LAND USE PLANNING AND PROPERTY TAX REFORM

By

David J. Allee

February 1978 No. 78-10

Land Use Planning and Property Tax Reform[1/]

by David J. Allee[2,3/]

Introduction

My main point is that the relationship of the property tax to planning public actions that affect land use varies across New York State. Think of urbanization as a continuum with Manhattan at one end and Mount Marcy at the other. At either end of the scale, property taxes must be paid from the income of the land owner, and decisions about how to use that land affect the owner's income. In theory, if not very accurately in practice, the ability of the land to earn income for its owner is related to its value. Assessments are related to value, and taxes are related to the size of the assessment. Thus, taxes should be roughly related to ability to pay. But the context is so different that, even though some of the principles may be similar, the problems and alternatives are quite different and should be considered separately.

At the more urban end of the scale -- well within the metropolitan regions of the state -- public decisions that affect land use (planning in an informal sense) appear to be heavily influenced, if not dominated, by fiscal considerations of the individual jurisdictions that make up these balkanized regions. In urban areas land use controls are usually administered by local planners (planning in the formal sense). In rural areas town and village boards act more directly. Regional planning agencies typically have no direct land use controls to administer. Various operating county and regional agencies can be quite important to particular services, however. Examples are county sewer agencies, utility companies, port authorities and the like.

1/ Presented at the Conference on Property Taxation and Land Use April 22-23, 1977, Lake Mohonk, New Paltz, N. Y. Co-sponsored by the Environmental Leaders Forum of the SUNY Colleges of Environmental Science and Forestry, Syracuse and of Agriculture and Life Sciences, Cornell University, Ithaca; the Catskill Center for Conservation and Development and the Center for the Hudson River Valley.

2/ Professor of Resource Economics, Department of Agricultural Economics; Chairman of the College Land Use Committee, College of Agriculture and Life Sciences, Cornell University, Ithaca, N. Y.

3/ Very helpful comments on a draft of this paper were received from Nelson Bills, Ken Gardner, Bill King, Jim Lassoie, Ray Marler, Bert Mason, Jim Preston, and David Taber.

The result, according to conventional wisdom, is urban sprawl with all its attendant problems. Sometimes a picture is painted of an informal land development industry of bankers, land brokers, builders, real estate salesmen, plus most of those connected with local government services, acting in a loose coalition. They are kept together by similar views of the world, by compatible goals and beliefs about what should be done. Proposals for metropolitan reform are seen as a threat to the interests of this coalition and only statesmanship-like action from state or federal government levels is expected to make a change. Tax reforms are sometimes seen as providing some help, but only in a context of many other changes to rationalize the urban form.

From the urban edge to the wilderness end of the rural portion of the continuum, formal land use planning, where it exists, is a more recent and more tentative phenomenon. It includes urban land use regulations transposed to rural areas. Many public decisions affect land use, but the importance of fiscal considerations may be more or less important to those who make them. New schools, sewers and roads, welfare programs and the like tend to impact the whole tax base. Extensive land uses such as farming, forestry and many recreational-residential properties make up a higher proportion of that tax base. But more to the point than fiscal considerations may be the way the land market operates to indicate value. If there is any potential for transition from farm to urban use, or from commercial forestry and extensive recreational uses to more intensive recreational use the market may value far more land for that "higher" use than is reasonable. The result is that investments, on and off the property, needed to sustain that more extensive use are prematurely allowed to deteriorate. The expanding intensive use scatters itself over the area whose values have risen, sometimes contributing further to the deterioration of the extensive use. The result can be loss of production, related jobs and tax revenues that a more orderly transition would have yielded.

As long as assessors waited until use actually changed to raise assessments, the problem was not compounded by tax increases over an area far greater than was desirable to convert. With the pressures from the Guth and Hellerstein decisions and the urging of the State Board of Equalization and Assessment needed reform in assessment procedures is in prospect and in jurisdiction after jurisdiction it is a reality. Agricultural Districts and the recent Forest Tax Law have made steps in the right direction. Reasonable adjustments in assessment can be made in a more systematic, studied manner. Further improvements in the links between land use planning and tax reforms may be desirable, but the forms for those links are not immediately obvious. Recent slowdowns in population and income growth, regrettable as they are on other grounds, provide a pause within which new policies can be worked out. We should take advantage of this opportunity to develop new strategies and policies as well as improve those now in use.

The Conventional Wisdom of Fiscal Planning

Land development has been called a central issue in the reform of metropolitan governance. The pattern of development affects and is affected by the location, cost and level of service of the whole range of public services and amenities of urban life. It is seen as at the heart of local politics and involves a complex network of agencies, firms, organizations and individuals. Land assembly and acquisition by those interested in change is the impulse from which other actions follow, and land assembly is often easier and cheaper at the periphery of the region. Since many of the extra costs of the peripheral location can be paid for in the future and/or borne in part by others than the developer, the full cost is not reflected in the direct prices of the development. A willing seller has more to do with location than the suitability of that location from the regional or sometimes even the local perspective. Locations with greater access to new roads, sewers, employment, schools, shopping and the like have a slightly higher chance of development, particularly for non-residential uses, but the process is almost random within the urban region.

Where zoning is well established, the lot yield of land (the number of lots allowed under the rules) may be reflected in the price asked for the land. But there is so much land zoned for every use that zoning has little effect on sprawl. The use of zoning to discriminate against development that would be attractive to low income residents, children ad other high service demanders is widely recognized and probably less effective than often supposed. Zoning is usually adopted before a formal plan is prepared and then the formal planning must take most of the zoning as a given. Typically each jurisdiction has more than ample land zoned for the higher tax yield, lower expense activities. And zoning has proven stable and successful in maintaining compatible uses, but usually only for established residential areas occupied by those with middle incomes and above.

Roads, sewers and water lines must be on hand or in prospect in some areas for land to be marketable, but not always. Other services are more deferrable.

Prices are not very effective allocators of land in part because so many costs and values are not incident to those involved in the transactions. While there are often permits and approvals, inspections and compliances to be dealt with, only a small part of the effects of the development on others are taken into account. Each public decision is too narrowly defined by function and jurisdiction, and is usually found difficult to administer efficiently, even at that. Many of the impacts "spill over" from one jurisdiction to another, usually with no bargaining arena in which they can be worked out. "Spillovers" from parcel to parcel, jurisdiction to jurisdiction, and from present to future generations, are at the heart of much of the discontent with land use.

With many tax jurisdictions in a region and with most location decisions for people and their activities fairly free within the region,

the setting is clear for competition to attract taxable, low cost activities and to discourage the reverse. The folklore of fiscal economics is the usual basis for decision since detailed analysis is rare. Further, the decisions usually come in such small increments that broad policy analysis appears either impractical or not applicable in this "special" case.

The above indictment is familiar to most. Urban life is more expensive and less rewarding than the critics feel it needs to be if only a more rational process were instituted. It is not difficult for reformers to identify improvements in the quality of life that appear tantalizingly close to attainment but aren't commonly achieved.

"Spillovers" are too frequent. Upstream development causes flooding downstream that could be avoided by proper investments both upstream and downstream -- but who is to require them? Who is to pay for them? Similarly, for traffic and other congestion of nearby public facilities, libraries, schools, parks, and recreation programs. Incompatible uses are mixed together, too much and for too long. Housing among farms raises farm costs for public services they can't use, from vandalism, drainage problems, pollution, etc. Farms among the housing brings problems with odors, noise, chemicals and the like. Problems at the edges between different kinds of land use may be unavoidable but with sprawl there are more edges than necessary.

Public amenities are not worth creating by each single developer, and when the community gets itself organized to provide them, the opportunities are often lost. Thus open space and natural areas are underprovided. Fewer trees are planted. Sewer, water, and other construction standards are enough to get by, but the buyer in his limited experience at buying property is left with too many unpleasant legacies of the development process.

Old areas are prematurely abandoned. Tax policies are often blamed for discouraging redevelopment. Extensive land uses such as dairying and fruit growing are prematurely abandoned. Neighborhoods are overly divided by race and income. Equal protection of the law has been successfully argued as denied when the richer communities can afford to spend more on schools than the poor communities.

Some of the Economic Reasoning Behind the Conventional Wisdom

Householders are seen as electing their local officials and wanting their values enhanced. Indeed the local officials are householders themselves. Consider that $500 in taxes per year represents around $5000 in capital value on a residence. Also consider that higher quality services add to the value, too. Thus a rise in the non-residential part of the tax base adds value to the associated residences. Likewise, if the market is working, householders "should" be attracted to communities that offer just the level and mix of services they want and are successful in discouraging homes just smaller than they want to buy. In other

words, people should be attracted to communities where their new neighbors have at least as much income and similar demands.

Statistical evidence suggests that such homogeneity exists but is less where state aid to schools is greater. And it is even less where state aid is compensatory -- that is, where aid rises with the number of low income families or where the tax base per child is lower. Also where state aid to local governments is higher, the pressure to fragment local government units is less. Economies of scale, such as they are in local services, are then more possible but representation and tailoring of services to preferences are more difficult. Note that New York has high aid levels to schools which is at least partly compensatory and has fairly well developed aid to local governments. This may be offset somewhat by a number of state mandated expenses that press on the property tax, such as welfare, which are entirely state funded in some states.

Likewise, industry "should" go where tax rates are already low and where high value per capita already exists. But firms play communities off against each other for services and tax breaks that reduce this attraction. Such competition is limited; otherwise, the tax break advantages might disappear. Likewise, residential values are seen as threatened by pollution, congestion and low wage employees.

Evidence to test this reasoning for industrial location is more mixed than for residential areas. There are municipal enclaves of industrial activity in many urban regions.

Some Prescriptions

Some of the prescriptions regularly put forward in recognition of analysis like that summarized above have been mentioned or implied. Fuller connections between cost incurred and "prices" paid for public services is a favorable suggestion of economists.

Pricing policy can be used to promote efficiency. In other words, if the development in the more distant location from roads, schools, sewage plants, lines for phone, power and gas had to pay the full costs they cause it would not only be fairer to everyone else, it might encourage more efficient locations. But note that a large non-residential tax base dramatically cuts the cost of taxing the homeowner for services, making it easier for the price-cost connection to get lost from view. Add to this the federal and state subsidy of householder property taxes by allowing them to be deducted from income for income tax purposes. All this is seen as allowing the taxpayer-householder to become too tolerant of inefficiency and low value services.

Special assessments and tax districts often only cover the incremental capital costs -- eg., a sewer -- and not the capacity used -- eg., at the treatment plant. More use of state and federal aid is encouraged. Other related prescriptions include more use of region-wide tax and spending authority and the Twin Cities Region in Minnesota is sometimes cited as a successful case.

If some or all of the property tax were levied against the land instead of land plus improvements it would provide an incentive to develop close-in land and to stop the discouragement of redevelopment that taxes on improvements are thought to cause. A tax on land alone is seen as not distorting development -- but that conclusion depends upon the accuracy of the land market to set values and to indicate what land should be used for something else -- more on this later.

But there is little evidence that taxes are all that important in development and location in urban regions. Tax policy alone will not turn around the process to deal effectively with the regional public interest. However, tax abatement to encourage open space uses and discourage premature abandonment or decline in extensive uses, perhaps through staged reassessment, combined with other measures, is seen as providing significant reinforcement. Low density zoning, easements and transferrable development rights, "critical area" controls by the state and other overlay arrangements, coordination of public investment, development districts for coordination and/or assembly of land, are some of the other measures discussed in the recent literature.

One more specific suggestion is to remove the "big ticket" items -- power plants, railroads, large industrial and commercial establishments -- from the local tax rolls and place them on a state or regional roll. Assessment would be uniform and the tax rate set independently of local jurisdiction. At first through an aid formula, the tax receipts would replace exactly what the local jurisdiction would have collected. But gradually, year by year, allocations of the funds would be based on a formula that reflected the need for funds. The local jurisdiction can still tax itself to suit its own demand for service. But some of the spillover and windfall effects of these big taxable properties might be alleviated or at least easier to deal with.

A more common prescription is that relief from the property tax should be offered to low income families. But there is not universal agreement as to the extent of such need. About 30 states have adopted some form of the "circuit breaker" approach and many state aid formulae are designed to deal with that problem. A "circuit breaker" is a provision that limits the percentage of current family income paid in property taxes. Some states reimburse local governments for revenue lost, some simply limit it, others provide for reductions in state income tax in the amount of all or part of the excess.

A more widely held view is that too much use is made of the property tax. Like public schools and welfare, too much of the benefits of the services being funded by the property owner go to others and, more to the point, to others outside of the jurisdiction levying the tax.

Finally an almost unanimous view is that assessment procedures are grossly mismanaged in most jurisdictions. Some studies have shown that much of the regressive nature of the property tax -- ie., taxing the poor at a higher proportion of their income -- is sometimes, perhaps often, due to inappropriate assessments. Other studies have found the opposite result. Assessors are seen as operating with little training,

inadequate staff, without modern data processing aides and other support services, and sometimes subject to pressures that are not the result of open, well supported public policy.

There certainly is a wide margin for improvement. But if every property were valued at full market value would all the problems be solved? No one argues that. And we should consider carefully where full market values are not an appropriate basis for taxation, and what should be done about it. One approach is to allow or mandate different rates for different classes of property. Another is to link assessments more directly to land use restrictions. There are other approaches and little consensus. Perhaps we need to consider more carefully why the land market might give the wrong "signals" and to what extent they may be wrong. An example of such wrong signals would be the tendency to price too much land for a more intensive use than the current use. This may be easier if we consider what might be happening outside the urban region.

The Land Market at the Urban Fringe and Beyond

There are some symptoms that suggest that the land market doesn't work very well from an overall social point of view. These are more technical and go beyond the familiar indictment of urban sprawl.

Note for example that about one acre of farm land that otherwise would stay in farm use is idled for every farm acre that actually goes into urban use. Now obviously land is released from farming perhaps to go into forest or recreation uses and for other reasons, too. Less than half of the land that was once farmed in New York is now in farms. Between 1950 and 1968 there was about a 14 percent increase in commercial forest land in the state. Most of this was once farmed and urbanization had little to do with the change to forestry. Most of this former farm land was disadvantaged by technological changes that favored other farm land both in the state and elsewhere. Some is so disadvantaged that even at a zero price and no taxes it wouldn't be farmed. Other acreage can't be bought cheaply enough and the taxes are too high, even though it technically could support beef cow-calf enterprises, for example, superior to those in the West. People are willing to pay those prices and taxes for the other values in owning that land -- extensive and intensive recreational uses, for example. These are not idle acres.

The acreage idled by urban development seems to be of another sort -- speculation is more of a factor in its ownership. Combined with land on which the investments in buildings, drainage and similar improvements are being prematurely allowed to deteriorate and you have a loss of productive output that is replaced at higher cost elsewhere. The local jobs that related to its output also go elsewhere. The issue is the amount of disruption and speculation that takes place. Some is unavoidable with growth and development. Does it need to be so extensive?

Another technical symptom has been identified in the value changes that take place when land transitions from farm use to urban use. This

was first estimated around 1964. Farm land around urban areas was selling between farmers for farm use for around $300 per acre. The cost of improvements -- streets, sewer, water, etc., necessary to produce urban lots -- were about $6300 per acre. The finished lots sold for an average of about $10,000 per acre, leaving a net incentive for transition of about $3400 per acre or an appreciation of over 1000 percent above the farmer-to-farmer price. The evidence was fairly clear that farmers received a small part of that appreciation -- most of it going to other owners between the farm use and the final urban uses. It has been estimated that since 1964 these values have gone up at rates well above that of inflation. The net "take" in these capital gains adds some $15 billion per year to cost of land development paid by the eventual users.

This should not be taken as an indication of what all owners of land in the urban fringe can expect. Only a few owners of a very small percentage of the land in the fringe are so lucky. Most just sit on their investment, paying taxes.

The issue is again one of appropriate degree. A farmer operating a successful business does need considerable compensation over what the land is worth to his business to re-establish himself elsewhere. Even if the sale is for a small amount of land not cropped by the farmer, compensation for potential disruptions is certainly reasonable. If every farmer or nearby non-farmer were actively offering land for sale, and given that there is so much land out there with characteristics that seem so similar to that which is developed, then why does the increase in price need to be so high? Logically, with so many potential sellers, the fact that the total supply of land is fixed should be irrelevant. Such large appreciation in price would indicate that the supply of land is being restricted in the face of the amount being demanded. A widely held belief is that you can always make money owning land. Why might this be so? Is it valid?

A number of reasons for the prices of land being bid up so much over the opportunity value of the land can be suggested. Note that many of them also explain why development, when it does take place, is so scattered over the urban region. The basic explanation must answer two related questions. Why do land owners expect such high prices in the first place? And second, why don't price cutters change those expectations? The usual monopolistic competition explanations for monopoly-like prices obviously don't apply.

First, it seems likely that land owners do not have very good information on what land is really selling for. Most of it doesn't sell. If five percent per year of the parcels in a jurisdiction sell in normal transactions, that is a very active market. It seems likely that news of the big winners is more likely to get around than the losers. Indeed, the real losers don't sell.

Second, a variety of situations make it easier for some owners to wait, or restrict availability otherwise. Zoning is frequently cited as restricting supply in a given area although in many statistical studies of land transactions it is not a significant variable for open land

in urban fringe areas. Property taxes and interest payments are deductible from income for federal and state taxes and thereby are shared by the other taxpayers. Property tax exemptions would have similar effect. Likewise, the special treatment of capital gains by the income tax makes holding out for land value gains very attractive to many in middle and upper income brackets.

Third, pricing of urban services and their availability contributes to more landowner expectations of development. The extension of services is so uncertain that any land owner can feel he is as likely as another to benefit from them, and so should hold out for the price they would justify. Distances from existing urban centers, congestion that will occur with development, paid for amenity values in developed areas are all difficult for the average land owner to evaluate. Thus, there probably is a tendency to appraise them optimistically. Fourth, many land owners obtain non-money returns from owning land. There is pride of ownership and emotional ties to the land and the like. Owners feel they must be compensated for giving up these values.

These and other factors indicate why land owners might expect an unreasonably high price, then why don't price cutters bring these expectations down to a more reasonable level. If the land owner hears of a low priced sale, he may discount it as an aberration. Typically, that seller can only get more land to sell by buying it from another land owner -- he can't produce it like toothpaste. In a generally growing market, by the time the land owner should realize he has been asking too much, prices have inflated enough to catch up to him. Land markets have had booms and busts in the past. If we have found the means to avoid major depressions, we may also have removed a major corrective for land markets as well.

A recent study of Orange County suggests that practically every acre there had been affected by the potential for urban development prior to the recent slow down in construction and now a net downturn in population statewide. Orange County is in that outer ring of counties around the New York urban region that gained 173,000 people since 1972 while the region overall lost population from a peak of 19.9 million to 19.6 million, the first decline in its 350 year history. Yet Orange County has enough space for much of the existing urban development in the region, and the same thing was happening to some degree in the other nine outer ring counties. Part of the problem is that a reassessment was made just prior to the downturn and acre after acre went on the tax rolls at values which were reasonable only at the margin. In other words, land really was selling for those prices before the downturn in activity -- what little of it actually changed hands -- to make the market observed by the appraisers. Then with the downturn in activity those assessments were even more awkward for everyone. But was the present value of future use ever really there? Does it make sense to use those signals to direct use? Can we do better?

Use value assessments were available to the commercial farmers in Orange County. The guidelines for the development were relatively untested, but in the situation their assistance has been significant.

References

Bish, Robert L., Understanding Urban Government: Metropolitan Reform Reconsidered, The American Enterprise Institute, 1150 17th St., N.W., Washington, D. C. 20036, 1973.

Clawson, Marion, Suburban Land Conversion in the United States: An Economic and Governmental Process.

Ervin, David, et. al., Land Use Control -- Evaluating Economic and Political Effects, Ballinger Publishing Co.

King, William H. and Howard E. Conklin, "Who Owns the Land of Goshen," New York's Food and Life Sciences Quarterly, Vol. 10, No. 3, 1977.

Mason, Bert and Edward Lutz, Real Property Tax Assessments in New York: A Primer, Information Bulletin 130, an Extension publication of the NYS College of Agriculture and Life Sciences at Cornell University, October 1977.

Muller, Thomas, Fiscal Impacts of Land Development: A Critique of Methods and Review of Issues, The Urban Institute, 2100 M Street, N.W., Washington, D. C., 20037, 1976.

_____, Economic Impacts of Land Development: Employment, Housing and Property Values, The Urban Institute, 1976.

Peterson, Everett E., Editor, Property Taxes -- Reform, Relief, Repeal? North Central Regional Extension Publication 39, Cooperative Extension Service.

Peterson, George E., Editor, Property Tax Reform, The Urban Institute, 1973.

Raup, Philip M., "Urban Threats to Rural Lands," from the Conference on the Severe Restriction of Development, Syracuse, New York, March 4, 1976.

Schmid, A. Allan, Converting Land From Rural to Urban Uses, The Johns Hopkins Press, Baltimore, Maryland, 1968.

Siejan, Bernard H., Other People's Property, Lexington Books, Lexington, Mass., 1976.

Wingo, Lowdon, Editor, Reform as Reorganization, Resources For the Future, Inc., Series on the governance of metropolitan regions, 1974.