cheaper than elsewhere. But for the unemployed in a rust-belt city, even a cheap home may be unaffordable. In rust-belt cities and other "weak" markets, inclusionary zoning is unlikely to be helpful in addressing problems of housing affordability.[53]

In contrast, land value return and recycling can be effective in both weak and strong real estate markets. In weak markets (like Harrisburg, McKeesport, Duquesne, and Clairton), it increased development and employment to some extent. In strong markets, like Pittsburgh prior to the demise of the domestic steel industry, it helped keep development (both residential and commercial) more affordable than would otherwise have been the case. Prior to the collapse of the steel industry, Pittsburgh's housing market was relatively affordable compared to other cities with robust economies.[54]

To the extent that housing is not being developed because landowners are waiting for future appreciation, LVRR will motivate more development activity. This, in turn, could increase the number of below-market rate units to be produced if inclusionary zoning mandates were in place.

V. Penalty Taxes on Vacant, Blighted or Underutilized Property

If the property tax were to be transformed by shifting the tax off of privately created building values and onto publicly created land values, and if this were accomplished in a revenue-neutral manner, then owners whose building value to land value ratio was smaller than average would experience increases in tax liability. Thus, owners of vacant lots, surface parking lots and boarded-up buildings would typically receive the greatest percentage tax increases from such a shift.[55] And this fits within the overall concept of rewarding those who develop and maintain buildings on high-value land while discouraging those who allow buildings to deteriorate or who allow high-value land to sit idle.

Not surprisingly, some may say that we need not overhaul the tax system for everybody. A more "targeted" approach would simply impose a penalty tax on those who own vacant and/or blighted property.[56] Indeed,

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53. Problems associated with a lack of affordable housing can be related to inadequate supply of housing units, inadequate effective demand, or both. Building more units will not solve housing affordability issues in an area that already contains a surplus of housing units. Likewise, increasing housing vouchers or other income supplements will simply inflate housing prices further if the root problem is an undersupply of units. An effective remedy requires an accurate evaluation of the situation which may vary significantly from one location to another.

54. Sullivan, *supra* note 24.

55. This is basic math. However, to see an example using actual assessment data, see 1992 Tax Burden Comparison, https://www.justeconomicsllc.com/pdfs/TaxReformScenarioAnalysis.pdf.

56. Several articles regarding a vacant property tax (Measure W) that was recently approved in Oakland can be found online. *See* Kathleen Pender, *Oakland's Vacant-Property*

this approach was pursued in Washington, DC, beginning in 1991.[57] At first blush, this may seem like a reasonable alternative to a more fundamental tax shift. Unfortunately, this approach is not as simple as it might appear and may be inherently flawed.

For example, buildings must be vacant for at least a short while for people to make orderly transitions from one property to the next. So a legislature must determine how long is too long for a property to be vacant. Whatever the answer may be, it will be somewhat arbitrary. Then, the assessor's office (whose job is to determine the value of land and buildings) must now determine whether properties are occupied or vacant and, if vacant, for how long. This is a complex problem. One difficulty is that as soon as the list is compiled, it becomes obsolete. Some properties that were beneath the threshold will now exceed it. And those that were beyond the threshold, may become occupied. And, mistakes will be made that will anger and frustrate law-abiding residents.[58]

And some property might not be vacant or blighted by fault of the owner. The D.C. Council created some exceptions to the penalty tax.[59] They included (but are not limited to) the following:

- Properties for sale. The owners should not be penalized or punished simply because nobody wants to buy their property. Indeed, many owners of vacant properties complain that people simply do not want their property. In some cases, if "unwanted" properties were placed on the market for $1, there would be a line around the block of potential buyers. Thus, it is not always true that "nobody wants to buy" a vacant or boarded-up property. Instead, it might be that nobody wants to buy "at the price the owner is demanding." If a property owner is seeking a sales price that exceeds what the market will bear,

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Tax Takes Effect, Sparkling Hope—and Alarm, S.F. Chron. (Jan. 26, 2019),https://www.sfchronicle.com/business/networth/article/Oakland-s-vacant-property-tax-takes-effect-13563273.php; *A Special Parcel Tax on Vacant Properties*, SPUR (2019), https://www.spur.org/voter-guide/oakland-2018-11/measure-w-vacant-property-tax; *Oakland, California, Measure W, Vacant Property Tax*, Ballotpedia (Nov. 2018), https://ballotpedia.org/Oakland,_California,_Measure_W,_Vacant_Property_Tax_(November_2018).

57. Kenyon, *supra* note 37.

58. Ellen Czaplewski, a realtor, shared her experience with clients who moved into an historic townhouse. Prior to the purchase, the previous owner was living on the top floor, with minimal belongings. Some city official must have looked into windows on the first floor and, seeing no furnishings or belongings, concluded that the property was vacant. The new owners moved in and noticed that their tax escrow had been drawn down by $15,000. They inquired and were informed that the draw was to pay the vacant property tax penalty. By law, the penalty tax needed to be paid prior to any appeal. This was a hardship in itself. The District government then, on more than one occasion, misplaced their submitted evidence. *See also Oakland, California, Measure W*, *supra* note 56.

Thus, even this supposedly "targeted" approach will burden many property owners in an attempt to address a smaller number of vacant and blighted properties.

59. Kenyon, *supra* note 37, at 22.

the property will not sell. So if we make an exception for properties that are "for sale," we simply encourage speculators to stick a for-sale sign on the property and then ask an above-market price. Is it realistic to expect city bureaucrats to scrutinize all properties for sale and to flag those where the asking price is "unrealistic"? Again, how much above-market would be too much? And whatever the answer, it will be somewhat arbitrary.

- Properties affected by fire. Owners who have suffered from a fire should not be penalized or punished as a result. This would be "adding insult to injury." Land speculators may own land with buildings. But it is the land (and not the buildings) that appreciate in value over time. Buildings, if not maintained, depreciate. Not surprisingly, in Washington, DC, shortly after the vacant property tax was instituted, the rate of suspected arson jumped by about 400%.[60]

Problems associated with administration of the penalty tax on vacant and blighted property have caused the District of Columbia government to amend this law continually since its inception.[61] Needless to say, this "moving target" makes the law difficult to comprehend[62] and results in collection rates that are very low.[63]

But perhaps the biggest flaw is that this "penalty tax" fails to understand that property investment (and disinvestment) decisions are often made with long time horizons. The traditional property tax will continue to penalize owners who create, enhance, or maintain value in buildings. It will also continue to reward owners who allow their buildings to deteriorate, until that deterioration crosses some arbitrary level of offensiveness. Then, overnight, some penalty is due. Thus, this is neither effective in promoting compliance nor in fostering a more productive approach to property management and stewardship.

Penalty taxes on vacant and/or blighted property may be well-intentioned. And legislators are surely interested in crafting "sensible" exceptions. But the result will probably be "feel-good" legislation that appears to

60. *Development & Implementation of a Management Reform Plan for the District of Columbia Fire and Emergency Medical Services Department: Task 1: Problem Identification*, TriData Corp. & Arthur Andersen, LLP (Oct. 1997).

61. Kenyon, *supra* note 37, at 9. Classification and rates applied to vacant land and/or vacant or blighted buildings changed eight times between 1991 and 2012. *See id.*

62. *Id.* at 8 ("According to DC Law 8-150, within the five classes of property there were separate rules for occupied buildings, unoccupied buildings, and vacant land. In effect it was nearly impossible for even a well-educated person to read this statute and understand the property tax classification system, either generally or as applied to a particular property.").

63. *Id.* at 30. In FY2012, the collection rate for occupied residential and commercial property was about ninety-five percent. But the collection rate for the class of vacant buildings (Class 3) was only sixty percent and for blighted properties (Class 4) was only twenty-nine percent.

address problems associated with vacant and boarded-up properties while failing to do so.

Finally, some who worry that LVRR is too comprehensive might argue that it will lead to overdevelopment. Under typical conditions today, some planning departments might predict that X acres of land at Y floor area ratio (FAR) will be required for land-use Type 1. However, if they zoned only X acres at Y FAR for Type 1 land use, landowners within this zone might hold out for exorbitant prices, thereby depressing Type 1 land use and employment due to high land costs. To avoid this, planning departments concerned about the monopoly power of landowners to extract excessive land prices, might zone more land (X + A acres) and/or more density (Y + B FAR) for a particular land use than is reasonably predicted to be used. The belief is that this "over-zoning" will cause landowners to compete for development, and thereby keep land prices more reasonable. As mentioned previously, landowners may or may not compete. And the over-zoning may result in haphazard or suboptimal land use allocations.

Into this "over-zoned" environment, some might be concerned that the introduction of LVRR might lead to overdevelopment. LVRR, as the differential between building rates and land rates widens, will induce more development. But, regardless of property tax rates, there will not be any more development of Type 1 land use than is demanded by the general economy. So, while over-zoning is a dubious strategy, adoption of LVRR should be accompanied by attempts to reign it in. And, to the extent that any new development is deemed inappropriate (to preserve historic structures, agricultural land or conservation land), then LVRR should be accompanied by historic preservation ordinances, conservation easements, and transferable development rights.[64]

VI. Proposals for Moving LVRR Forward

Regarding implementation, the good news is that almost every community is already implementing land value return and recycling to the extent that a tax (fee) on land values is embedded in the traditional property tax. Thus,

1. No new taxes or fees are required.
2. Incremental change in existing taxes and fees can gradually increase the robustness of beneficial land value return and recycling while reducing the harmful tax penalty on privately created building values.
3. Mechanisms such as exactions and development impact fees can be retained, strengthened, or introduced in areas where infrastructure

64. For a more thorough discussion about whether LVRR would lead to over- or under-development, see Rick Rybeck, Funding Long-Term Infrastructure Needs For Growth, Sustainability & Equity, Appendix 4, 43–54 (Sept. 27, 2013) (prepared for the DC Tax Revision Commission), http://docs.wixstatic.com/ugd/ddda66_2817111b198bdd64898d8b19e4ac331c.pdf.

capacity is lacking and where development would be inappropriate for environmental and/or fiscal reasons.

The most significant impediments to implementation are:

- First, a general lack of understanding by the general public, public interest advocates and public officials about the Jekyll and Hyde nature of the traditional property tax and about how to remedy it via land value return and recycling. In particular they do not understand how the portion that taxes building values reduces supply (and employment) while raising prices. Nor do they understand how the portion that taxes land values could be helpful in reducing blight and sprawl. Most importantly, many people are unaware that LVRR has been used with considerable success both in the United States and elsewhere around the world.[65]

- Second, statutory limitations on property tax assessments and/or rates that constrain the implementation of land value return and recycling.[66]

- Third, in many jurisdictions, individual property assessments provide the assessed value of the land, the assessed value of improvements, if any, and the total assessment.[67] However, assessment appeals are sometimes limited to disputes that exceed a certain percentage of the total assessment. In other words, an appeal about the apportionment of value between land and buildings would not be allowed if the petitioner did not contest the total value. After all, given the single tax rate that is typically applied to both land and buildings, such an appeal would not change the property tax liability and therefore not be a productive use of anybody's time or effort.[68] However, in the event that LVRR was made more robust by reducing the rate applied to improvement values and increasing the rate applied to land values, such an appeal could have material consequences even if the total value was uncontested. Therefore, jurisdictions contemplating the implementation of LVRR should amend the law or regulations governing assessment appeals to allow challenges to the apportionment of value between land and buildings even if the total value is uncontested.

- Fourth, those who talk about "value capture" or "value recapture" often include development impact fees, inclusionary zoning and

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65. Land Value Taxation: Theory, Evidence, and Practice 11–47 (Richard F. Dye & Richard W. England eds., 2009).

66. *See supra* text accompanying note 42 (California's Proposition 13 (and similar related statutes)).

67. David Brunori & Jennifer Carr, *Valuing Land and Improvements: State Laws and Local Government*, 25 State Tax Notes, Sept 30, 2002. In particular, see D.C. Code § 47–821(a) (requiring separate assessment of both land and improvements to land).

68. Wash. Post Co. v. District of Columbia, 596 A.2d 517, 522 (D.C. Ct. App. 1991).

> penalty taxes on vacant property in this category, even though the liabilities for these fees are based on the value of privately created improvement value (or lack thereof), rather than on publicly-created land value. Many experts also include tax increment financing (TIF) as "value capture," although it is more aptly described as "revenue segregation."[69] These other mechanisms may be appropriate under certain circumstances, but they have very different incentive effects than LVRR.

These impediments require education leading to legislative reform.[70]

So step one entails an education process—for the general public, public officials and the media. If fundamental economic principles are not understood, effective policy tools are almost impossible, particularly given some of the counterintuitive effects of economic externalities.

Step two might entail a reorientation of our perspective about public infrastructure. Instead of creating it and giving it away (perhaps with minor user charges to some direct beneficiaries), it should be seen as something to be created in exchange for reasonable user fees and access fees. Any inability to collect reasonable access fees should result in a refusal to provide the infrastructure. Where infrastructure is truly needed, the public-sector's refusal to create it and give it away should result in legislative actions and/or contractual agreements to generate reciprocity—that is, value given for value received.

Once steps one and two have met with some success, research can be performed to identify potential infrastructure beneficiaries and appropriate mechanisms to generate a fair level of land value return and recycling. Such research might entail a study of potential tax shift scenarios that would be gradual enough to avoid creating windfalls and wipeouts while being aggressive enough to reorient landowner behavior regarding the stewardship of land and natural resources along with the creation and stewardship of buildings.

Conclusion

Most communities in the United States fail to obtain a fair return for the land values that they create through the provision of public goods and services. This failure transfers wealth from the general public to affluent

69. Rick Rybeck, *Financing Infrastructure with Value Capture: The Good, the Bad and the Ugly*, Strong Towns (Feb. 21, 2018), https://www.strongtowns.org/journal/2018/2/20/financing-infrastructure-with-value-capture-the-good-the-bad-the-ugly.

70. The author and others assisted in the drafting of model legislation for the American Legislative and Issue Campaign Exchange (ALICE) in 2014. ALICE has since been replaced by State Innovation Exchange (SiX). The model legislation did not get transferred to the new website. However, the model authorizing legislation can be found at https://www.justeconomicsllc.com/pdfs/ALICE-SplitRatePropertyTaxAct_14-01-23rev.pdf, and the model implementing ordinance can be found at https://www.justeconomicsllc.com/pdfs/ALICE-SplitRatePropertyTaxOrdinance_14-01-22rev.pdf.

owners of prime real estate, thereby exacerbating inequality. It also induces land speculation which has harmful impacts on housing affordability, employment, infrastructure effectiveness and efficiency, fiscal solvency, and environmental sustainability. Furthermore, this failure makes it much more difficult to improve conditions in distressed neighborhoods and communities without displacing the intended beneficiaries.

Fortunately, some communities are utilizing land value return and recycling to remedy these problems. These communities recognize that *how* we raise funds for infrastructure is just as important as *how much* funding we raise because of the incentives that methods of taxation create.[71] And, by tapping an often overlooked source of public revenue, land value return and recycling can help reduce harmful taxes such as those on privately created building values. In particular, shifting the property tax off of privately created building values and onto publicly created land values can make both buildings and land more affordable, while encouraging more compact land use that has fewer adverse environmental impacts and reduced infrastructure requirements, thereby reducing fiscal strain.

Land value return and recycling is not the only tool necessary for improving housing affordability, job creation and equitable development. However, as is apparent from the "infrastructure conundrum" and "no good deed goes unpunished," if LVRR is ignored or overlooked, other remedies will be less effective or even counter-productive.

Perhaps this article can begin to move the ball forward in this regard. JAHDCL readers, whose daily work attempts to prove that the term "economic justice" need not be an oxymoron, might exercise leadership by sharing this information about land value return and recycling as an important tool in promoting affordable housing and job creation along with more sustainable and equitable development.[72]

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71. Water services are typically paid for "by the gallon." This measure encourages owners to conserve water. And, when they have a leaky faucet, they do not just see water going down the drain; they see their money going down the drain, which encourages them to fix the faucet. We could pay for water services from sales taxes. But would property owners have any incentive to conserve water? Would they be motivated to fix leaky faucets? Would they purchase something they did not want, just to compensate the water authority with sales tax revenue for the water that they are wasting? The answer to these questions is "no," and it demonstrates that how we pay for infrastructure is very important. In a similar vein, think about the owner of a vacant lot. The owner is not drinking any water there. Should the owner pay anything to the water and sewer authority? Assuming that municipal water pipes are at the property boundary, the answer is "yes" because this vacant lot is more valuable that it would otherwise be if no water pipes were nearby. Thus, achieving a balance between infrastructure user fees and infrastructure access fees (LVRR) is important.

72. In addition to the *TRB Guidebook*, *supra* note 25, TRB has also recently posted a presentation on this topic. *See* http://www.trb.org/Main/Blurbs/178905.aspx. Additionally, the Strong Towns website posted articles on this topic during the first week in March 2019. *See* https://www.strongtowns.org/landtax.