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Transit Value Capture for California

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OVERVIEW

To meet the demands of climate action, California must significantly shift trips away from private automobiles to less carbon-intensive modes of transportation, including public transit. Investment in public transit is hampered by high costs and lack of federal investment. Regressive consumption taxes instituted by local and state governments to fund public transit investment are approaching legal and political limits.

An untapped source of revenue for public transit is land values. Recent studies have shown that private land value uplift associated with rail investment in Fremont, California and Manhattan, New York were multiple times the cost of the transit improvements. This document proposes ways in which California transit operators could re-capture the land value uplift in commercial and residential property to re-invest in public transit expansion and service.

GOALS

1. Re-capture public infrastructure investment around transit stops from commercial and residential landowners.
2. Re-invest captured land values into transit capital improvements and operations.

BACKGROUND

Given the global climate crisis and California's excessive share of lengthy private automobile trips, expanding the transit network and service are critical. In 2018, the state's leading air pollution regulator called for a 25% reduction in Vehicle Miles Traveled to meet its emissions reduction goals by 2040. Transit infrastructure and service, however, are expensive. American rail construction costs per kilometer range between two and seven times European and East Asian costs. With uncertain support for transit at the federal level, states and local governments struggle to fund transit capital investment and operations. These efforts have mostly relied on raising revenue from consumption taxes such as sales and gas taxes.

Generally regressive, consumption taxes have reached statutory limits (many local governments are brushing up against the 10% sales tax cap imposed by the state) as well as political limits (see, the failure of ½ cent sales tax in Contra Costa County; failure of ¼ cent sales tax in Marin County to fund transportation projects; and decision to abandon regional Bay Area transportation mega-measure in March 2020). So far, there has been no effort to sustainably fund transit expansion and operations from the rising land values associated with public infrastructure investment. We present feasible ways to do so.

Transit, Investment, and Land Values

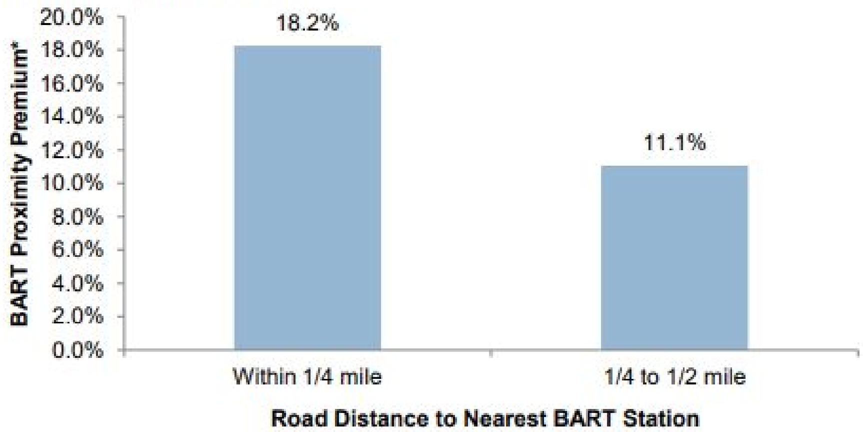
Urban economists have long noted the relationship between infrastructure investment and land values. In addition, discussions surrounding attempts to increase homebuilding around transit in California through state land use reform (SB50, et al) have raised questions over windfall gains due to increased development potential to affected landowners.

Faced with the aforementioned high transit and infrastructure costs, as well as interest in transit-oriented development, research has been done on the value of public improvements relative to private land value gains.

In 2014 a study commissioned by BART found that a condominium within a ½ mile of BART was worth 15% more than a condominium five miles from BART, all things being equal. For single-family homes within a ½ mile of BART the premium amounted to 11%. For office space and apartments, another BART study found similar premiums for properties within walking distance of

BART stations. Residential rents were 20% higher for apartments located between 0 and ½ mile of BART stations compared to those located ½ and 1 mile away.

Figure 1. Office Rent Premiums Associated with Proximity to BART Compared to Areas More than a Half Mile from a Station: East Bay



Benefits of BART for Office and Apartment Properties, BART July 2015

In 2019 researchers at San Jose State University found that the uplift in nearby private land values after completion of the Warm Springs BART station in Fremont were large enough to fund the extension five times over.

Furthermore, in 2020, a NBER working paper determined that the completion of the Second Avenue Subway in New York increased nearby private property values by 10% or $7 billion. Only 30% of this uplift was captured by higher property taxes.

California transit operators, including BART, have faced this issue before. In the late 1960s and early 1970s, economists, labor unions, and civic organizations pushed BART to adopt land value taxation (LVT) around transit stations to pay for capital and operating costs during the build out of the agency's mass transit system. In spite of the California legislature passing an enabling mechanism for transit operators to do just this with SB443 (Mills, 1968), BART decided to pursue a series of county sales taxes to fund their transit system.

The adoption of Prop. 13 by voters in 1978 made ad valorem Land Value Taxation incredibly difficult to enact broadly. Local assessment districts, created for the purpose of recapturing land value gains from public investments, were made similarly difficult to enact due to Prop. 218's passage in 1996. Prop. 218, among other things, required special taxes and assessments to demonstrate a special benefit to assessed property as well as meet higher election bars. In the case of assessments districts, Prop. 218 further entrenched privilege by weighting landowner votes in assessment elections by assessed value of property.

SB443 was subsequently repealed and replaced with a transit benefits assessment district (TBAD) mechanism created by SB142 (DeSaulnier, 2013) that complied with Prop. 218 election requirements of affected property owners. The law allows transit agencies, upon the establishment of the TBAD, to assess property values uplift to pay for improvements to streetscape and transit-access improvements that meet the general benefit and direct relationship to property ownership tests required by Prop. 218. It is unlikely that large capital projects such as new stations and operating costs such as staffing can be funded through TBAD revenue. The efficacy of this law is low; it is unclear if any transit agency has successfully established a TBAD. Based on discussions with BART, SB142's principal sponsor, the agency has not established a TBAD as of 2020. SB142, and with it, TBADs will expire on January 1, 2021.

Global Transit Land Value Practices

Hong Kong MTR system map

The funding of transit investment through land values is a well-documented best practice of successful transit agencies in national and sub-national governments throughout the world. In Japan, transit agencies partnered with public agencies to develop land around transit stations. Among the seven rail operators in the Greater Tokyo area, ground rent accounted for between 30-50% of their revenue.

In Hong Kong, the public-private rail operator MTR receives no subsidies from the state but has an exclusive right to develop land on top of and around rail stations. Drawing upon these development rights, MTR negotiated rental income streams from adjacent property developers to support rail development and operations.

Singapore's transit agencies, known collectively as MRT, operate under a similar "rail + property" regime to leverage transit-adjacent land values to support transit capital investment and operations. State-owned enterprises or public-private partnerships are not, strictly speaking, necessary to capture these transit-adjacent land values. An enterprising local or state government can also capture these land values through taxation.

Taiwan has assessed a land value increment tax on property sales since World War II. The tax is explicitly aimed at curbing land speculation and achieving social equity by taxing the windfalls gained through realization of land value gains. Taiwan's modern land value increment tax features a progressive scale and distinguishes commercial property sales from owner-occupied sales. After implementation local governments within Taiwan enjoyed both significant revenues from land value increment tax as well high rates of urbanization and development.

Taiwanese Land Value Increment Tax

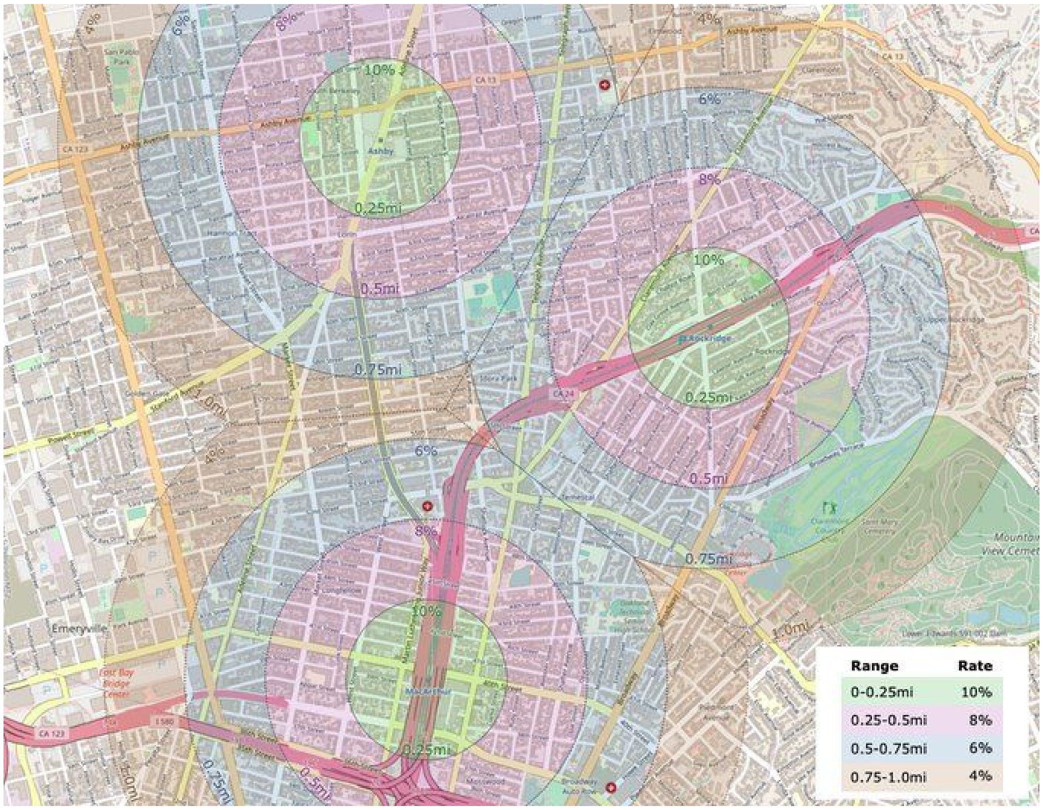
Land gain as % of gain over basis	Tax rate
Owner-occupied property sales	10%
Commercial property sales < 100%	40%
Commercial property sales < 200%	50%
Commercial property sales > 200%i	60%

OPTIONS FOR TRANSIT VALUE CAPTURE

There are several tools and strategies for transit value capture in California. They are broadly grouped into two categories: 1) tax/fee value capture and 2) development value capture. Given the size of needed transit investment over the next 50 years and various political, governance and constitutional constraints, both tax/fee and development value capture should be pursued.

TAX/FEE VALUE CAPTURE

Transit Districts Transfer Taxes



Radial areas surrounding three Alameda County transit stations

Under this proposal, state legislation would direct the California Department of Finance to map transit stops, such as fixed-rail stations, high-frequency bus stops, and ferry terminals, and establish a qualifying radii of 1/4 mile or up to 1 mile of a transit stop, depending on the nature of the transit option (e.g. bus rapid transit versus regional rail). The resultant map of Transit Value Capture Districts (TVCDs) would establish the eligibility of properties for Land Gain Tax.

A Land Gain Tax in the form of a progressive capital gains tax on commercial, industrial and owner-occupied and rental home sales within the TVCD would be redirected to transit agencies operating within the TVCD. A higher rate would be imposed within the TVCD based on eligible property sales within closer radii to the qualifying transit stops; for example, eligible property sales within ¼ mile of a subway station may have a higher Land Gain Tax rate than those sales approaching 1 mile. Borrowing from Taiwan, the rate could also have a progressive graduation based on realized gain relative to property basis with properties realizing higher land gains paying a higher rate. Finally, a slight discount on rate could be applied to owner-occupied property sales. The rising land values associated with transit improvements would thus be partially re-captured and re-invested in transit operations, creating a virtuous cycle promoting further expansion and re-investment in public transit.

It is important to distinguish a Land Gain Tax from other revenue tools. A Real Estate Transfer Tax (RETT), imposes a tax on the transfer of real property. California allows these taxes to be negotiated between buyer and seller. In practice many land sellers require buyers to pay all or some of the RETT. The tax incidence of the RETT can be shifted from seller to buyer, which makes land value recapture elusive--although a RETT may discount land prices. Some cities like Oakland and San Francisco have enacted progressive RETTs that have graduated rate based on the transfer price of the property with higher-valued property paying a higher rate. Presently many transit agencies within California do not have the authority to enact their own RETT.

Under this proposal, a Land Gain Tax on commercial, industrial and residential property sales within a TVCD would be applied through the capital gains section of California's personal income tax. A graduated progressive rate would be applied to the land gain realized using the delta between the property's basis and sales price. The graduated rates could be tiered according to dollar value of land gain. But arbitrary tiers according to nominal dollar figures could encourage manipulation of prices to avoid higher tiers. Instead, it may be preferable to graduate rates based on percentage value of land gain over the property tax basis. For example, a property sale with a land gain of 200% would pay a higher rate than one of a mere 50% gain. Such a graduation scheme would target capturing windfall land gains rather than high sales prices in and of themselves.

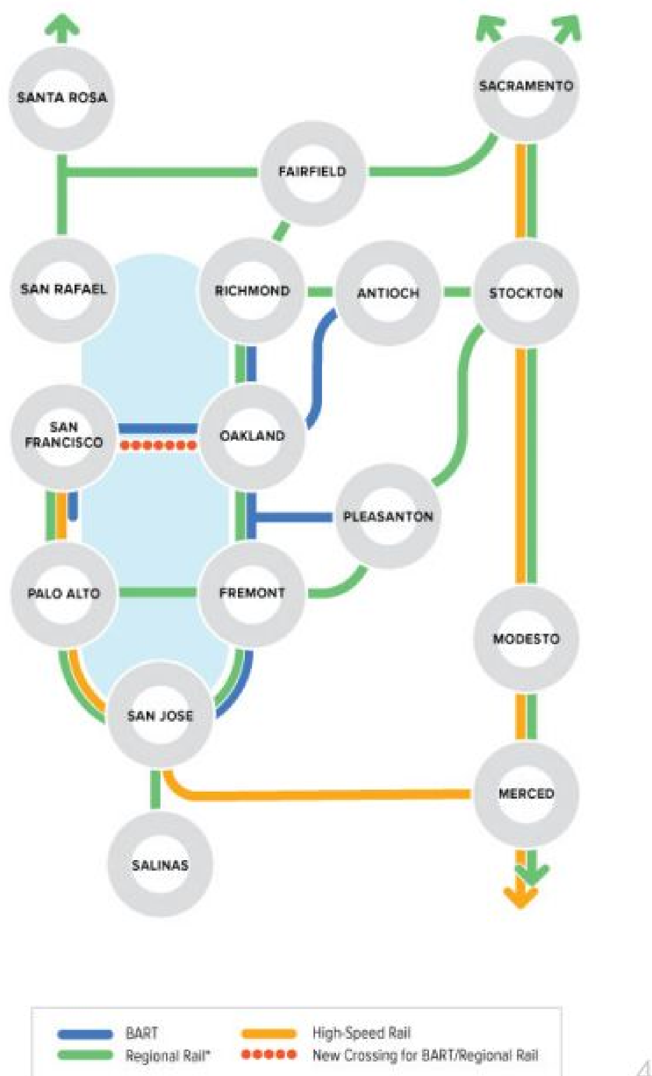
A Land Gain Tax could also discriminate in rates between owner-occupied and commercial property. Taiwan imposes a smaller, but still significant, tax on land gains from owner-occupied properties compared to other uses such as rental housing and office space. This ensures that owner-occupiers contribute at least some of their realized land windfall back to public transit.

A Land Gain Tax would ensure that, unlike the RETT, tax incidence would fall squarely on the seller. Sellers would be allowed to deduct recent improvements from the sale. Since the lion's share of appreciation in both residential and commercial property values comes from land value rather than improvements, these deductions would not inhibit the Land Gain Tax's revenue potential. Moreover, since the Land Gain Tax is administered through the Revenue and Taxation Code, it does not require constitutional amendment by ballot initiative or referenda to be enacted. The trade-off is that administration of the tax and the distribution of the revenue would occur at the state level, as opposed to locally by transit agencies, be they special districts, joint power authorities or other local government entities.

In 2017, the staff of the Bay Area's metropolitan planning organization MTC through the CASA (Committee to House the Bay Area) process identified a Land Gain Tax (dubbed a windfall tax) as a source of revenue for affordable housing production. After excluding the $500,000/$250,000 federal capital gains exclusion for personal home sales, MTC planners determined that a Land Gain Tax using a 3.5% tax on home sales in the nine-county Bay Area could yield $100 million per year in revenue.

MTC's analysis included properties distant from new and existing transit that would be unaffected by the establishment of a TVCD under this proposal, so a certain discount is necessary. However, as MTC was specifically calculating the potential of various instruments to raise $100 million a year, a higher Land Gain Tax rate could potentially yield additional revenue in Transit Value Capture Districts. Moreover, MTC's study excluded typically higher-value commercial and industrial property from their analysis. Further analysis is necessary to determine the potential revenue yield of a Land Gain Tax near transit stops throughout California.

Regional Transfer Tax



Another option would be to implement a regional real estate transfer tax (Regional RETT) on property sales to capture large-scale regional transit investment. A Regional RETT would tax property sales at a fixed percentage. Given the scale of regional transit investments proposed for Link21 in the Bay Area and Sacramento Valley, land owners throughout the mega-region are poised to gain trillions in land value gain through mobility, amenity and agglomeration effects. While parcels far from transit are less likely to see direct benefit from this investment, landowners generally have seen massive gains already in a dynamic regional economy even without significant transit investment.

A regional RETT could also raise serious revenue for desperately needed transit. Shane Phillips of the Lewis Center for Regional Policy Studies at UCLA recommends a progressive real estate transfer tax for the City of Los Angeles (population ~4 million). Phillips estimates that graduated, progressive rates applied to the existing real estate transfer could yield nearly a billion dollars a year in revenue. For context, LA Metro's Measure M (which applies to the 12 million person Los Angeles County) raises roughly $3 billion each year over 40 years. There may be even more revenue on the table. In a separate blog post Phillips suggests additional land value gains by use of a multiplier that factors in the seller's Prop. 13 property tax tax savings. Phillips finds $1.85 billion in real estate transfer tax revenue for the City of Los Angeles using this Prop. 13 multiplier.

Such a Regional RETT would require enabling legislation from the California legislature. In some cases, it may be politically necessary to pair or complement a regional real estate transfer tax with other revenue raisers such as a sales or income tax. A regional tax on realized land value gain, however, can help reduce the burden on consumers and workers alike to fund transit investment.

Commercial Land Value Recapture

Proposition 13 currently limits the ability of agencies to capture increased land values that accrue to commercial land owners. Assessments are fixed at acquisition-date and cannot grow more than 2% each year, despite dramatic shifts in land values due to increased population and public investment. Prop. 15, which narrowly lost 48-52 in November 2020, would have amended the California Constitution to allow re-assessment of certain commercial and industrial property every three years. Given the closeness of the result, there is a strong chance that this basic concept will return in the future.

Prop. 15, as written, did not specifically raise revenue for transit operators. Instead it directed a portion of the increased property tax revenue from re-assessed commercial property on a county basis to transit operators that were already drawing upon property tax. For some transit operators such as LA Metro, SFMTA and AC Transit Prop. 15 represented a significant increase in annual revenue. For others, such as VTA, County Connection and SacRT there was zero upside to Prop. 15 in terms of revenue.

A revived effort to re-assess commercial and industrial real property should strive to make sure all transit operators receive at least some of the revenue. As commercial property owners largely benefit from the mobility and agglomeration effects of transit, it seems fair that transit operators should see at least some benefit from future land reform.

Mellos Roos for Transit

Another option would be for California to enable transit agencies to establish community facilities districts (aka Mello Roos Districts) around new transit stops. These Mello Roos Districts would allow the transit agency to issue bonds and levy special taxes to support transit operations.

An attempt to amend the Mellos Roos law, AB2705 (Jones, 2008), to include transit operations failed despite support from AC Transit, SacRT and other transit agencies. Real estate and anti-tax organizations opposed the bill. One salient criticism of the bill was that its tendency to focus on new development represented a tax on new homebuyers and renters for the benefit of transit system improvements enjoyed by entire cities or regions.

Partial Prop. 218 Repeal

California may consider a partial repeal of Prop. 218 to do away with the weighted vote requirement for the establishment of a new assessment and the special benefits requirement.

Under Prop. 218, votes on new assessments are weighted according to the amount of assessment each property owner would pay. A partial repeal of Prop. 218 would remove the weighting requirement for votes to establish a new assessment and allow equal votes of property owners. A more aggressive proposal could expand the franchise on questions of value capture via assessment to all voters, not just property owners.

A partial repeal of Prop. 218 might include repeal of the requirement of a special benefit for a new assessment. The idea behind this requirement is that new assessments should have a particular relationship between the assessed property and public benefit accrued, rather than the general benefit. This requirement prevents local governments, including transit agencies, from using their tax power to provide comprehensive and broad public services that benefit all of society.

Reducing the Special Taxes Threshold

California may consider allowing cities, counties and transit agencies to enact special taxes for public transit with only 55% of the vote. ACA-1 (Aguiar-Curry, 2019) would have placed a referendum on the 2020 ballot on whether to reduce the threshold for special taxes for affordable housing and transit from 66% to 55%. This constitutional amendment failed in 2019 but may be worth re-consideration in the future.

DEVELOPMENT VALUE CAPTURE

Following best practices of transit value capture from East Asia and other parts of the world, California could make it easier for all transit agencies to buy and develop land around their transit stops into apartments, offices and retail. Dr. Shishir Mathur of the Mineta Transportation Institute at SJSU presents an extensive review of obstacles to such in "Promoting Transit-Oriented Developments by Addressing Barriers Related to Land Use, Zoning and Value Capture." Dr. Mathur's paper discusses in-depth strategies for development value capture including: joint development, joint powers authorities, sale of development rights and eminent domain. Those interested in development value capture are highly encouraged to read it.

Building Off of AB2923

AB2923 (Chiu, 2018) allows BART to impose baseline zoning and development standards for land owned by that agency within a ½ mile of BART stations. While the law's intent is to allow BART to develop its land around its stations to increase ridership and access, it also allows the agency to capture higher rents to support operations and maintenance of the system. BART's policy of land lease and development, as opposed to fee simple property sales of entitled land, ensures an ongoing revenue source for the agency. One limitation of AB2923 is that it does not allow BART to develop land purchased after January 1, 2018.

Legislation could be developed and enacted to build on AB2923 by allowing more transit agencies to buy and develop land to baseline zoning and development standards near their transit stops. Political opposition in the form of ideological local control and agency disinterest may limit the effectiveness of such an option. This opposition could be in the form of traditional suburban exclusion for new extensions or even opposition to development of agency-owned property to highest and best use in central business districts in places like downtown San Francisco or Los Angeles. Finally, agency-led station land development, absent extreme land buying authority and funding, will be unlikely to capture rising land values around legacy stations.

TAKEAWAYS

In light of its ambitious climate goals and strained commutes, California's transit capital and operations needs are immense. California can leverage land values to re-capture the uplift from public infrastructure investment to create a sustainable positive feedback of transit investment and economic justice.