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LAND-VALUE TAXATION AS A METHOD OF ENCOURAGING GROWTH IN BALTIMORE

Michael Safko

I. Introduction

The events that occurred last May have left many residents of Baltimore wondering what can be done to rebuild their city better than it was before.¹ One particular suggestion is the elimination of all current property taxes along with the implementation of a land-value tax (LVT).² An LVT would tax property owners based on the unimproved land they own, rather than on the improvements and structures that have been built on the land.³ The argument follows that this method of taxation would incentivize property owners to develop their land, rather than leave it undeveloped so they can pay less in taxes.⁴ Indeed, several journalists have postulated this same theory over the course of the last century.⁵

Baltimore's house-flipping market is one of the most lucrative in America.⁶ In the second quarter of 2014, flippers in Baltimore were making an average return on investment (ROI) of 73 percent.⁷ Baltimore was the third best market for house-flipping in the entire country, behind only New Orleans with an average ROI of 76 percent and Pittsburgh with an average ROI of 106 percent.⁸ The LVT is considered essential to drawing more investors into Baltimore's real estate

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1. Dan Reed, *Can a Land Value Tax Save Baltimore?*, BALT. SUN (June 1, 2015), <http://www.baltimoresun.com/news/opinion/oped/bs-ed-land-value-tax-20150601-story.html>.
 2. *Id.*
 3. Merryn Somerset Webb, *Land Value Tax – the Best of All Possible Taxes*, MONEYWEEK (Oct. 10, 2013), <http://moneyweek.com/land-value-tax-best-possible-taxes>.
 4. Reed, *supra* note 1.
 5. See *Municipal Real Estate Taxation as an Instrument for Community Planning*, 57 YALE L.J. 219, 220 (1947) [hereinafter *Real Estate Taxation*] (“[The common American system of property taxation] has produced results which are in basic conflict with the efficiently planned use of land.”); see also Harold S. Buttenheim, *Unwise Taxation as a Burden on Housing*, 48 YALE L.J. 240, 255 (1938) (“The less we tax improvements . . . the greater is the inducement to erect new homes or improve old ones.”).
 6. Reed, *supra* note 1.
 7. Jeff Clabaugh, *House Flipping in Baltimore Pays Off*, WASH. BUS. J. (Sept. 2, 2014), http://www.bizjournals.com/washington/breaking_ground/2014/09/house-flipping-in-baltimore-pays-off.html.
 8. *Id.*

market and curbing inflation of property values when many Americans are still struggling to afford housing.⁹

II. Background

A. LVT: History and Description

The most primitive stages of the LVT emerged in seventeenth century with the concept that “*produit net*”¹⁰ should sustain the state exclusively via the “*impot unique*”.¹¹ This concept is different from the modern LVT in two ways: (1) the value taxed was on the resources yielded by the land, not the land itself,¹² and (2) the tax was to be on the full net value of the yield.¹³ This introduced the principle that taxes should be levied on the “unearned” benefits from the land, rather than the changes made by the property owner.¹⁴ “*Produit net*” eventually led to the conception of “economic rent” theory by David Ricardo.¹⁵ Economic rent is the idea that the benefit of valuable property to property owners can be considered a kind of taxable income.¹⁶ For example, a vendor in a prime marketplace will be more profitable than a vendor in the middle of nowhere, simply because the former has a more valuable property.¹⁷

The concept of economic rent spurred a social reform project called the “single tax,” by a man named Henry George.¹⁸ The single tax was to be levied as a method to tax the value of the economic rent generated by the land.¹⁹ While very similar to an LVT, the single tax was proposed to be a method of appropriating the entire value of the land, minus the improvements, while an LVT would likely be lowered to tax only a fraction of the land’s value.²⁰ The likely reason for this difference is that George believed, as the name suggests, that the sin-

9. Reed, *supra* note 1.

10. OXFORD DICTIONARIES, *available at* <http://www.oxforddictionaries.com/definition/english/produit-net> (“In the politico-economical doctrine of the physiocrats: the amount by which the value of agricultural products exceeds the cost of their production; the net product.”).

11. *Real Estate Taxation*, *supra* note 5, at 230.

12. *Id.*

13. *Id.*

14. Webb, *supra* note 3.

15. *Real Estate Taxation*, *supra* note 5, at 230-31 (“Recognizing that the value of land tended in “the natural course of things” constantly to increase, he urged that the future increment of all land be taxed heavily to return to the community the values which it created independent of any individual initiative or outlay.”).

16. *Economic Rent*, HENRY GEORGE FOUNDATION, <http://www.henrygeorgefoundation.org/the-science-of-economics/economic-rent.html?jij=1444315521493> (last visited Oct. 5, 2015).

17. *See id.* (using an in-depth example with computer salesmen).

18. *Real Estate Taxation*, *supra* note 5, at 231.

19. *See id.*

20. Samuel B. Clarke, *Criticisms upon Henry George, Reviewed from the Standpoint of Justice*, 1 HARV. L. REV. 265, 265 (1888).

gle tax should be the only tax.²¹ The modern interpretation of the LVT does not require the abolishment of all other taxes.²²

B. Baltimore's Current Property Tax

In 2013, Baltimore City's property tax rate was by far the highest in the state.²³ That is why Mayor Stephanie Rawlings-Blake implemented the "Change to Grow" plan that same year.²⁴ The goal of this plan is to greatly increase the population of the city within the next decade.²⁵ Among other methods, one way this goal was to be achieved was by reducing the heavy burden that is the city's property tax.²⁶

Within ten years, Mayor Rawlings-Blake had hoped to decrease the overall property tax rate by twenty cents per one hundred dollars of assessed property value.²⁷ For the fiscal year of 2015-16, two years after the implementation of "Change to Grow," the City has lowered property taxes for homeowners by fourteen cents, but non-residential real property has not seen any change in its tax rate.²⁸ The slight decrease in tax rates had little effect on Baltimore's ability to compete with surrounding counties.²⁹ Mayor Rawlings-Blake submitted another idea to incentivize the improvement of property by granting tax credits to developers and homeowners for up to 50 percent of the taxable value of the property.³⁰ This tax break would decrease gradually for five years until it is gone.³¹ The plan was approved by the Baltimore City Council in June of 2014.³²

21. *Id.*

22. *See Real Estate Taxation, supra* note 5, at 232-40 (using examples of 20th century incarnations of the LVT that retain some sort of minimized property tax).

23. Yvonne Wenger, *City Passes Latest Property Tax Break*, BALT. SUN (Jun. 4, 2014), <http://www.baltimoresun.com/news/maryland/baltimore-city/bs-md-ci-city-taxes-20140604-story.html> (Prior to July 2013, the property tax rate for home owners was at \$2.25 per \$100 of assessed value in Baltimore City, while, currently, Baltimore County pays \$1.10 per \$100, Harford County pays \$1.04, Howard County pays \$1.01, and Anne Arundel County pays \$0.95 per \$100 of assessed value).

24. Stephanie Rawlings-Blake, *A Ten-Year Financial Plan for Baltimore*, CHANGE TO GROW (Feb. 2013), <http://archive.baltimorecity.gov/portals/0/agencies/finance/changetogrow.pdf>.

25. *Id.*

26. *Id.*

27. *Id.* at 9.

28. Wenger, *supra* note 23.

29. *Id.*

30. Yvonne Wenger, *City Council Approvals Tax Breaks to Spur Baltimore Development*, BALT. SUN (June 23, 2014), http://articles.baltimoresun.com/2014-06-23/news/bs-md-ci-tax-credits-development-20140623_1_tax-bills-tax-breaks-property-tax.

31. *Id.*

32. *Id.*

III. Analysis

A. Precedent of the LVT and Other Jurisdictions

In order to make an informed decision on whether an LVT would be beneficial for Baltimore, it would be prudent to look at other jurisdictions which have adopted the system, or did in the past, and examine the effects. To determine the success of these previous implementations, the effect of the LVT on the areas' populations and property values will be examined.³³ Two specific instances shall be observed: the first in Pennsylvania³⁴ and the second in Japan.³⁵

i. The Pennsylvania Experiment

In 1913, Pennsylvania passed an experimental law on its "second-class cities"³⁶ that required them to assess a lower tax rate on buildings than the rate that was assessed on land.³⁷ By 1925, the tax on buildings was to be one-half of tax on land.³⁸ The result of the experiment showed that building and improvement may have been stimulated as a result of the lower building tax, with an average of 89.4 percent more permits issued per capita in effected cities than neighboring cities.³⁹ The new tax resulted in a disincentive to own unused tracts of land, so they would be sold at a low price to those who would improve it.⁴⁰

Of the two cities targeted by the tax, Scranton and Pittsburgh,⁴¹ it is difficult to tell whether the population of either was significantly affected by the change. Both cities' populations were steadily increasing from a time before the LVT was implemented and did not appear to

33. Some proponents of the LVT believe it would incentivize property owners to improve their land, *see* Reed, *supra* note 1, while others such as the mayor do not mention the LVT, but want to incentivize more people to live in the city, *see* Rawlings-Blake, *supra* note 24.

34. *Real Estate Taxation*, *supra* note 5, at 232 (*citing* PA. LAWS 1913, No. 147 p. 209).

35. Neal W. Zimmerman, *Japan Adopts Land-Value Tax to Curtail Spiraling Prices*, 2 J. INT'L. TAX'N 167, 167 (1991).

36. 53 PA. CONS. STAT. ANN. § 101 ("Those containing a population of eighty thousand and under two hundred and fifty thousand and which by ordinance elect to be a city of the second class A shall constitute the second class A.").

37. *Real Estate Taxation*, *supra* note 5, at 232 (*citing* PA. LAWS 1913, No. 147 p. 209).

38. *Id.*

39. *Id.* at 233 ("The number of permits which were issued per capita during the transitional period show a margin of 25 per cent over New York, 52 per cent over St. Louis, 66 per cent over Philadelphia and Cleveland and 238 per cent over Baltimore.").

40. *Id.*

41. *Scranton, Pennsylvania Population History*, LARGEST US CITIES BY POPULATION, <http://www.biggestuscities.com/city/scranton-pennsylvania> (last visited Sept. 24, 2015); *Pittsburgh, Pennsylvania Population History*, LARGEST US CITIES BY POPULATION, <http://www.biggestuscities.com/city/pittsburgh-pennsylvania> (last visited Sept. 24, 2015).

change afterward.⁴² Scranton reached its highest population of all time in 1930,⁴³ so if it was benefitted, the effect did not last for very long.⁴⁴

ii. The Japanese Take a Different Approach

Japan instituted an LVT itself much more recently, in 1992.⁴⁵ The purpose of the LVT in this case, however, was to stabilize the rapidly increasing value of property.⁴⁶ In the twenty five years before the LVT had been implemented, property values in Japan's largest cities had raised nearly twenty-fold.⁴⁷

Japan's LVT differs slightly from the traditional model in the sense that the tax would apply to the value of the land assigned for inheritance taxes.⁴⁸ These values averaged around 70 percent of the official values of properties of 1990, meaning that landowners would not pay as much for the LVT as they would for other property taxes.⁴⁹ Exemptions from the tax are provided to properties that are below a certain value or are used for public-interest.⁵⁰

By 2013, the property values in Japan's largest cities had fallen back down to the prices they were in 1983.⁵¹ The effect of this on the urban population is apparent, as there was only a 5 percent increase in the urban population from 1970 to 1990, but a 17 percent increase after the LVT was implemented from 1990 to the present day.⁵² In this instance, because the stabilization of the housing market occurred around the same time as the implementation of the LVT,⁵³

42. *Supra* note 41.

43. *Scranton, Pennsylvania Population History*, *supra* note 41.

44. *See Real Estate Taxation*, *supra* note 5, at 232 (stating that the Pennsylvania law came into full effect in 1925).

45. Zimmerman, *supra* note 35.

46. *Id.*

47. *Id.*

48. *Id.*

49. *See id.*

50. *Id.* at 168 ("The following land is exempt from land-value taxation: Land owned or used by the government and designated public-interest corporations, or used for public welfare, such as for hospitals or social welfare facilities[, r]esidential land, but limited to 1,000 square meters per unit[, c]ompany-owned housing provided to employees (but not directors)[, l]and where the value is 30,000 yen (\$214) per square meter or less.").

51. *Looking into the Japanese Real Estate Mirror: Residential Home Prices in Japan Back to Levels Last Seen 30 Years Ago in Spite of Near Zero Percent Mortgage Rates*, DR. HOUS. BUBBLE (Jan. 6, 2013), <http://www.doctorhousingbubble.com/japan-real-estate-bubble-home-prices-back-30-years-zero-percent-mortgage-rates/> [hereinafter *Japanese Real Estate*].

52. *Population of Japan*, WORLDOMETERS, <http://www.worldometers.info/world-population/japan-population/> (last visited Sept. 24, 2015).

53. *Japanese Real Estate*, *supra* note 51.

and the population of cities increased significantly as well,⁵⁴ the LVT appears to have been very beneficial for Japan.

B. Would an LVT Have the Desired Effect on Baltimore?

Most would agree that Baltimore's property tax policy needs to be "fixed,"⁵⁵ but there is disagreement about how and for what purpose.⁵⁶ Mayor Rawlings-Blake has already begun to take the action she considers necessary to solve the problem.⁵⁷ Only two questions are left to determine whether or not Baltimore should attempt to implement an LVT: (1) does further action need to be taken in addition to the mayor's current tax plan, and (2) will an LVT effectively fulfill the goals of all the interested parties?

i. The Necessity of Change

One could argue that there is no need to fix what is not necessarily broken, especially with a system that has had varying degrees of success in the past.⁵⁸ Baltimore's house-flipping market was one of the most profitable in 2014,⁵⁹ and continued to become even more profitable through at least the first two quarters of 2015.⁶⁰ Considering these facts, it might not be completely unreasonable to let the current tax system be.

Mayor Rawlings-Blake disagrees with the notion that Baltimore is on the right path.⁶¹ Among other reasons, she believes that a failure to make any change will result in taxes for property owners remaining uncompetitive with neighboring counties and a widening budget gap that will require future budget cuts.⁶²

ii. The Possible Effects of an LVT

The most prolific argument for instituting an LVT is that, since it would be a penalty on unimproved land, it would incentivize owners of unimproved land to develop their property.⁶³ This argument, how-

54. *Population of Japan*, *supra* note 52.

55. Reed, *supra* note 1; Rawlings-Blake, *supra* note 24, at 20.

56. See Reed, *supra* note 1 (arguing that an LVT would be best used for encouraging land development and attracting investors); see also Rawlings-Blake, *supra* note 24 (aspiring to bring in 10,000 new families to Baltimore within the next ten years).

57. Rawlings-Blake, *supra* note 24.

58. See *Real Estate Taxation*, *supra* note 5, at 232; see also *Japanese Real Estate*, *supra* note 51.

59. See Clabaugh, *supra* note 7.

60. See Reed, *supra* note 1 (claiming that Baltimore has the most profitable market as flippers saw an average ROI of 94% on an investment of \$125,313).

61. Rawlings-Blake, *supra* note 24, at 20.

62. *Id.*

63. J. Anthony Coughlin, *Land Value Taxation and Constitutional Uniformity*, 7 GEO. MASON L. REV. 261, 264 (1999).

ever, fails to account for the fact that an LVT would apply the same “penalty” to a landowner with fully developed property.⁶⁴

A property owner who did not previously have any intention of improving or developing his land would probably not be further incentivized by a higher LVT,⁶⁵ but this type of property owner may be less incentivized to own property in the first place.⁶⁶ The LVT in Pennsylvania exemplifies this.⁶⁷ Proponents of the LVT would take that further and abolish the current system of property taxation completely.⁶⁸ If the majority of property in Baltimore was owned by those who wanted to develop, and there was no property tax to penalize them for doing so, then it becomes more apparent why an LVT may be helpful to Baltimore. That being said, implementing an LVT in a manner similar to Pennsylvania’s would only affect the development in the city and is unlikely to have any significant impact on the city’s population.⁶⁹

The Japanese implemented an LVT for the explicit purpose of reducing the value of land,⁷⁰ and it ended up working fairly well for that purpose.⁷¹ However, Japan’s LVT also had a significant effect on the population growth in the cities.⁷²

Currently, statistics show that 48 percent of housing transactions in Baltimore are being made in cash, which is indicative of a market driven by investors.⁷³ It is possible that the investors are attracted to Baltimore because of the rapidly increasing property values.⁷⁴ If the LVT is implemented similarly to Japan’s, it could drive away many of the investors and house-flippers who are solely concerned with profit margins.

There are those who believe that an LVT could not raise the sufficient funds necessary for modern local governments.⁷⁵ The argument follows that the LVT would need to be higher than current tax rates in order to remain profitable for the government.⁷⁶ The benefit of the LVT is that it can be higher than the current rate of property taxes,⁷⁷ as long as it does not increase with the value of the structure built on

64. *Id.* at 264-65.

65. *Id.* at 265.

66. See Reed, *supra* note 1 (“An LVT would financially incentivize owners of the vacant property to make a decision. Develop or ditch the property.”).

67. See *Real Estate Taxation*, *supra* note 5, at 233 (explaining that owners of unused tracts of land would sell off their property at lower prices).

68. *Id.*

69. See *supra* notes 38-44 and accompanying text.

70. Zimmerman, *supra* note 35.

71. *Japanese Real Estate*, *supra* note 51.

72. See *supra* note 47 and 52 and accompanying text.

73. Reed, *supra* note 1.

74. See *supra* notes 54-55 and accompanying text.

75. Coughlin, *supra* note 63, at 265.

76. *Id.*

77. Clarke, *supra* note 20, at 265.

top of the land.⁷⁸ This way, landowners who intended to develop the land would not have to worry about any further tax penalty, and owners who were not using their property would likely sell it to developers.⁷⁹ Those who develop their land will be able to profit off of the improvements to their land, rather than the economic rent generated by it.⁸⁰

IV. Conclusion

The potential benefits of the LVT cannot be ignored.⁸¹ History shows that, at the very least, an LVT will help prevent housing bubbles caused by the constantly increasing values of land.⁸² Stabilizing the property values also has a clear correlation with the population of the area.⁸³ Since the mayor has already conceded the necessity for a change,⁸⁴ paired with a desire to attract more residents to the city,⁸⁵ the LVT may just be the logical next step.

78. See Reed, *supra* note 1 (“[The LVT] eliminates the idea of ‘punishing’ owners from developing a property”).

79. See *Real Estate Taxation*, *supra* note 5, at 240 (arguing that the benefit to developing landowners would likely come at the expense of idle landowners).

80. *Id.*

81. See *supra* notes 69-72 and accompanying text.

82. See *supra* notes 46 and 51 and accompanying text.

83. See *Population of Japan*, *supra* note 52.

84. Rawlings-Blake, *supra* note 24, at 20.

85. See *supra* notes 24-26 and accompanying text.