Effects of Urban Containment on Housing Prices and Landowner Behavior

Arthur C. Nelson

Smart growth has moved from the domain of policy analysts into more general acceptance. It is championed by national leaders such as Vice President Al Gore, governors (Parris Glendening of Maryland), urban mayors (William A. Johnson of Rochester, New York), non-governmental organizations (National Trust for Historic Preservation), and the private sector (Urban Land Institute). Voters in many California cities, including Sacramento, Santa Barbara, Irvine and Davis, and in numerous suburbs around San Francisco have approved urban growth boundaries (UGB) as one type of intervention to contain sprawl development.

Urban containment policies are not limited to environmentally active communities in California, Oregon or Colorado, or booming economies in states such as Florida, however. Lexington, Kentucky, observed the 40th anniversary of its urban growth boundary last year, and Sioux Falls, South Dakota, has had a containment boundary for many years. This kind of broad-based popular support for smart growth policies is more than simply a growth management fad and is likely to continue, particularly as long as the national economic expansion continues. Indeed, urban containment appears to be building a kind of momentum as a land use policy that has not been seen since the Supreme Court's sanctioning of zoning in Ambler Realty Co. vs. Euclid, Ohio.

Urban containment planning has two basic purposes: (1) to promote compact, contiguous, and accessible development provided with efficient public services; and (2) to preserve open space, agricultural land and environmentally sensitive areas that are not currently suitable for development. Urban containment consists of drawing a line around an urban area within which development is encouraged, often with density bonuses or minimum density requirements, to accommodate projected growth over a specified future time period, typically ten to twenty years. Land outside the boundary is generally restricted to resource uses and to very low-density residential development by limiting the extension of utilities, wastewater services and other infrastructure.

Intuitively, however, this sort of land regulation appears to be a double-edged sword. On the one hand, measures aimed at reducing traffic congestion or infrastructure costs, or improving the aesthetic quality of urban areas, are appealing. On the other hand, measures that are seen to limit land supply and potentially cause housing prices to increase are unappealing, particularly to those seeking to expand the stock of affordable housing.

To explore the implications of these two faces of urban containment as smart growth policies more fully, Urban-Suburban Interdependencies edited by Rosalind Greenstein and Wim Wiewel (2000) and Mediating Land Use Disputes: Pros and Cons by Lawrence Suskind, Mieke van der Wansem and Armand Ciccarelli (2000) are two new publications that focus specifically on the effects of urban containment on land and urban economics.

To explore these topics in greater detail, see the Land Lines newsletter page of the Lincoln Institute website (www.lincolninst.edu) for the articles that announced these publications.

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growth policy, the Lincoln Institute and the Fannie Mae Foundation convened a group of scholars and practitioners for a symposium in Cambridge last February. The economists, planners and other researchers in attendance discussed the existing literature on urban containment and identified questions for future research that could inform policy making in this dynamic area of land regulation.

Housing Price Effects
Housing costs reflect the price of land, the price of the house and the value of amenities. Urban containment policies change housing costs for two reasons. First, land prices change when land supply is altered. Second, if urban containment increases the value of the amenity package associated with a house, then that, too, will cause a change in house prices. Much of the discussion at the symposium centered around these two theoretically distinct aspects of the housing price problem.

Most economic literature assessing urban containment argues that it raises land and housing prices principally by constraining the supply of land and/or by failing to accommodate new demand for serviced land. But, others argue that urban containment systems, when coupled with increased densities within the growth boundary, should not adversely affect supply and, indeed, should generate benefits to residents. This latter view shifts the focus away from the microeconomic theory of price determination to housing economics, which introduces the concept that house prices capitalize the value of neighborhood amenities.

For example, the increased densities within an urban growth boundary can make it practical to extend or enhance existing public transit, thus yielding greater accessibility. In addition, increases in densities can result in lower costs to provide urban services by the public sector. Similarly, higher neighborhood densities can lead to more interactions with neighbors and more “eyes on the streets,” which, in turn, can translate into lower crime rates. Finally, if urban containment is successful in preserving open spaces, house values in neighborhoods near the preserved open space should also rise.

All of these benefits can be counted among the amenities that give value to a house and are ultimately capitalized in its value, even while the land supply restriction can also put pressure on house prices. In truth, both factors may be at work, and we still have much to learn about their impacts. Furthermore, some of these internalized benefits may have different values for households at different income levels.

A comparison of Atlanta, Georgia, and Portland, Oregon, both suggests these sorts of benefits and points to areas for future research. In a comparison of Atlanta, Georgia, and Portland, Oregon, both suggests these sorts of benefits and points to areas for future research to answer these questions more comprehensively (see Table 1). During the first half of the 1990s, Portland experienced a large increase in housing prices (approximately 60 percent compared to almost 20 percent in Atlanta, in nominal terms). Between the mid-1980s and the mid-1990s, homeownership rates in Portland increased by nearly 5 percent while Atlanta’s rate remained virtually unchanged. Finally, perceptions of improved house quality were greater among Portland residents than those in Atlanta. In both metropolitan areas and in both time periods, the proportion of household income spent on housing was virtually the same, suggesting that income growth in Portland exceeded that in Atlanta. However, it is difficult to conclude definitively that increases in house quality in Portland were due to enhanced amenities conferred on households by changes in land regulation, rather than to rising incomes.

Although urban containment policies may stabilize the supply of land, they usually increase the supply of development opportunities. Such policies are typically accompanied by “upzoning” whereby land zoned formerly at one level of development intensity is changed to allow for a higher density. One strategy to increase densities is to infill and redevelop (or “refill”) urban areas at higher than extant levels through the adoption of “minimum intensity” zoning. We do not know the subsequent effect of such policies on house prices, and we know even less about their

<table>
<thead>
<tr>
<th>Condition</th>
<th>Portland</th>
<th>Atlanta</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing prices 1991</td>
<td>$79,700</td>
<td>$89,700</td>
</tr>
<tr>
<td>Housing prices 1996</td>
<td>$129,000</td>
<td>$107,000</td>
</tr>
<tr>
<td>Percent change</td>
<td>+61.9%</td>
<td>+19.3%</td>
</tr>
<tr>
<td>Home ownership, 1986–87</td>
<td>60.0%</td>
<td>63.0%</td>
</tr>
<tr>
<td>Home ownership, 1995–96</td>
<td>64.7%</td>
<td>63.7%</td>
</tr>
<tr>
<td>Persons per room, 1986–87</td>
<td>0.40</td>
<td>0.40</td>
</tr>
<tr>
<td>Persons per room, 1995–96</td>
<td>0.39</td>
<td>0.30</td>
</tr>
<tr>
<td>Housing costs, percent of income, 1986–87</td>
<td>19.2%</td>
<td>19.0%</td>
</tr>
<tr>
<td>Housing costs, percent of income, 1995–96</td>
<td>20.0%</td>
<td>20.0%</td>
</tr>
<tr>
<td>Change in opinion of house quality, all households</td>
<td>+2.2%</td>
<td>+1.3%</td>
</tr>
<tr>
<td>Change in opinion of house quality, owners</td>
<td>+1.0%</td>
<td>+0.1%</td>
</tr>
<tr>
<td>Change in opinion of neighborhood quality, all households</td>
<td>+3.6%</td>
<td>+1.0%</td>
</tr>
<tr>
<td>Change in opinion of neighborhood quality, owners</td>
<td>+1.2%</td>
<td>+0.6%</td>
</tr>
</tbody>
</table>

Sources: Housing prices from National Association of Realtors, www.NAR.org. All other figures from the U.S. Bureau of the Census and U.S. Department of Housing and Urban Development, American Housing Survey, Washington, DC, for respective years (as calculated by author).
effect on household budgets and disposable income. For example, higher housing prices may simply reflect capitalization of more efficient development patterns that reduce expenditures in other parts of the household budget.

It is possible, however, that current and future homeowners will benefit directly from these sorts of capitalized savings. For example, location-efficient mortgages, a lending instrument being tested in a few markets, allow lenders to extend mortgages to households based on a higher mortgage-to-income ratio. The rationale for altering the income eligibility is that, in comparison to suburban households, urban households can substitute walking and public transit for automobile payments, including both capital costs and operating expenses. Thus, disposable income is effectively increased as non-housing expenditures decline. Current experiments with the location-efficient mortgage are underway in Chicago’s northside neighborhoods and in central Seattle. If default rates for these loans are similar to those for traditional mortgages, we may see greater adoption of this instrument in appropriate submarkets.

Other savings that may accrue to urban homeowners as a result of containment policies are lower taxes due to lower capital costs or increases in supplemental income if higher densities are achieved through the addition of accessory apartments on existing houses.

Landowner Behavior Implications
The imposition of urban containment policies and changes in density are also likely to result in changed expectations of landowners. Therefore, an additional consideration for researchers, which the symposium participants confronted, is the role of containment in affecting the nature of landowner behavior with respect to land acquisition and land development.

In an environment of a relatively inexhaustible supply of land, speculation can be reasonably efficient while the competition to sell land keeps prices low. The end result may be that housing prices will not be affected materially. However, when supply is constrained, even if upzoning increases development capacity, the number of players in the land market can fall and cartels may form. Furthermore, an assumption of urban containment policies is that undeveloped land inside the boundary will come on-line in sufficient amounts and at appropriate times to sustain development. There is no research into this, however. Will owners of land, knowing they hold an oligopolistic position in the land market, delay its sale to get a higher price?

Until now, in our studies of urban land markets, we have lived with the assumption of relatively inexhaustible (i.e., elastic) land supply. Urban containment policies can change that premise by making land an exhaustible commodity, resulting in the problem of dual predictability. On one hand, developers are given more certainty in whether and how they develop land; on the other hand, landowners know that land supply will become exhaustible and therefore they may be enticed to become speculative, in their own right. Will local governments reward those willing to develop vacant or underused parcels with higher densities to offset others who delay sale? Certainly, a land tax is expected to limit this sort of behavior. Can other changes in the tax regime encourage development within the UGB? For all of these reasons, we have much to learn about the effect of urban containment on landowner and speculative behavior.

Summary Observations

The symposium participants spent more time on the economic issues related to urban containment than on environmental concerns. However, some material was presented that suggested significant environmental benefits as a result of urban containment. Table 2 presents additional comparisons of Portland and Atlanta between the mid-1980s and the mid-1990s. While vehicle miles traveled increased in both places, Portland experienced little change (2 percent) whereas Atlanta experienced a significant increase (17 percent). At the same time, Portland’s average commute times fell, air quality improved, and per capita energy consumption declined.

All of these indicators suggest that Portland is different from Atlanta in meaningful ways. Furthermore, typical behavior by individuals in each of these metropolitan areas is presumed to be different. We should attempt to find out the degree to which growth containment policies account for these behavioral differences and whether there are other policies that may also play important roles in affecting the economic and environmental dynamics of metropolitan regions. For example, the problem of housing affordability remains a serious concern in most cities, whether with or without urban containment boundaries.

Urban containment creates an entirely new regime in urban planning and development decision making, offering research challenges because of the difficulties in developing methodologies that can tease out complex interactions and frame the results in a manner that can advance both public and private interests. The Lincoln Institute, the Fannie Mae Foundation and the U.S. Department of Housing and Urban Development are among a growing number of research entities interested in pursuing these challenges.

Arthur C. Nelson is professor of city planning, urban design and public policy at the Georgia Institute of Technology in Atlanta. He organized the seminar referenced in this article and has researched and written extensively on this topic. Contact: chris.nelson@arch.gatech.edu.

<table>
<thead>
<tr>
<th>Measure</th>
<th>Portland Urban Containment</th>
<th>Atlanta Business As Usual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population Growth</td>
<td>+26%</td>
<td>+32%</td>
</tr>
<tr>
<td>Job Growth</td>
<td>+43%</td>
<td>+37%</td>
</tr>
<tr>
<td>Income</td>
<td>+72%</td>
<td>+60%</td>
</tr>
<tr>
<td>Government Revenue</td>
<td>+34%</td>
<td>+56%</td>
</tr>
<tr>
<td>Property Tax</td>
<td>-29%</td>
<td>+22%</td>
</tr>
<tr>
<td>Vehicle Miles Traveled</td>
<td>+2%</td>
<td>+17%</td>
</tr>
<tr>
<td>Single Occupant Vehicle</td>
<td>-13%</td>
<td>+15%</td>
</tr>
<tr>
<td>Commute Time</td>
<td>-9%</td>
<td>+1%</td>
</tr>
<tr>
<td>Air Quality in Ozone Days</td>
<td>-86%</td>
<td>+5%</td>
</tr>
<tr>
<td>Energy Consumption in BTUs per Capita</td>
<td>-8%</td>
<td>+11%</td>
</tr>
<tr>
<td>Neighborhood Quality</td>
<td>+19%</td>
<td>-11%</td>
</tr>
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Local Government and Property Tax Reform in South Africa

Riël C.D. Franzsen

Since first holding democratic elections at the national and provincial levels in 1994, South Africa has undertaken far-reaching constitutional changes. Arguably, the most fundamental transformation is taking place at the local government level, where the divisions created by apartheid were most severe. These changes were set in motion by the Local Government Transition Act of 1993, and during 1994–1995 the formerly racially segregated urban local authorities were amalgamated into a variety of non-racial transitional councils:

- in metropolitan areas, transitional metropolitan councils (TMCs) with constituent transitional metropolitan local councils (TMLCs);
- in secondary cities and towns, transitional local councils (TLCs); and
- in rural areas where no primary municipalities existed in the past, transitional representative councils (TRepCs) or transitional rural councils (TRCs).

In non-metropolitan areas, the former regional services councils were transformed into district councils, thereby retaining a secondary tier of local government in rural areas.

In March 1998 the national government published the White Paper on Local Government, which set out its vision for the future of local government. The White Paper resulted in passage of the Local Government Demarcation Act and the Local Government: Municipal Structures Act. Under the Demarcation Act, the Municipal Demarcation Board was established to assign new boundaries for the different categories of municipal governments throughout the country. The present 843 transitional municipalities are to be severely reorganized after the local elections in November 2000 into 284 newly demarcated municipalities (see Table 1).

Within the six metropolitan areas to be established, single-tier metropolitan municipalities will replace the TMCs and TMLCs. In the non-metropolitan areas 47 district municipalities will replace the present 42 district councils. Each district municipality will consist of two or more (primary-tier) local municipalities to replace the present local and rural councils. A typical future local municipality will consist of a number of neighboring towns and their rural hinterland. In sparsely populated rural areas where the establishment of a local municipality is not viable (designated as district management areas), a district municipality will be the only form of local government.

Municipal Finance Reform

The structural reforms at the local government level also require reform of municipal finances. The government is currently preparing two important pieces of legislation in this regard, the Local Government: Property Rates Bill (dealing exclusively with property taxation) and the Municipal Finance Management Bill.

Section 229 of South Africa’s Constitution guarantees “rates on property” (i.e., the property tax) as an autonomous source of revenue for municipalities. It states that the “power of a municipality to impose rates on property...may be regulated by national legislation.” National framework legislation regarding the property tax is indeed needed for the following reasons:

- Property tax is presently levied only in terms of four outdated provincial ordinances retained from the apartheid era (e.g., it is not presently possible to utilize computer-assisted mass appraisal (CAMA) because physical inspections of each rateable property is legally required).
- Property tax is presently levied only by urban municipalities.
- The future amalgamation of urban and rural councils (i.e., the structural changes to date and still to be effected) necessitates change.
- The amalgamation of racially segregated urban municipalities has resulted in a number of constitutional challenges.
- It is the most important own-tax instrument at the local government level, accounting for 19 percent of total local government operating income (Budget Review 2000).

Therefore, the Local Government: Property Rates Bill, currently in its 10th draft, is to be welcomed, at least in principle. It has not yet been published for public comment and may be further amended. However, when this bill is eventually passed into law, it will regulate the levying, assessing and collection of property taxes by municipalities.

Policy Issues in the Property Rates Bill

Diversity of Tax Bases

Urban municipalities generally have a choice between three tax bases, which are spread remarkably evenly throughout the country:

- Site rating (rating land values only) is prevalent in at least three of South

<table>
<thead>
<tr>
<th>Table 1: Present and Future Municipalities</th>
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<tbody>
<tr>
<td><strong>Municipalities</strong></td>
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<tr>
<td><strong>Metropolitan areas</strong></td>
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<td></td>
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<tr>
<td></td>
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<tr>
<td><strong>Non-metropolitan areas</strong></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
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Africa’s nine provinces (Gauteng, Northern Province and Mpumalanga); 
• Flat rating (rating improved capital values) is dominant in the Western Cape; and 
• Composite rating (rating land values and the value of improvements, but at different tax rates) is most commonly used in KwaZulu-Natal.

Earlier drafts of the Property Rates Bill retained this diversity as well as local choice. However, clause 5(1) of the 10th draft of the bill now states that a rate levied on property “must be...an amount in the Rand (South Africa’s currency) determined by the municipality on the improved value of the property.” Although it seems that government has opted for a single tax base (i.e., improved capital value), the bill goes on to provide that a rate levied on the “improved value of property may be composed of separate amounts on the site value of the property and the value of the improvements.” By implication, therefore, composite rating and site rating have been retained (if the amount in the Rand on improvements is set at zero).

Extension of the Tax Base and Possible Exclusions

In principle a municipality may tax “all property in its municipal area,” including areas where the property tax has not been levied before, such as agricultural and tribal land. However, the bill also allows a municipality to exclude a category or categories of property from rating. These excluded properties need not be reflected in the valuation roll.

McCluskey and Franzsen (2000) suggest several reasons why municipalities should include all properties in the valuation roll, and then allow specific exemptions rather than exclusions from the taxing process. First, it can be difficult to justify and defend exclusions constitutionally; second, it is politically easier to phase out an exemption than to introduce a tax on formerly excluded properties; and third, if properties are not valued and thus not reflected in the valuation roll, the extent of the tax base relinquished through exclusions is not known.

“Public infrastructure” is to be excluded from the tax base. This will have significant implications, particularly for municipalities with large tracts of land owned by public utility companies, and may need to be reconsidered in light of privatization. International practice suggests that public utilities should be rated at least on their operational land.

Differentiation and Phasing-in of Rates

Current legislation only provides for rate uniformity throughout a municipal area. However, municipalities sometimes achieve effective differentiation by granting arbitrary rebates to certain properties on the basis of zoning. For example, all improved residential properties in the Pretoria TMLC are presently granted a 35 percent rebate.

The bill provides that different rates may be levied for different categories of property according to use, status or location—a critical point in light of the extension of municipal boundaries into rural areas. For example, it would be possible for a future local municipality (comprising various small towns, commercial farmland and tribal land) to have the following different property categories (and therefore different tax rates): 
• residential properties in a formal township in town A (consisting of generally low-value properties); 
• residential properties in a formal township in town B (consisting of generally high-value properties); 
• residential properties in an informal (squatter) settlement; 
• commercial properties; 
• industrial properties; 
• commercial farmland; 
• tribal land.

However, a municipality will have to justify its differential rate schedule in an annually revised rates policy document presented to all taxpayers. Although municipalities may be permitted to treat ratepayers differently, they must justify this action. The bill also allows for the phasing-in of rates over a three-year period with respect to property not subject to property taxation before 1 July 1999 (e.g., tribal land). In certain instances the period may be extended for a further three years.

Tax Rates

The bill (clause 5(2)) states that municipalities may set their own tax rates. However, the Minister for Local Government, in concurrence with the Minister of Finance, may set a limit or rate cap on the amount. Apart from reducing municipalities’ fiscal autonomy, rate caps set nationally may not reflect differences in taxing capacity that exist between municipalities (see Table 2).

An alternative, and more practical, “capping” measure that has been inserted in the 10th draft (clause 5(3)(a)(ii)) is to limit the annual tax rate increases, not unlike one part of Proposition 13 in California.

Extension of Property Tax to Tribal Land

Extending property taxation to tribal land is an area of major political concern and is fraught with practical problems. “Ownership” of tribal land is not uniform, and some tribal authorities are not prepared to accept any form of local government within their area of jurisdiction, let alone any form of taxation of “their” land. Identifying the taxpayer may be problematic. Furthermore, formal ownership of tribal land seldom reflects the complex system of tenure rights of the individuals entitled to the use of that land. Even if it were possible to identify a taxpayer and establish an assessed value for (tribal) “property,” the abject poverty and inability of residents in many tribal areas to pay any tax will have to be considered. In fact, few tribal areas presently receive municipal services that could justify the introduction of a property tax.

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<table>
<thead>
<tr>
<th>Municipalities</th>
<th>Population Estimate</th>
<th>Number of Rateable Properties</th>
<th>Rate in the Rand on Site Value Only</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pretoria TMLC</td>
<td>1,060,000</td>
<td>150,000</td>
<td>7.82c/R</td>
</tr>
<tr>
<td>Leandra TLC</td>
<td>100,000</td>
<td>6,000</td>
<td>19.00c/R</td>
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<tr>
<td>Wakkerstroom TLC</td>
<td>10,800</td>
<td>2,050</td>
<td>22.00c/R</td>
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<tr>
<td>Perdekop TLC</td>
<td>6,500</td>
<td>1,150</td>
<td>54.00c/R</td>
</tr>
</tbody>
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Rates Policy
Clause 13 of the bill requires municipalities to adopt a rates policy and then levy rates accordingly. This is a welcome change. The rates policy, which is to be reviewed annually, must explain and justify the provision of exemptions, rebates, reductions and relief for the poor. This policy should significantly enhance the transparency, efficiency and accountability of municipal councils, and perhaps encourage compliance. 

Valuation Quality Control
Another welcome aspect in the bill concerns monitoring valuation quality for equity and consistency across the country. However, the bill (clause 64) confers this responsibility on the Minister responsible for local government. McCluskey and Franzsen (2000) suggest that an independent and professional valuation agency, preferably at the national level, should be established for this highly technical task. Such agencies exist in Australia, New Zealand and Canada. In South Africa, this type of agency should perform the following primary tasks:
• provide technical advice to government on valuation issues and the regulation of the valuation services sector;
• set minimum quality standards and specifications necessary to meet government outcomes;
• monitor and audit the valuations submitted by valuation providers (e.g., municipal valuers) against certain minimum standards; and
• certify to municipalities (and through them to ratepayers) that the resulting valuations meet the minimum standards for a fair and consistent property tax system.

The monitoring service could well be expanded to provide valuation advice, expertise and data to municipalities. Such an agency could also undertake valuations of property for other taxes levied at the national level, such as estate and gift taxes.

Conclusion
The Local Government: Property Rates Bill should provide a solid framework for property taxation as South Africa begins to implement its new local government structure. If municipalities adhere to the principles articulated in the bill, a more uniform, equitable and efficient property tax system will play an even more important role in the future.

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REFERENCES

Abstracts of New Working Papers

The Lincoln Institute supports research and curriculum development by scholars and practitioners investigating a wide range of land use and taxation issues. In many cases this research is documented in the form of a working paper that is distributed as part of the Institute’s publications program.

To order the complete printed version of any of these working papers, please call 800/LAND-USE (800/526-3873) or use the Request Form on page 11 of this newsletter. Some of these papers are also available on the Lincoln Institute website for free downloading (www.lincolninst.edu).

Tax Increment Financing: A Theoretical Inquiry
This analysis of tax increment financing (TIF) exploits the theoretical connection between property values and public-good levels, which is the subject of a large literature in local public finance. Using this approach, the paper shows that localized public improvements are likely to be opposed by property owners outside the affected area, who pay higher property taxes with no offsetting benefits.

By using tax revenue captured from overlapping jurisdictions, TIF may circumvent this opposition, allowing the city to implement the public improvement without an increase in its tax rate. TIF is not always viable as a financing method, however, because it may not generate enough additional revenue. The analysis shows that TIF’s viability is ensured only when the public good is at least moderately underprovided relative to the socially optimal level. In the case where the public good is only slightly underprovided, a public improvement is desirable, but TIF is not viable. Finally, the analysis shows that the public-good levels ultimately chosen under TIF need not be efficient, with both under- and over-provision being possible outcomes. Thus, while TIF may allow a city to carry out needed public improvements, the stimulus it provides may be excessive.

Jan K. Brueckner is professor of economics and a member of the Institute of Government and Public Affairs at the University of Illinois at Urbana-Champaign. 1999, WP99JB1, 34 pp., $9.00.

The Impact of Property Taxes and Property Tax Classification on Business Activity in the Chicago Metropolitan Area
We investigate the extent to which Chicago’s unusual system of property taxation, whereby commercial and industrial property is “classified” and assessed at a higher rate in Cook County than in the outer counties, has contributed to the relative decline of business activity in the inner county. We find clear evidence that property tax classification raises business property tax rates. However, we find no relationship between property tax rates and the growth in market value of commercial or industrial property, or in the growth in the number of business establishments. We do find strong evidence of an effect of property taxes on growth in employment. We can-
not rule out the possibility that property tax classification is partially responsible for Cook County’s relatively slow growth in business activity. However, the preponderance of our evidence leads us to believe that classification is not the root cause of Cook County’s slow growth.


Resisting the Reality of Race: Land Use, Social Justice and the Metropolitan Economy

This paper examines how problems of racial discrimination complicate three mutually reinforcing difficulties of the American metropolis: social inequality, economic inefficiency, and damage to land use and the environment. The paper discusses some shortcomings in metropolitan business competitiveness, the depth and nature of racial inequality in metropolitan areas, and the most severe urban environmental and land use problems. The conclusion examines selected “smart growth” programs and their implications for racial inequalities. The paper finds that problems of “race” penetrate fundamentally into many areas of metropolitan life, including the economy and land use. Unless planning forcefully confronts racial inequality and discrimination, there are slim chances for good planning to actually help cities. Along current trajectories, U.S. metropolitan areas will become more segregated by race and income, less sustainable environmentally, and less competitive economically.

William W. Goldsmith is professor of city and regional planning at Cornell University. 1999, WP99WG1, 46 pp., $9.00.

Implementing Property Tax Reform in Tanzania

Countries in East Africa are undertaking a variety of local government reform efforts aimed at improving local service delivery and economic governance. In addition to rationalizing central-local fiscal relations, these governments are placing attention on improving financial management and revenue mobilization efforts. One key reform priority is improving the role of the property tax as a source of dependable local own-source revenue. Tanzania embarked on its property tax reform in 1993, following a “valuation-pushed” implementation strategy that focused on creating a property valuation roll for the capital city of Dar Es Salaam (DSM). Phase One of the reform was completed in 1996, producing a valuation roll covering about one-third of all properties. The DSM City Commission, established in 1996, used this new valuation roll to generate significant increases in the property tax, along with major increases in all locally generated revenues. This paper analyzes the current Tanzanian property tax reform to identify possible lessons for refining and improving the property tax reform implementation strategy.

Roy Kelly is an associate at the Harvard Institute for International Development, specializing in public finance, fiscal decentralization, and local government finance. Zainab Musunu is the national property tax coordinator for the Urban Sector Rehabilitation Project (USRP) for the Government of Tanzania. 2000, WP00RK1, 32 pp., $9.00.

Property Taxation in East Africa

While they share a common British heritage, the countries in East Africa have distinct property tax policy structures. The tax base, assessment basis and tax rates vary considerably. Tanzania taxes only buildings, Uganda taxes both land and buildings, while Kenya taxes only land. Despite these differences, each faces similar problems of weak administration: tax base coverage is incomplete; valuation rolls are out of date; collection rates are low; enforcement is virtually non-existent; and taxpayer service is poor. This paper examines recent property tax reforms in East Africa. Part One discusses the major policy distinctions, highlighting differences in the tax base, assessment basis and tax rates. Part Two presents a revenue-potential model that emphasizes the importance of administrative improvements in coverage, valuation and collection. Part Three provides a brief summary of the three ongoing reforms from the “valuation-pushed” strategy initiated in Tanzania and Uganda in the early 1990s to the “collection-led” strategy recently adopted by Uganda and Kenya. The paper concludes with four lessons for effective property tax reform.

Roy Kelly is an associate at the Harvard Institute for International Development, specializing in public finance, fiscal decentralization, and local government finance. 2000, WP00RK2, 22 pp., $9.00.

Promoting More Equitable Brownfield Redevelopment: Promising Approaches for Land Banks and Other Community Land Development Entities

This project identifies promising approaches for improving the redevelopment prospects of the least marketable brownfield sites typically found in depressed urban neighborhoods. The current practice of many brownfield redevelopment projects is to select only the most marketable sites for remediation and redevelopment, essentially perpetuating the age-old “creaming” process. Private and public developers’ practices of avoiding the lowest market value parcels typically exclude disadvantaged neighborhoods from programs aimed at redeveloping brownfields, potentially widening inequalities between better-off and worse-off neighborhoods.

This project specifically sought to identify land transfer procedures and processes through which land bank authorities and other community land development entities are willing to receive vacant brownfield property that is tax-delinquent and environmentally contaminated, and authorities are able to arrange for remediation and sale of such property. The primary focus has been on an additional barrier typically associated with tax-delinquent properties: their low market values. A land bank authority could be helpful in forgiving the property taxes owed on the parcel as an incentive for re-use, however, the property’s redevelopment potential is still thwarted by having little-to-no market desirability. It is this more difficult question of how to address sites in areas where demand for property is low, and contamination further complicates redevelopment, that we focus upon here to promote more equitable brownfield redevelopment.

Nancey Green Leigh is associate professor in the Graduate City and Regional Planning Program at the Georgia Institute of Technology. 2000, WP00NL2, 50 pp., $9.00.
Rethinking Value Capture Policies for Latin America

Fernanda Furtado

Scholars and public officials concerned with social justice consider redistribution of land values to be an especially important objective of urban policy in Latin American countries, where great differences in access to scarce urban infrastructure and services result in an unfair distribution of land values. However, value capture policies and instruments used in principle to “redistribute the valorization gain” or “promote redistribution of land value increments” are rejected by some progressive sectors because they believe that, in spite of the redistributive connotation, those instruments are not really aimed at redistribution in practice. This article explores a number of questions that must be addressed to achieve a better understanding of the value capture concept and its potential to play a truly redistributive role in Latin America.

The Distributive Principle and the Redistributive Goal

The basic principle of value capture is to return to the community the land value increments that result from community action. The most usual way to define those increments is to focus on particular increases in land value that result from specific and dated public actions. The corresponding value capture instruments could, therefore, be thought of as devices to recover for the public the increase in land value associated with public actions that otherwise would be captured by private entities. The aim of this distributive policy is to restore a previous state of distribution, in essence, is taken as a proper or given one.

An alternative interpretation is based on the principle stated by Henry George that all land value, irrespective of its origin, is the product of community effort. In this view, only when all of the land value is taken into consideration and the goal of altering the current state of land value distribution is introduced can the value capture idea acquire a truly redistributive perspective.

Redistributing land values is but one of the possible goals of urban land policy. Other goals are raising public revenues to finance urban services, regulating and managing urban land uses, and controlling undesirable outcomes of the functioning of urban land markets. That is, redistribution may be a guide to more progressive distributive policies, but it is not necessarily the basic principle of value capture.

Thus, we can distinguish between the distributive principle of value capture policies—to restore a certain state of distribution—and a redistributive goal of urban land policies—to alter a certain state of distribution. This distinction allows us to address the confusion about distribution and redistribution applied to land values and to the value capture idea.

The Practice of Value Capture in Latin America

In its generic sense, the value capture idea applies to any levy or planning tool intended to distribute land value increments. Almost all Latin American countries have experience with the property tax, and many have other planning tools such as the compulsory donation of land for public purposes in land parceling or subdivision projects. Historically, the development of the value capture idea has been associated with a specific instrument known as Contribución de Valorización/Mejoras. This special assessment or valorization charge, incorporated into the legislation of most Latin American countries, aims at capturing a portion of special benefits (land valorization) that arise from public investments in infrastructure and services, to finance such investments.

Even with this narrow definition, the implementation of value capture has been limited and controversial. Both the political influence of landowners and the technical (but also often legal) shortcomings of adequately assessing land values have been identified as constraints on its use in many countries. Colombia is perhaps the only country with an established tradition of using the instrument, but even there its implementation is subject to serious limitations. Some observers acknowledge its incapacity for redistribution and others claim it frequently loses the link with the distributive principle and becomes simply a practical way to divert the community for the costs of a public action that generates benefits for only some individuals.

A closer look at concrete Latin American experiences with the implementation of value capture instruments leads to a disturbing conclusion. Rather than evolving from the ethical principle of fairness, whereby the increment of land value resulting from community action returns to the community, the value capture idea seems to have been adopted as a pragmatic cost-recovery mechanism to overcome the chronic shortage of public revenues to finance urban infrastructure, whether based on a distributive principle or not.

Linking Value Capture and Redistribution

Even when the distributive principle is secured, the goal of raising public
revenues can differ from or even contradict other goals of urban land policy, including the important redistributive goal. For instance, when a public investment in urban infrastructure generates land value increments in a highly valued area, and then associated income from the use of a value capture instrument is reinvested in the same area, the result is not redistributive and can even be regressive.

To understand the contradictions that arise between the traditional use of value capture instruments to raise general revenues and the necessity of incorporating the redistribution goal into those policies, we need to consider value capture as a more comprehensive concept. Even when limited to its usual definition centered on specific land value increments, at least three non-autonomous public actions or decisions must be associated with the distributive principle of value capture:

1. an original public action (regulation, investment, etc.) that results in land value increments;
2. a second action to capture (some of) this value; and
3. a third action related to the destination or use of collected resources.

While the second action implies the use of a general or specific value capture instrument, the first and third actions, though related to specific decisions, cannot be separated from two basic questions concerning public decisions as a whole: How are public works allocated in space, and how is the general revenue distributed?

Allocation of public works
When raising revenues and promoting redistribution are concurrent goals, the second does not necessarily follow the first. In Latin America these goals are often contradictory. Under conditions of highly uneven distribution of wealth and scarce funds to finance public works, it is usually easier to guarantee the raising of revenues through the allocation of public works (original action) in areas where more absolute revenues can be collected. Even with the use of a value capture instrument, when the subsequent decision (destination of resources) maintains the same state of wealth distribution, the whole public action becomes regressive.

On the other hand, rejection of value capture instruments does not prevent the misallocation of public works between higher- and lower-income areas. For example, the facelift of Copacabana in Rio de Janeiro, which replaced old trees and modernized sidewalks, was financed by the general revenue, not by a specific value capture device. At the same time, many of the poor areas of the city have neither sidewalks nor a single tree on their streets, yet they receive no public funds for improvements. Recognizing this irony reinforces the need for a new framework for value capture policies that can allocate public works more equitably.

Distribution of general revenue
Latin America presents extreme relative and absolute differences in public infrastructure provision, calling for equity criteria to evaluate distributive policies. Yet, equity criteria are subjective and there are distinct visions on what is fair. Given the disparities in wealth and in access to serviced land, it is important to consider both relative and absolute differences between highest and lowest levels of wealth.

To illustrate this point we can apply the classic redistributive argument to the distribution of land values in a society with 10 units of wealth (i.e., land value) distributed between two groups: the higher-income group has 8 units or 80 percent and the lower-income group has 2 units (see Table 1).

This example can represent the typical differences between serviced areas occupied by the rich minority and unserviced areas occupied by the poor majority in Latin American cities. An increase of 50 percent in this wealth (5 total units of land value increments), if distributed in the same ratio, does not change relative differences, but increases the absolute difference between the two groups by 50 percent, from 6 to 9 units.

Another important consideration is the level of the group in the lowest position. Value capture instruments are justified as distributive tools to return to the community special benefits resulting from a public action that only some individuals receive. But, that justification in turn raises the need to clearly separate special benefits from basic needs. If we consider access to urban infrastructure as a basic need, the society must decide on the minimum level of access for the lower-income group. Priority should be given to actions that achieve those minimum levels before other benefits accrue to the higher-income group. If this society decides that the minimum level of wealth should be 6 units for the lower-income group, then an increment of 5 units of land value would be distributed in such a way as to decrease both relative differences and absolute differences (see Table 2).

Value Capture and Socio-spatial Equity
Urban planning decisions, such as the norms and regulations on land use and development rights, also affect the distribution of urban land values and must be integrated into value capture policies. In Latin America, where the differences in access to public infrastructure and urban services are marked by severe social segregation and exclusion, this integration implies the inclusion of a socio-spatial dimension that can deal with the disparities between serviced rich center cities (for the few) and unserviced poor peripheries (for the majority). Therefore, land value redistribution policies acquire a particular political context in which the generation of land value increments and the destination of corresponding funds are fixed in distinct socio-economic areas of the city.

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However, even when this socio-spatial dimension is incorporated, most redistributive value capture instruments provide necessary but not sufficient conditions for a better distribution of land values. While redistribution from rich areas to all areas involves altering the distribution of general revenue to achieve its equity objective, redistribution from all areas to poor areas involves altering the allocation of public works and/or development rights on land to arrive at a better distribution of land values.

Since these approaches involve greater institutional changes, a third option seeks to stimulate the generation of land value increments in rich areas in order to raise revenues that can be redistributed to poor areas. These so-called “Robin Hood” policies are being considered to deal with urgent needs in poor areas, combined with specific opportunities and demands in rich areas. One example is the “linkage operation” recently popularized in many large Brazilian cities, where the negotiation of legal exceptions for development generates payments earmarked for social housing. However, a careful examination of this transfer tool shows that stimulation of land value increments in rich areas actually increases intra-urban differentiation and as a result may exacerbate the gap between rich and poor areas.

This and other largely unanticipated perverse outcomes show that the development of value capture policies and instruments for Latin American countries cannot be considered independently from an urban land policy oriented to the reduction of socio-spatial inequalities. The latter can be attained only by direct actions geared to altering the current distribution pattern of land values. This means that redistribution, although not necessarily implied in the value capture idea, must be incorporated deliberately into the development of distributive value capture policies.

Guidelines for Implementing Value Capture Policies

This discussion reinforces the argument that value capture policies in Latin America must be preceded by changes in the process of distributing land values in the broadest sense, especially where redistribution is pursued as a major goal of urban policy. This perspective would help to consider in an integrated manner, in each public decision concerning a specific way of distributing urban land values, several other ways in which the public sector contributes to this distribution, including:

• the way taxes on land are designed and collected;
• the way public revenue is allocated for public works;
• the way specific value capture instruments are applied (or not);
• the way the collected resources are apportioned; and
• the way land uses and development rights are defined.

The potential and limits of specific value capture instruments are conditioned by those distributional public actions and decisions. When specific value capture instruments are used independently from this consideration, the whole process may be undermined. Collection of land taxes is usually neglected; public investments tend to be allocated unjustly; political impediments to the use of value capture instruments abound; revenues are not distributed in a socially equitable manner; development rights are incorporated in ownership rights, etc. As a consequence, redistribution cannot be attained and the distributive principle is imperiled.

The challenge in Latin America, then, is to work out the preconditions for improved use of the value capture idea, rather than simply to focus on overcoming procedural difficulties in applying existing instruments or to reject those instruments in favor of replacement tools usually subject to similar shortcomings. To have a chance of being truly redistributive, these distributional decisions should account for all components of land value, including accumulated, potential and specific increments, not only land value increments in the strictest sense. Efforts in this direction may contribute to a redistributive perspective on value capture policies. How much value capture is “enough” will vary among countries, but the balance of policies should include these basic guidelines:

• improvement and strengthening of the property tax, especially its land component based on all of the land value as opposed to specific land value increments;
• universalization of the provision of public infrastructure and urban services (i.e., basic needs as opposed to special benefits); and
• socially responsible approach to the definition and regulation of ownership rights and development rights on land.

These guidelines are strongly associated with urban land value increments in the broadest sense, and they can be used to reduce absolute and relative socio-spatial differences. If they continue to be neglected, and value capture policies are confined to specific land value increments, attempts at redistribution in Latin American countries are bound to fail. Furthermore, the implementation of value capture instruments will continue to serve as an anti-social mechanism that only exacerbates the already great differences between rich and poor.

Fernanda Furtado is a fellow of the Lincoln Institute. She received a dissertation fellowship from the Institute to help complete her Ph.D. thesis on “Urban Land Value Recapture in Latin America” at the Faculty of Architecture and Urbanism at the University of São Paulo, Brazil. Contact: furtado@gb.com.br.

See the Latin American Program and Land Lines sections of the Lincoln Institute’s website (www.lincolninst.edu) for additional articles and reports on this topic in both English and Spanish.

NOTES

1 See Donald Shoup, “Is under-investment in public infrastructure an anomy?” in Gareth A. Jones and Peter Ward, eds. 1994. Methodology for Land and Housing Market Analysis. Cambridge, MA: Lincoln Institute of Land Policy. Shoup’s piece includes the debate held during the 1991 Fitzwilliam Workshop on Land Values and Land Valorization in Developing Countries at the University of Cambridge on whether value capture instruments are intended to redistribute the valorization gain or are just a device to strengthen government finance.

2 It would be more precise to speak of value recapture, because besides better representing public interventions in order to return to the community the unearned land value captured by private entities, the term alludes to redistribution as a specific way of developing such policies. However, the more generic term, value capture, is used in this article.
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