This is a study of the anticipated tax shift effects of a conversion from Oregon's present property tax system to a land value tax as a remedy to the inequities caused by the tax limitations that have been in effect since 1997. The study consists of models simulating a change to real market value assessments and land value taxation in two contrasting Portland communities.

In 1990, Oregon voters passed ballot Measure 5, which limited the property tax rate that counties can levy to $15 per $1,000 assessed value. In 1997 voters approved Measure 50 which prevents the assessed value of all individual properties from increasing more than 3% annually. Previous analyses by the Northwest Economic Research Center concluded that a consequence of these tax limitations is inequitable tax burdens. Following up on this finding, Common Ground-OR/WA requested that NERC examine an alternative tax structure to determine if a Land Value Tax (LVT) would lead to increased equity and incentives to utilize land more wisely in concert with Oregon's statewide growth management policies. The study design assumes a local option LVT whereby revenue neutrality is established at the county level. The study involves model simulations of a two-step process:

1. First, a local option exemption from M-5 and M-50 limitations. This would allow assessments to revert to current real market value (RMV) instead of the maximum assessed value (MAV) determined by the 3 percent limit. This also allows the tax rate on land assessments to reach higher levels required under LVT to offset lower rates on building assessments, thereby achieving revenue neutrality. First stage simulation results compare taxes on selected properties under two scenarios – MAV and RMV under the conventional equal rate tax.
2. Secondly, a change from an RMV equal rate tax to a split rate LVT – a higher rate on land assessments and lower rate on improvements. Split rates are determined on a revenue-neutral basis, and assessments are RMV. Variations in tax shift on individual parcels and parcel aggregations are examined by land use class and development status.

This NERC study focuses on the tax incidence effects of LVT in two illustrative Portland communities. Inner Northeast (INE) is a rapidly gentrifying residential and commercial district where MAV assessments lag behind RMV; count: 9,621 parcels. Outer Southeast (OSE) is a lower income, low property value community with MAV and RMV assessments in closer alignment; count: 15,059 parcels. Both have a mix of vacant, commercial, industrial, multifamily and single-family property types. However, average lot size being much larger in OSE does carry implications for tax burden under the LVT regime.

Initial findings of this study confirm the inequities caused by tax limitations that have accumulated over the past 22 years. OSE properties in the aggregate are subject to a higher effective tax rate under the current tax system. A change to RMV assessments causes a significant shift in tax burden – higher taxes in INE and lower taxes in OSE. A change to a split-rate LVT, with a high effective rate on land and a low rate on improvement value, results in a significantly more balanced rate distribution and is slightly income progressive, as contrasted to the marked regressivity under MAV equal rate.

Tax Shift Indicators

A given parcel will generally pay a higher tax levy if its MAV/RMV ratio is lower than the county's average ratio of 39.1%. Here there is a marked contrast between the two study communities: among the parcels in INE, the MAV is only 29% of RMV; in OSE, the MAV/RMV ratio is 55%.

The impact of the split rates largely depends on the land share of property value. For Multnomah County, the average land-to-total value (LTV) ratio is 39.5%. This LTV ratio is the fulcrum of tax shift; any property with a higher proportion of value in land will pay a higher effective tax rate under LVT. Parcels having low LTV ratios are found to have a higher land utilization status. Thus, in terms of incentive effects, LVT shifts tax burden away from more efficiently used sites onto less intensively utilized sites. The LTV ratios are similar for both communities.

Tax Shift by Land Use

MAV/RMV ratios range from a low figure in the vacant land use class to mostly high figures in the single-family residential class. The inverse is generally true for the LTV ratio, but more pronounced for the multifamily residential class. The indication of tax shift is borne out by tax incidence results reported by community and land use category.

A change from the current MAV tax to RMV equal rate tax results in a significant rise in tax burden among all land uses in INE; the highest positive shift is 158% for the vacant land class, and above 100% for the commercial class. The change to RMV results in lower tax incidence for all classes in OSE, except the vacant category.

When moving from an equal rate tax on RMV assessments to a land value tax, tax shift shows more variation due to the differences in LTV ratios across land use categories. Parcels indicated by high improvement values relative to land values experience declines in their tax bills. For example, improvement values being roughly 2.5 as much as land value, multi-family developments of more than 4 units will see significant reductions in tax bills in both INE and OSE communities.

This is consistent with previous LVT research findings where the multifamily category typically experienced the greatest negative tax shift among major land uses. This is a function of land utilization status; a larger number of dwelling units on a unit of land is a more efficient use of land, hence is rewarded under the LVT tax system.

On the other hand, single family and smaller multi-family developments have an LTV ratio slightly higher than the total county-wide ratio, hence are in the aggregate subject to a moderate upward tax shift – ranging from 5.6% in OSE to 18.5% in INE. Commercial uses in INE are more likely to be nested within pedestrian-oriented commercial "ribbons" than commercial uses in OSE which are likely dispersed along commercial strips and in strip malls. Vacant sites in INE will see an increase in tax bills of nearly 300% when moving from an equal rate tax on RMV assessments to an LVT; in OSE the increase is 133%.

In practice, a move to a local option LVT will likely take place as a complete conversion, not in two stages as performed in this analysis. In the INE community the only negative tax shift effect

occurs in the case of multi-family dwellings – a 15.5% reduction in tax duties. While all other land uses pay in the aggregate more taxes, in part due to their low MAV/RMV ratio, less productive sites see their tax duties increase. Because vacant lands, commercial-auto related sites and warehouse have highest LTV ratios, they witness the highest percentage changes.

While most parcels in OSE experience negative tax shifts (partly due to their MAV/RMV ratio above to the county's average value), multi-family developments with four units or more gain the most advantage – a 36% decrease in tax burden. Absent of improvements, vacant lands will pay significantly more under LVT – a 148% increase.

Incentivizing Development

This section of the report highlights how an LVT implemented in Multnomah County would incentivize development by shifting tax burden onto underutilized sites and off more intensively utilized sites. Comparisons in tax shift are drawn between underutilized and fully developed parcels under the current property tax and two-rate tax simulations while holding county-level tax revenue unchanged. As expected, sites utilized more intensively experience comparatively lower mill rates under LVT. In both communities fully developed parcels have close to 60% of their total RMV in improvements, whereas underutilized parcels have over 80% of their total value in land.

Because improvements are taxed at substantially lower rates than land, underutilized parcels will see effective tax rate increases ranging from 1.5% to 2.0%. Fully developed lands still pay a marginally higher tax after exempting Measures 5 and 50 limitations and switching to a specific formulation of LVT—90 /10% (where 90% of the tax falls on land and 10% falls on improvement) . The reason is they still have higher land value's share of total value than the county average. The one exception is found in OSE where fully developed parcels see a lower marginal rate under LVT compared to the current tax regime.

Four commercial corridors found in Inner Northeast present an interesting case study of incentive effects. Portland city land use policies encourage more pedestrian-friendly commercial settings – akin to the "main street" configuration, as opposed to the sprawl pattern of commercial strips. Here a redevelopment scenario is introduced that compares tax shift effects on vacant and underutilized commercial sites that are "redeveloped" by simulating new construction on the same site to full zoned development capacity.

Moving from the current tax system to an LVT incentivizes redevelopment in all four commercial corridors, where tax shift results are similar. For example, in the NE Alberta Street corridor the average tax bill under the current system for underutilized parcels is about $1,000; changing to LVT would raise the bill to nearly $10,000. Redeveloping the same sites to zoned capacity changes the outcome significantly. Now the current MAV tax rises to over $40,000; but under a conversion to LVT the tax bill is now about $12,000.

Changing to the 90%/10% LVT tax regime, a much smaller increase in tax burden is experienced in the redevelopment scenario. In the North Mississippi corridor redeveloped properties in the aggregate actually see a lower tax bill compared to the current MAV levy on currently fully developed sites.

Mitigating Hardship Cases

Under the LVT system, specific situations may arise that create disproportionate and unintended hardship for landowners. This may create some resistance to a reform of the property tax system taking the form of a land value tax; thus, some form of mitigation or exemption may be needed to offset undue burden.

The most common case is households that are asset rich but cash poor. This often occurs in urban areas that have seen high appreciation in properties values over the last 15 to 30 years. Oregon currently has in place tax deferrals that could be extended to help such households. Another mitigation method involves introducing LVT with a graduated rate differential over a period of time. Implementation might begin with a 60/40 land-to-total value split. This LTV ratio is gradually increased over a number of years to 90/10 or more, easing the transition period for cost-burdened homeowners.

An additional tool is an alternate model to the LVT that produces some similar incentive effects but reduces the impact on owners of small or lower value residences. The Assessment Exemption of Improvements (AXI) model is an equal rate tax whereby a fixed amount of improvement value is exempted from taxation. All else constant, this results in lower effective tax rates for properties with building value near the exemption level. A simulated application of this model shows that lower income occupants will receive the largest benefit.

Conclusion

Ultimately, land-based property tax systems, whether a split-rate LVT or a building exemption tax, are found to achieve what they are designed to do—place more of the tax burden on wealthier landowners and encourage the highest and best use of land. Based on the simulations performed on properties in the INE and OSE communities, an LVT would provide a more equitable tax structure, incentivize building upgrading and development of underutilized properties, and discourage “holding” land for speculative purposes. The potential downsides of this tax policy—such as increasing taxes on low-income homeowners—can be mitigated with carefully crafted legislation. In short, many of the inequities created by Measure 5 and 50 would likely be reversed if LVT were implemented in the Portland region.