

Effects of Property Taxation on Development Timing and Density: Policy Perspective

Richard Arnott

This paper focuses on the distortionary effects of different property tax regimes on development timing and density, employing a simple, partial equilibrium model of the developer's decision concerning when and at what density to build. A tax regime is described by three tax rates: one on predevelopment land value, one on postdevelopment site value, and one on postdevelopment structure value. There are two general results. First, the deadweight loss from property taxation may be substantial even at tax rates lower than those in place in many states. Second, the distortionary effects of taxation are sensitive to how postdevelopment property value is decomposed into postdevelopment site value and postdevelopment structure value for taxation purposes. The model is then applied to several property tax policy issues: It characterizes the set of nondistortionary property tax systems; it examines circumstances under which lowering the tax rate on postdevelopment structure value both generates more revenue and raises property value; and it presents a second-best argument in favor of the preferential tax treatment of undeveloped land. The paper's overall message is that the analysis of any property tax reform needs to consider the effects of the reform on development timing and density.