Absentee Ownership: Its Causes and Solutions
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Setting the Scene

It's the bane of old cities. Once stately and beautiful homes, as well as others built for two or three families, are now sold off by their former owners and decedents for a pittance. The population's move to the suburbs, for better schools, to get away from inner city street violence, or to maintain home equity, for whatever reason, have left once grand cities dying. Two generations ago it was explained as "white flight," but it was less often rooted in racism than it was in the desire of homeowners to protect the value of their most valuable asset, their home investment.

The real estate industry abetted the process in a sense, but so did public policies. Every public policy initiative seems to have made suburbia more attractive and cities the havens of last resort. Those who came to populate the cities, especially the inner cities, were the poor. Most couldn't afford to own their homes, so they rented. If they couldn't afford to rent, then government programs at least made rental possible through various subsidy programs. That's the situation today.

Who are the owners of rental property? Not typically the most savory characters in the community; in fact they are often called slumlords. Many of those who buy up tenant housing in America's inner cities do just enough to avoid that label. But structures housing their tenants get nowhere near the care and maintenance they did when they were owner-occupied. There are striking exceptions as in all generalizations, to be sure, but the size of the problem is ample evidence of the scope of the practice. City governments don't attend to the poorer sections as much either. Narrow streets are lined with overgrown trees that block sunlight and keep in a dampness that never leaves. Lawns are unattended and sidewalks have heaved. Cars line the street because parking and garages were never planned when most of these houses were built.

Gradually the houses deteriorate, attract lower quality tenants, and are ultimately boarded up or burned down. The vacant lots become sometime backyard auto-repair business, with vehicles stored there either for spare parts or because they no longer run and are waiting to be sold for parts or scrap. The lots are strewn with rubbish, broken glass, and overgrown with weeds and scrub, so they can't even be used for playgrounds or gardens. Because they are private property, they are not available to the neighborhood for common use. In the worst instances, the remaining homes, now vacant, become havens for drug users and the homeless. Violence reigns. The neighborhoods are so endangered that they drive away the few holdouts that hoped to last, hoping, that is, for some miracle. The scenario, and the cycle, is so typical that its further elaboration is unnecessary.

Of course the hopes are for resurrection with outside renewal money. Their assortment and variations are too numerous to count — special public housing programs, enterprise zones, tax abatements, tax increment finance, and so on. Every consultant huckster peddles his solution; it's a wholesale and lucrative business. What began in the

1950s as "urban renewal" continues in other guises, but the common feature in them all are the ribbon cutters, the politicians that glory in being able to boast and crow about some neighborhood's rebirth. The money for these programs is usually federal, often matched with state and local contributions. The latest gimmick is public-private partnerships, usually more public than private. Anchor projects like convention centers, hotels, stadiums, and new shopping centers are touted as being the harbingers and cores of new downtown life, promising that, finally, this renewal will once and for all revive the neighborhoods. There are many such ventures competing with one another, but few fulfill their opening promises. Many are rife with backdoor deals if not actual corruption. The newest justification for urban projects is now the creation of jobs. It's where lots of new "stimulus money" is going! Imagine! The projects are not justified by promised results but by the process of doing them, not for their accomplishment but for their means. It is the ultimate in policy confusion.

Thinking Systematically

The problem exists, and persists, because there has been no systematic analysis of the economic and legal dynamics, let alone a solution. Matters need to be reviewed at a more distant and abstract level. Why are urban homesteads less attractive to people than suburban homes? Why, one should ask, do owners of these homes find them such an advantageous and lucrative investment? Why do they invest so little in their maintenance and improvement? Why, on the other hand, do tenants have so few options in choice of housing that they are driven into the arms of exploitive slumlords? And why do public revitalization programs meet with such limited success?

It helps to understand the simple economics of real estate, particularly the market prices of land, and set this against the backdrop of investment opportunities elsewhere. Buildings of all sorts — offices, stores, garages, factories and homes too — depreciate in market value over time, just as do cars, computers and refrigerators. One recent study by a team at the Federal Reserve Bank of St. Louis calculated that the depreciation rate is typically about 1.5 percent per annum, and that the realistic lifetime use of many structures is typically comparable to the lifetime of a person. Of course many structures are rehabilitated — new electrical and plumbing service, new roofing, improved insulation, fitting for phone, cable, and internet, and even sometimes re-arrangement of interior partitions. With proper maintenance and upkeep, buildings can last hundreds of years, as usually they more often do in countries outside the United States. In the U.S., however, there is less incentive to maintain and improve structures; it is cheaper, often, to replace them or to move to new structures elsewhere. The moderate price for making such choices is explained by the relative cost of materials and labor, and the rapidly changing needs and lifestyles that we have become used to. But most of all, it's explained by our tax codes! Who would ever think it possible to depreciate a building, and then do it again, and then again so long as there is a willing owner! Yet our tax laws accept this.

Then again, space is less of a premium, not only on account of the vastness of American landscape but by the advent of motor vehicle transportation and the network of publicly-provided highways to serve that vastness. Land is cheap, at least relative to land sites in Europe, Japan, and other industrialized places. One may even, on occa-

sion, forget that there is a limit to the supply of land altogether, at least for purposes of access in our modern economies. The market pricing of land in today's world means that it fluctuates in value not only in response to population demands but with respect to the economic vitality of locations. These fluctuations are measurable at the local, regional, national, and even at the international levels. Fifty years ago, it was the Midwest that was booming and the South was a backwater. Today it's the reverse; it's called "the Rustbelt" for a reason. As the world becomes ever more unified and globalized, no region or nation is insulated from the market forces of other nations, and this goes for land as well as other goods and services.

Indeed, the changes in the value of land sites may actually be more acute than for other marketable items, because land is, as earlier noted, fixed in supply, such that the adjustments in price can be caused and explained solely by changes in demand. This is unlike changes in market goods and services that are more "elastic" in nature and offer more latitude for adjustment. Land, then, not only experiences amplitudes of price from place to place and time to time; it actually does so in regular cycles, as has been recently demonstrated by the work of several students of such phenomena. (Anderson, Foldvary, Gaffney, Hudson, Kavanagh being the most important) There is a compelling record of these cycles going back to the beginning of the industrial era — some two centuries — every eighteen years. Macro- and micro economics have closer links than most people realize; they're just not taught.

What these changes provide is an invitation to those with discretionary investment resources to invest in land sites that have a high prospect of rising in market value in short order. Investors might reasonably bank on real estate prices continuing to rise, faster than the interest rates of the loans made for their finance, and even as tax policies allow for faster book depreciation of structures. Recent data show that some real estate markets increased in price as much as 20 percent in a year! These volatile markets were ripe for speculative investment, and fostered a practice known as "flipping" for those seeking quick returns. Soaring housing prices, arising essentially from changes in the price of land sites, were leveraged by opportunistic investors and predatory bankers to feed a market fervor. On the other hand, over-heated markets are subject to precipitous downturns that can leave these investors "high and dry," or, worse, totally bankrupt. It was the housing market, abetted more by speculative fever, that brought on the recent economic crisis. But there was a reasonable chance that, except in rare cases, one could still come out ahead.

Here's why: Real estate is subject to enormous tax preferences, so that depreciation schedules, favorable loan rates, and the continuing and growing demand for rental housing have typically make it a win-win situation. Assessors, by conventional practice, put a value on the land separate from that on buildings (improvements), and their assignment of value to each is, sadly but typically, quite arbitrary and subjective. It is not unusual, for example, for parcels to be marked 90 percent building and 10 percent land, even though municipalities' land values are in the aggregate often closer to 40 or 50 percent of the total. The over-valuation of improvements offers to owners an enormous write-off of tax burdens. Yet, when a parcel is sold, the new owner depreciates the building all over again, dividing the building-land proportion in the same way. The land

value proportion will rise on its own anyway, just because the building's depreciation and land's appreciation quickly changes the balance. Moreover, real estate businesses usually have many parcels, and this allows them to buy and sell on a continuing basis, always having the leverage and collateral to secure favorable loans from banks. And when parcels are sold, the price can be taken as a "capital gain," therefore taxed not only at a rate lower than conventional earned income, but balanced against losses — usually paper losses — assigned to other property parcels. But most skillful real estate investors never pay capital gains; the common practice to zero-out gains and losses so that no tax is paid at all. Only chumps pay capital gains in the real estate industry.

Then there are the monthly returns to be had in rent payments by tenants, be they household, office, or commercial. Even if a building is only half leased, the return is often large enough that the investment is still profitable to the owner. Unless the owners and managers are assiduous in maintaining the investments, the proper but seldom followed practice, the return on capital is enormous, particularly when compared to the return of other ventures. Of course, tenants are not all respectful of premises, responsible for their lease terms, or reliable in their rent payments. Still, the record of business ventures at all levels — households to major firms — plying their trade in real estate is testimony enough to the attraction of its returns.

Why the rise in absentee ownership?

In recent years there has been an enormous rise in the proportion of absentee owners. This might first appear to be paradoxical, because national housing data also show that the proportion of households owning their own homes has risen to the highest level on record, over 65%. The reason why the number of tenants and rental properties has also risen are two: first, the average household size has declined and more people are opting to live alone, and second, the number of larger apartment complexes has not kept up with the demand for rental space. Many smaller rental properties — mostly single family or two family homes — are now part of the rental market, what used to be essentially large, multi-unit buildings. Decades ago, it was unusual for tenants to be housed in single or dual unit property parcels; today this is common. The classic apartment was a walk-up flat in a large city, managed usually by a resident supervisor who lived on the first floor. The building was likely to be on an equal-sized plot of land. Today, apartment complexes are usually in the suburbs, arranged in adjacent units so that vehicle parking is right by the entrances. For those who want to live in the cities, fewer multi-unit apartments are available, but older homes are taking the place.

There are many sites, vacant or with obsolete structures, where new apartment units could easily be built. But the numbers don't work as well; the land is often expensive, zoning restrictions are cumbersome, and the costs of clearing old buildings is high. It is more advantageous for an apartment developer to buy cheaper land at the edge of a city, put up an extensive apartment development, and let the public bear the costs of transportation. This becomes clear when it is understood that the costs of land and the costs of travel are essentially reciprocal, even though the economic complexity of the pricing doesn't make this easy to understand. Because apartment developers and their tenants don't bear the full costs of transportation — a factor largely assumed by the public generally, suburban apartment units are competitive with those in urban areas,

especially those in older and depreciated structures. Only those older homes, once owner-occupied, are really competitive with the apartment complexes in the more remote localities. If any new complexes are developed, they tend to be for the high-end luxury market.

The scarcity of apartment buildings in downtown areas in many cities is therefore explained by the fact that it is cheaper to drive to outlying areas and the suburbs. And besides, many people value the feeling of being closer to grass and nature more than they miss the activity and beat of the cities. And besides, these days, there's not much going on downtown anyway. So even though there is potentially land available on which to build, the transportation requirements, the costs of construction, and the competing opportunities elsewhere all make the availability of modern apartment complexes a rare item in the city. If there are opportunities available, they are more often likely to take the form and model of condominiums, with all the tax and equity-building advantages they offer, than of apartment units.

Where's the Profit in Urban Residential Real Estate?

If there is any profit anywhere in building homes downtown, it's likely to be either at the high end ("Townhouses") or with government assistance of one type or another. Fill out this section later.

Getting the Numbers Right

The problem can only be corrected if first the tax regimes are sound. This means that the assessment of property parcels need to be accurate. Since the real property tax is, at least from an economist's perspective, really two taxes, each with very different dynamics, it is important to make sure that the land values are assessed accurately as well as the improvement values. Otherwise whatever tax rate is levied — remember, rate X base? — won't be fair. Moreover, it is really necessary to assess all the parcels on a locality-wide basis frequently, or else shifts in neighborhood or regional economic vitality, as well as differential depreciation of structures, will throw comparisons off. The state of Maryland performs the assessments for every county on a tri-annual basis; that is one third of all the counties each year. This assures, first of all, that the task of assessing is totally removed from the task of administering the tax — no hand-in-glove shenanigans there! Connecticut now has a law requiring re-valuations once every five years.

One frequently hears from political leaders that re-assessment is infrequent because it is such an expensive project to undertake. There are places here in New York State that haven't done a 'reval' in decades (although the State is now giving money to localities to do so). But the cost of doing the job has dropped radically, especially given the use of computer technology. To be sure, technology is not being used nearly as widely as it could be, nor are the most advanced techniques being employed. GIS (geographic information systems) programs can not only assume much of the task of valuation but can check the work of conventional "eyeball" assessments as well. GIS can be used for the assessment of the land values, revealing the contours of the value gradients from highest points in urban cores, following along transit and highway corridors, and con-

trasting with less accessible and attractive points of space in remote areas or in the boonies. A good GIS land value map has lots of similarities with a USGS Topographical Survey map — showing all the isobars of elevation, all the cliffs and valleys, as well as the peak points. Good assessments of land, with colors showing value per square foot, or per acre, will show all the gradients of value from place to place — the highs in places like shopping centers with traffic, and the lows in places like suburban side streets. A bad land assessment looks like confetti scattered over the map.

Once the land values are identified, this serves as the foundation of any assessment roll; the buildings may still need to be appraised according to traditional methods, but there are stock formulas to help with that. It is important to know how to relate the land component to the building component of each parcel. Most assessors agree that it is best to first assess the land, and then make the building value the residual. Buildings, after all, are much more difficult to assess than land. But there are powerful incentives to take the building assessment first. For structures that are depreciable, and that's any property used for a business, there is an advantage in writing it off as fast as possible. Moreover, it's advantageous to the owner to write off as much of the value as possible. So making the building 80 or 90 percent of the total parcel value gives much more opportunity than making it half the value. Many assessors are quite willing to cooperate with public officials and favoring the business sectors, thereby allowing a far greater building proportion than is really warranted. It is revealing to see many parcels, in the best sections of town weighted so that land value component is trivialized.

The Georgist Solution for Absentee Ownership

Of course, another course is to abandon the tax on, and the assessment of, buildings altogether, making things all more simpler, and cheaper. With the cost to a city of doing a reassessment now approximately $100 per parcel, and then with all the associated costs of grievance proceedings for those that wish to file an appeal (most of which are on the building and not the land component), a fair amount of complexity, paperwork, time, and expense is quickly eliminated. Moreover, as any economist knows, the economic efficiency of a tax on land alone is incomparable. All the arguments in favor of taxing only the land component of real property are weigh in its favor. Measured against the common textbook principles of sound tax theory, a land value tax is completely neutral, totally efficient, highly progressive, easily administered, highly stable, simple to understand, and impossible to avoid. Each of these items deserves more explication. Tax theorists typically measure revenue structures according to any or all of these criteria:

Tax *neutrality* refers to the influence (or absence of such) that any particular design has on economic behavior. Typically taxes are perceived as a damp on economic activity: taxing income reduces the incentive to work, taxing sales discourages retail transactions, and taxing savings reduces the propensity to save.

The more a tax is perceived to be neutral the less the identifiable distortions it imposes on the economy. The common assumption of most tax theorists is that all taxes impose distortions; it's simply a matter of which ones are least burdensome to economic health. A tax which imposes no distortions is ideally best, and a land tax imposes no distortion.

Tax *efficiency* is much like tax neutrality, and is the measure of how much shifting of behavior it imposes, resulting in what is called "excess burden," or "deadweight loss" on the economy. Tax economists usually hold that the best taxes are those that are shifted little if at all. Because the elasticities (a technical word for the slope of supply and demand curves) of each are very different, a tax on land values and a tax on improvement values have very contrastive effects on economic choices. Using a tax base that has little or zero elasticity is the best way of assuring that taxes are not shifted. Zero elasticity is another way of saying fixed supply.

The principle of *equity* is central to any discussion of tax design. Tax design requires concern with both what is fair and the extent to which it must sometimes be compromised to satisfy the other principal criteria. Fairness can be evaluated according to what is termed "horizontal equity" — the extent to which those in similar circumstances will pay similar tax burdens, and "vertical equity" — how well those in different classes bear different burdens in the tax structure. It is this latter perspective that leads to the use of terms like "proportional," "progressive," and "regressive" in referring to tax structures. A tax is progressive with respect to income if the ratio of tax revenue to income rises when moving up the income scale, proportional if the ratio is constant, and regressive if the ratio declines. There is an ancillary question of whether taxing to reach greater equity should employ measures of income or of wealth, difficult as this is to measure. Such questions of equity are a matter particularly central when discussing the property tax. This will be discussed further below.

Administrability refers to the ease with which a tax can be administered and collected. Taxes which distort the economy are inefficient but so are taxes that cost lots to administer. This is measured not only in the direct costs of tax avoidance and accounting expenses, but in the level of evasion and cheating, and by the cost of government auditing and policing. When the taxpaying public perceives that a tax is easily evaded, cumbersome, and unfair, it loses its legitimacy and calls government itself into question.

This is why the principle of *simplicity* is important: the more complex the tax design, the more lawyers and accountants will find loopholes, encourage the appearance of unfairness, and drive up the cost of its administration. People know that with simple taxes other parties are also paying their fair share, and all this enhances the legitimacy and therefore the compliance of the tax system.

Stability refers to the ability of a tax to produce revenue in the face of changing economic circumstances. Income and sales taxes, for example, vary greatly according to phases in the economic cycle; the property tax, in contrast, is highly stable regardless of the state of the economy. This is one reason why school administrators have typically been supportive of using the property tax base rather than some other tax to support school services.

The *certainty* of a tax's collection ensures that the number and types of tax changes be kept to a minimum. Frequent changes in tax rates and bases interfere with business decisions and the ability to make long-term financial plans. This concept reinforces the

need for stability because an unstable revenue system is more likely to require continual adjustments.

In assessing the value of a tax it is also important, of course, to understand its potential to bring in revenue for the purposes of government, usually deemed revenue *sufficiency*. Income, sales and property taxes, along with corporation taxes to a lesser extent, have come to be regarded as the workhorses of the American revenue structure. But, as anti-tax politicians are quick to note, the higher these taxes are, the more they impose a drag on the economy. This is why one should ponder whether to consider raising taxes which have demonstrable distorting effects.

How then does a land tax address the problems of absentee ownership? It does so in three ways: it eliminates the opportunities and advantages of property speculation, it removes the penalty on construction and maintenance of structures, and it makes rentals more affordable, since the the building proportion of the property tax is the only part that is passed forward to tenants, the poor.

As noted above, buildings depreciate in value, and can be totally written off for tax purposes in the course of thirty years. This means that any appreciation of parcel value is due to appreciation of the land value. Part of this increase is typically due to general inflation in the economy, but part also is in the parcel itself since the loss of value in the building is compensated by a greater value in the land. Lastly, the health of the general economy and general population growth often accounts for the increase in demand for places to live. The vitality of the neighborhood and regional economy is reflected in the value of land sites, and this is explained by economists as the flow of ground rent through locations. That flow of rent is a socially created product, circulating through all the sites of a neighborhood or region, whether they are vacant lots of occupied and productive businesses. If that rent flows vigorously through those localities, it can be capitalized in a higher market price if the land parcel is sold. But if that rent is recaptured in the form of taxes, it not only returns to the community what it has created, it also stabilizes the market value of the parcel so that speculative practices are stemmed. There is nothing in it for the speculator if land taxes recover most, or even all, of the flow of rent that create the market value of the location.

High taxes on land value also exert a downward force on the capitalized market value of sites is really the payment of taxes "up front." This increase in regular carrying costs payments is a positive force to the economy by reducing the amount of "frozen capital," and thereby also putting more sites into the market at any given time as candidates for better development use. But this increased activity has the reverse force for increasing the market prices, so that one never knows for sure which effect is going to be dominant. Often they neutralize each other, and the land prices remain stable. It could be the case also that the prices of land actually increase. What is most essentially the case is that the total costs of parcel site ownership shift forward to the present, with more payment in the form of taxes, and less payment in the form of a capitalized purchase price. For the owner, it's simply a matter of when he pays for his site, just like the old television ad said, "You can pay me now, or you can pay me later." But for the

community, the effects are far more positive, and these ultimately return to the advantage of every title-holding member of the community.

The shift of the tax burden to land has a second effect of eliminating the penalty on any developer builder who wants to improve a piece of land. Under the conventional property tax regime, everyone understands what happens when he or she puts on a new wing, adds a garage, or otherwise increases the value of the building in any way: the taxes go up. Under a land value tax regime, there is no change in taxes whatsoever: in this way, there is every incentive for each property owner to improve and maintain his investment to the full extent that its location warrants. And the effect of his effort redounds to the benefit of every other property parcel in close proximity. That is, the value of my house is increased by what you do to improve your house, and vice versa. Contractors should arguably be overwhelmingly supportive of land value taxation, and those that are aware of it usually are supportive. But to most it is a strange new idea, even though the idea goes back a century and more. Therein lies the challenge for its proponents to educate potential supporters, not only contractors but developers and realtors of every sort. In fact, the Greater Philadelphia Board of Realtors, which works very closely with proponents in that area, is one of the strongest supporters of the shift to land value.

A third group that benefits from a land value tax are those that typically rent. Because a tax on the land portion of a property parcel is born solely by the titleholder and not passed forward to the tenant, households in this category, mainly poor people, pay less in rents. Moreover, because there is a general economic inducement to developers to add to the housing and apartment stock in a community, renting often becomes less costly because wider choices are available. There's no tax on the building to pass forward to the tenant, and the tax on land is not shifted because the supply of land is fixed — it is "inelastic" in economic parlance. It is also important to note that development opportunities are likely to open up most widely in areas where land parcels, previously held off the market, are now available. Not being able to afford the costs of motor vehicle transportation so much, the urban areas are apt to be where poor people often want to live. They are less apt to be relegated to last-chance options of ghetto and slum housing; all neighborhoods and regions stand to be revitalized.

Conclusions

So, when all is said and done, what's in it for the absentee landlord? There are still great opportunities, perhaps even more, given the number of new landsites now likely to be unfrozen and available for development. But the market for land is soon likely to become an open, vibrant, and fair market, not the kind that exists now based on limited options and exploitive circumstances. For the truly committed small developer, especially the kind that may enter the housing market focused on rebuilding their neighborhoods and their cities, the economic environment is likely to be much improved.

For the tenants, opportunities are likely to grow in number and in better quality housing. Often those choices are less expensive as well, because in a more competitive and wider market, the range of choices and their prices are likely to grown. Land value taxa-

tion is a win-win situation both for the tenant as well as the publicly minded landlord out to make an honest buck.

Who are the losers? Very few. They are the less scrupulous landlords, the kind likely to be drawn to rental opportunities in today's imperfect markets. A second category of losers are the land speculators who hold their land titles off the market in hope and expectation that they will grow in value, and/or some public program will at some point offer them the inducement to sell or to cooperate in some development. Neither of these constituencies deserve being rewarded as they now often are. Improving the life of all citizens, and the housing opportunities for all, lies within reach for cities that opt to phase in a regime of taxing land values alone rather than the conventional real property tax.

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