

CHAPTER 35

FUNDING RAPID TRANSIT

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*“Assuming Oahu gets
fixed rail, is there some ‘fair’
way to help pay for it?”*

As of mid-1992, the fixed-rail tab was to be paid with excise and income taxes. Because landowners in the vicinity of the planned transit stations are going to get “windfalls” as the value of their land increases dramatically, it makes sense to consider a special tax on them. After all, why should they get rich at taxpayer expense?

Whenever there are public projects, there are windfall gains (or losses) to nearby landowners. Allowing risk-bearing investors to keep such gains is as American as apple pie.

On the other hand, there is another American tradition of special assessments to pay for sidewalks and storm drains in old neighborhoods. By installing these, the government increases the value of nearby properties. Costs generally are paid by issuing bonds, but payments on the principal and interest are at least partly covered by special annual taxes against the benefiting properties. The only properties taxed are those in a special assessment district abutting the sidewalks or in the

storm-drain-catchment neighborhood.

Special assessment. The Honolulu City & County administration should seriously consider a special assessment on properties near transit stops at least to help cover the operating deficit. This revenue source also could be tapped to pay for capital-cost overruns. There are at least two arguments that the benefiting properties should be taxed.

First, you should pay for what you get from the government, just as you pay for what you get at the market. Widely accepted, this is called the “benefit principle” of taxation. We use it, for example, to rationalize taxes at the gas pump. Those revenues are used for road construction and maintenance, thereby ensuring that drivers pay for the benefits of government-provided roads.

Second, if land value increments (minus inflation) are unearned by their owners, this “profit” should be taxed away. When a transit station is constructed, the owners of nearby properties do nothing productive to increase the value. Rather, the value derives from a government decision on behalf of the public, and so it should be captured for the public. This argument, popularized by economist Henry George, is appealing because it is a tax that does not discourage productive activity.

Would it be fair? Before we accept the notion that the assessment is fair, we ought to consider that practically everything government does raises (or lowers) the value of someone’s land. Should a golf course development permit, construction of a pumping station, and widening of Kalanianaʻole Highway all trigger assessments on property whose land values rise? The revenue could be used to pay for these projects or even to compensate those whose land values fall. In principle, this is attractive. In practice, the costs of administering assessments on all but the largest projects (such as, perhaps, major transit stations), probably make it not worthwhile.

If we accept the notion that a tax is fair and administratively feasible for transit stations, then how would such a tax work? One possibility is the city would define district bounds (perhaps out to a half mile walking distance) around each station. The tax should be on land only; if it were also on capital improvements, that would discourage high density development near the stations, right where we want it. The tax would be collected annually.

Two variants of this tax should be considered. The first is ideal and the second is practical. The base of the first tax is 50 percent of the land value increment due to station access. The amount of the tax on a parcel would be the product of a 50 percent tax rate multiplied by the difference between parcel value when the station location was first announced and parcel value following initial operation. The increment, and the rate as well, could be revised periodically following initial station operation. (The increment would be adjusted downward by the amount of community-wide land appreciation during the ever-lengthening period of measurement.)

What would be the capital value of this tax liability on a typical parcel of land? It would vary from one parcel to the next. Parcels close to the station would pay higher taxes than those more distant. Some parcels within a district would not necessarily increase in value; they would not be taxed. To illustrate a possible case, suppose the value of a parcel was initially \$1 million and that its adjusted value in the absence of the tax would be \$2 million. It can be shown that legislation of this tax would create a capitalized tax liability of roughly \$500,000. This would depress the parcel's value from \$2 million down to only \$1.5 million.

How much of the transit system's operating deficit would be covered by such tax revenues? The answer requires some forecasting of the sizes of the deficit and of revenue collections. The forecast of revenue collections at any specified tax rate will be more uncertain than are revenues from the ordinary property tax. If the revenues actually collected are short of the forecast, then public officials will have to scramble to obtain additional revenues from alternative sources.

Others benefit, too. Even if it were possible to pay for all of this deficit out of special assessment revenues, it would not necessarily be fair to do so. That is because the benefit principle holds that costs should be borne in proportion to benefits, and property owners in the neighborhood may not be the only beneficiaries. If, as some advocates of the transit system allege, the freeways will be less clogged, it follows that drivers should also pay some of the deficit.

The only experience with special assessments based on changes in property value occurred in London between 1895 and 1902. Five projects—bridges and their approaches and road widenings—were



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specially assessed. This approach to financing public transportation was abandoned, partly because of opposition of taxable property owners and partly because the revenues raised were not worth the cost of assessment and arbitrating appeals.

The cost of administering benefit assessment district taxation in Honolulu should be a major concern in determining whether this whole idea is feasible. The specification of districts around stations, and the assessment of land value increments attributable solely to station access (after deflating for citywide land inflation) will be difficult, and will raise objections by property owners in those districts. The potential furor may make it difficult for some public officials to endorse such a tax. And the costs of resolving property owners' objections through the appeals process could make the tax wasteful.

An alternative type of tax would be more practical to administer, and more likely to be enacted. In 1983 the State of California passed a law enabling transit authorities to set up benefit assessment districts, and in 1985 such districts were created on a major segment of Los Angeles County's proposed transit system. The tax revenues are to be used to help pay the construction costs.

The Los Angeles tax, to be collected annually, is simply \$.30 per square foot times the land area or improvement area, whichever is larger. It would be possible for us to increase the tax rate and apply it to the land area alone, so as not to discourage property improvements.

This tax is not as fair as the previously described tax which is proportional to station-induced increases in land value. On the other hand, it is simpler to administer, and the revenues should be easier to forecast.

In short, tapping some of the property owners' windfall gains that result from the new stations is a good idea on fairness grounds. We just have to be sure that the revenue source is dependable and the costs of administering the tax are not too high. Although somewhat flawed on fairness grounds, an assessment per square foot against land may be the most practical way to capture a part of the land value increment.

MORE TAXES; HIGHER FEES;
INCREASE IN RATES; EVERYTHING
COSTS MORE; EVERYTHING'S
TAXED MORE - I GIVE UP!
WE'RE LEAVING
THE ISLANDS!...



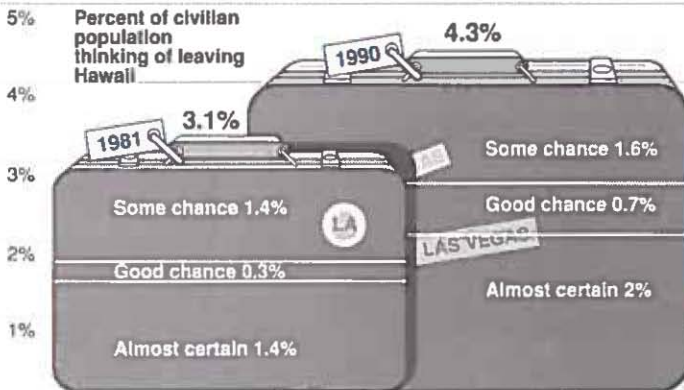
THAT WILL BE
\$3 EACH -
SURCHARGE.



LORRY

Packing their bags

The proportion of people thinking about leaving Hawaii has increased in the last 10 years.



Source: State of Hawaii, Department of Business, Economic Development and Tourism, Data Book 1991, table 39; Data Book 1983, p. 64.