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The Role of the Graded Tax in Urban Redevelopment:

A Case Study of Lancaster, Pa.

By STEVEN CORD

I

Purpose of the Study

LANCASTER IS A PICTURESQUE CITY at the center of an area with a very sound economy, yet like many other cities throughout the country, it has large sections with deteriorating housing and its downtown commercial district is suffering from serious competition with a number of outlying shopping centers.

There are many ways by which the cities can meet these twin problems, one of which, Pittsburgh's Graded Tax, has been recently endorsed by many prominent urban renewal authorities. This approach has been called "the golden key to urban renewal, to the automatic regeneration of the city—and not at public expense." Other endorsers are National Association of Home Builders, *Fortune Magazine*, *Nations' Cities Magazine*, and various chambers of commerce throughout Pennsylvania. This is, of course, only a partial list. The Graded Tax, then, should merit the attention of all those who wish to improve their city.

It is interesting to note that Hawaii has recently adopted the Graded Tax after having studied Pittsburgh's experience with it. The idea has worked successfully in Australia, New Zealand, the California Irrigation Districts, Fairhope, Ala. and Arden, Del. Three cities in western Pennsylvania are currently giving the Graded Tax serious consideration, and the State of Vermont has just shown recent and enthusiastic interest in it.

Construction is the most heavily taxed industry in America. This is undoubtedly one important reason why it needs so much governmental help to meet the needs of its customers, while other industries do not. The Graded Tax would make it possible to considerably untax improvements.

For all these reasons, the city of Lancaster has found it advantageous to inform the Department of Housing and Urban Development of its interest in adopting the Graded Tax when submitting its application for admission to the Model Cities Program.

What is the Graded Tax and how does it work? It is a modification

of the current property tax. At the present time, the tax assessor assesses both land and building, each according to their respective values; this would not change under the Graded Tax. Then the city determines the tax rate—*i.e.*, the millage (mills per dollar, a rate equal to the tax charge per thousand dollars of valuation) which will yield a tax revenue from all taxable properties which will suffice to meet city expenses. Here is where the Graded Tax differs from the current property tax: instead of taxing land and building at the same tax rate, the city would gradually decrease the tax rate on buildings while gradually increasing the tax rate on land. The city would continue to get the same revenue as before from the new property tax, except that it would get proportionately more from land and proportionately less from buildings. Instead of one tax rate there would be two.

The advantages claimed for this Graded Tax are:

(1) *An increase in housing and new construction.* If improvements are untaxed, there will be more of them. Also, the cost of owning improvements is reduced considerably and eventually space rentals will be reduced.

(2) *More efficient land use.* It would be difficult to keep land out of use, or only partially used, if the land is taxed.

(3) *A fairer tax system.* Government services increase land values and therefore the government should tax land values rather than what individual initiative creates (namely, buildings and income).

If Lancaster adopted the Graded Tax, would it reap these advantages? What would be the effects of the Graded Tax in Lancaster? It is the purpose of this study to answer these questions. A sample was developed of more than one hundred properties, reflecting the property picture of the city at large. Land and building assessments were determined for each property (from the city assessment records) and the properties were classified according to type of property so that the effect of the Graded Tax on each type of property could be ascertained.

This study was authorized by the city government of Lancaster and financed by a grant from the Lincoln Foundation, a non-profit organization interested in research in municipal government and finance.

II

Proposed Graded Tax Schedule for the Next Five Years

PENNSYLVANIA LAW CLEARLY AUTHORIZED CITIES like Lancaster to follow Pittsburgh's lead (also Scranton's) and adopt the Graded Tax. As far as the school tax is concerned, there is no law requiring a uniform tax

rate on land buildings, but neither is there any law authorizing local option on different tax rates.

Since the purpose of the Graded Tax is to improve land use by inducing certain landowners to improve their property, time must be allowed for this to occur. Otherwise these landowners would be put at an unfair disadvantage. Hence, instead of introducing a considerably larger tax rate on land and a lighter one on buildings all in one fell swoop, this should be done gradually over a five year period. Anyone contemplating adjustments would then have time to make them.

At the present time, the city would plan to maintain a 75 per cent–25 per cent ratio on buildings; that is, it should consider eventually exempting 75 per cent of assessed building values from taxation, leaving 25 per cent to be taxed. If the city does this, the following schedule of tax rates under the Graded Tax could apply:

Year	Reduction in Building Tax Rate (per cent)	Building Tax Rate (mills)	Land Tax Rate (mills)
Current	0	12	12
Second	25	9	33.1
Third	50	6	54.2
Fourth	75	3	75.3

These tax rates for both land and buildings are calculated on the assumption that land and building values would remain approximately the same during the five year transition period, and that the city budget requirements would not be materially increased or reduced. Since some variation is to be expected, actual millage rates can only be determined by the City Council from year to year. In the event of a material increase in either land or building values, the millage rates could be adjusted accordingly.

III

Effects of the Graded Tax on Different Types of Property

NO SURVEY IS NEEDED to realize that empty lots would be taxed more heavily under the Graded Tax than under the present property tax. The bigger and the more centrally located lots would naturally bear the heaviest taxes.

Owners of such lots would have two choices: build or sell out to builders. Either choice would be socially desirable as there still is a shortage

of good housing in Lancaster. Zoning should be employed to prevent over-building. While there is a need for small in-town parks (sometimes called mini-parks or vest pocket parks), certainly empty lots are not the answer.

Compared to the present property tax, the Graded Tax would make it easier for owners of empty lots to build because the improvements they erect would be taxed much less. It should be remembered that a 3 per cent annual tax on improvements is equivalent to a 50 per cent excise tax on new construction. At the same time the Graded Tax would exert pressure on owners of empty lots to build, it would make it easier for them to do so.

Taxes would decrease on single family, unattached homes. The savings would be substantial for two classes of homeowners: those living in well-maintained homes (the better the maintenance, the bigger the tax saving) and those whose homes are situated on land that has lost value because it fronts on truck routes, busy highways or gas stations. Only one home would receive no tax saving at all, and that was a well maintained home on State Street. The neighborhood is very desirable and the high land value precluded any real gain by a switch to the Graded Tax. In general, these findings are corroborated by studies made in other cities.

It can be predicted that the long range effect on private housing in Lancaster must be: first, to increase the supply of houses because they would be cheaper to build and maintain (taxes are a substantial cost factor in home ownership), and secondly, to make rehabilitation easier. Both effects are desirable because Lancaster will be needing more housing in the coming decade because of a predicted increase in population and because there are already too many overcrowded houses in the city. Also, many housing units in Lancaster are quite old and in need of repair. Today, a \$3,000 repair job will incur an increased assessment, and then an increased tax amounting to approximately \$20 a year ($\$3,000 \times .55 \times .012$; \$20 a year is equivalent to \$400 in hand and this must be added to the original cost of \$3,000). The current property tax inhibits home improvement as compared to the Graded Tax.

Taxes would decrease even more substantially on attached homes (row houses). For cities the size of Lancaster, this represents an efficient use of land.

Attached homes with stores on the ground floor would tend to have the highest tax savings under the Graded Tax, and there would be a slight tendency for the best maintained attached homes to receive the biggest tax savings. But this was negated to some extent because such homes

tended to be in desirable neighborhoods where land assessments were relatively high.

One pleasant surprise this survey uncovered was that attached homes in Negro neighborhoods would receive substantial tax benefits under the Graded Tax. In these neighborhoods rentals were relatively high¹ and there would be comparatively less Graded Tax to pass on to tenants in the form of higher rentals.

There would also be long range effects of the Graded Tax. It should tend to increase the overall housing supply and it should make compliance with housing code enforcement much cheaper and easier.²

Multi-family houses would receive tax relief under the Graded Tax. Apartment houses would be the biggest gainers of all. At first this would redound to the benefit of the owners, but the gains would be so substantial as to give tremendous impetus to new apartment construction. From the viewpoint of city planning, this would be highly desirable because only in this way will the stores in the central business district be able to meet successfully the increasing competition from the shopping centers soon to be ringing the city. If people want lawns to mow in suburban setting, they cannot expect to do this on city land. Cities exist to bring people together, not to spread them thinly about. City amenities can only be maintained among a fairly dense population. However, apartment living requires planning for a number of small parks within city limits. Such parks, if well planned could cost less than the increases in the taxable land value they would create.

Would apartment house tenants be paying lower rentals under the Graded Tax? This survey can offer no answer to this interesting question, although the economics textbooks are quite agreed that taxes on buildings are eventually passed on to tenants (under the Graded Tax, such taxes would be reduced) but the tax on land must be paid by the landowner.

Rooming houses would receive mild tax benefits. This was not anticipated. Only those rooming houses situated near the central business district with land values inflated as a consequence, would not receive such benefits. Presumably these benefits would eventually bring about a reduction of rooming house rentals, a not untoward effect in view of the low incomes of most such renters.

It will be noted that the Graded Tax generally would bring tax savings

¹ See the Lancaster Housing Study of 1966.

² A recent study in Dayton, O., confirms this.

to owners and tenants of residences. This is because residential land is inexpensive compared to commercial land.

Office buildings must generally be located in certain desirable downtown locations, and although they would be taxed less heavily by the Graded Tax, this would generally be more than offset by a higher tax on the land value. This is true even for the Griest Building, certainly a well-developed structure, although in this case the increase in tax would only be minor.

Some of Lancaster's office buildings seem to be in need of rehabilitation, and it must be noted that the Graded Tax would measurably reduce the taxation on such expenses.

Aside from a few store properties not within the central business district, store properties would pay more under the Graded Tax than under the current property tax. A central business district location presents tremendous opportunities for retail businesses, and it could be expected that the city which created such values should tax such values.

It is important to realize that it will not be the expense of operating stores that will be increased but rather the expenses of owning central business district property. In some cases, central business district stores own the property in which they are doing business, but this is not always so. Since the Graded Tax will reduce the building tax, an expense passed on to store owners in the form of higher space rentals, it is reasonable to expect that eventually retail space rentals would decrease, a fact which might commend the change to central business district store owners.

The higher Graded Tax rate in the central business district would have some indirect advantages for the retailers there. In the first place, repairs and rehabilitation would be cheaper because they would be considerably untaxed. This would encourage the central business district improvement which would stave off the growing blight afflicting so many other American cities.

Secondly, the prime effect of the Graded Tax would be to encourage the construction of high-rise apartment houses on the fringes of or near the central business district. This eventually would increase the sales and profits of central business district stores. If the city continues to lose its high and middle income population, no amount of retail tax relief can help the central business district stores. This emigrating population will increasingly shop in the rim shopping centers, draining trade away from the central business district. If they can be encouraged to stay or if their numbers can even be increased, it will be much more convenient for them

to shop in the central business district rather than in outlying areas. Such a population development would decrease traffic coming in and out of the city and would make in-city public transportation more feasible.

There are many reasons why high and middle income families are leaving the cities, but for the sake of central business district store owners, public tax policy should seek to slow down or even reverse such a population trend. The future of the central business district depends largely on this population factor.

Another possible long-term effect of the adoption of the Graded Tax might be the smoothing out of land prices throughout the central business district. At the present time, land prices fall off sharply as one moves away from Penn Square. The sharpness seems unnatural and one can see how the Graded Tax would encourage a more even development of the central business district.

The effect of the Graded Tax on industry will vary. But by and large industry will receive substantial tax encouragement. This is especially true if a factory is not located too near the central business district and is not in an old building (also if it makes intensive rather than extensive use of the land). Factory sprawl will be discouraged and so also would be factories near the downtown area.

This tax benefit should be of interest to corporations considering Lancaster as a possible location for a new factory. However, this tax benefit will not in any way decrease the total tax revenues of the city, as do some other forms of tax benefits to industry.

This tax benefit should also encourage the expansion in Lancaster of existing factories, and also their repair and rehabilitation. The growth of new and indigenous factory operations would be spurred.

The Graded Tax impact would vary for other miscellaneous improvements. The Hotel King Douglas (Lancaster's only hotel now) would benefit as would certain warehouses situated in low-land-value neighborhoods. But downtown warehouses, junkyards, and parking lots would be discouraged. (Other cities have found that municipally-owned parking lots in the interior of city blocks can be operated successfully at break-even profit.) Most gas stations, especially those in the downtown area, would receive tax increases.

Fortunately, this impact would encourage city development in line with modern urban planning goals. Downtown warehouses, junkyards, parking lots and gas stations represent an inappropriate use of central business district land and should be discouraged by the property tax system.

IV

Assessment Procedures

THE LAST LANCASTER PROPERTY VALUATION for tax purposes was drawn up in 1960. Property values have changed considerably since then and the city might very well consider another valuation. City property is supposed to be assessed at 55 per cent of market value, but much property is assessed much lower than that. It is also probable that land values are assessed lower than building values. Contrary to Graded Tax principles and modern city planning, land used commercially is assessed 50 per cent higher and vacant lots are under assessed by as much as 50 per cent or more. A new valuation seems in order.

A new valuation would probably reduce the present 7:1 building to land value ratio for the city as a whole. This would in turn result in a slight alleviation of the taxes central business district property would pay and raise slightly the taxes on residential uses in and near the central business district.

The Graded Tax could be applied using the present assessed values, but its effectiveness would be enhanced if more accurate assessments were used.³

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³ In an appendix to this article, the author presents six pages of factual data upon which the findings are based. It consists of assessment data from records of the City of Lancaster, Pa. Table I shows the incidence of the Graded Tax on a representative sample of real estate properties in Lancaster. For each address the following information is given: building assessment, land assessment, building/land ratio; selling price and date of sale; city tax at a rate of 12 mills; Graded Tax, first year; the amount by which the city tax exceeds or falls short of the Graded Tax, and a description of the property. Properties are presented in the following categories: empty lots; single family (homes); attached residences; apartment buildings; office buildings; store properties; industrial and miscellaneous. Table 2 shows the incidence of the Graded Tax on a small representative sample of real estate properties in Lancaster at the end of one, two and three years, at the following rates: 9 mills on buildings, 13.1 mills on land; 6 mills on buildings, 54.2 mills on land; 3 mills on buildings, 75.3 mills on land, compared to the present rate of the city property tax of 12 mills on land and buildings.

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