

THE LAND POLICIES AND THE TAXATION OF LAND AND PROPERTY: CONTRIBUTIONS FOR A SUSTAINABLE FINANCING SYSTEM OF THE CITIES

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October, 2018

ABSTRACT

This dissertation aims to give contributions in order to help the local governments to reach an autonomous financing system, where the taxation of land and property plays an important role. Furthermore, since it has also been debated in which ways these fiscal instruments can work as land policies, then, this topic will also be developed on this paper.

To achieve the targets discussed on the previous paragraph, it's important to understand, at first, how the local financing tools work in Portugal and abroad, focusing on the land and property taxation. With the comparison between frameworks and after the analysis to the Portuguese financing system, it will be possible to understand which kind of instruments are better for financing, as well as which gaps are still waiting to be solved. Also, the connection between the taxation of land and property and the land policies are going to be considered.

Then, it will be possible to apply these knowledges and critical sense to a practical case of the municipality of Almada, Portugal. On this chapter, the evolution of the local financing system, as well as the particularities of this territory and the targets of its urban plan are studied, in order to obtain a portrait of Almada. After that, it's possible to define a series of recommendations to help Almada becoming more financially solid and to achieve its territorial aims. This way, this paper might be useful for further studies about the topic of municipality financing.

Key-Words: Land and Property Taxation; Municipality Financing; Land Policy; Urban Planning.

1. INTRODUCTION

The issue of the sustainability of the local financing systems has been debated in many countries, and, particularly in Portugal, it's known that there are many cities which have problems on generating enough profits to balance the expenditures and the debt. It is noticeable that due to the demographic reduction, the real estate decline and the economical crises which affected the world in 2008, the Portuguese models for financing the cities stopped being suitable. Thus, according to the new reality of Portugal, this paper aims to give important contributions in order to build or rebuild sustainable financing structures for the municipalities.

On the construction of this new financing model, it is important to notice that the instruments for taxation of land and property will assume the main role, since they provide the cities with revenues, reducing the amount of funds transferred from the central government. So, the following methods used on this dissertation will focus on the study of the effects of the these instruments and how they can be designed.

Besides the financial side, other objective of this paper is to find also contributions for the relationship between these taxation instruments and the land policies settled by the local governments. This relationship might have some problems, since sometimes both sides are not compatible.

Then, to get further on this topic, the following paper will explore a literature review about the structures of financing in Portugal and abroad, focusing on how the taxation of land and property is executed. After that, it will be held a detailed study on a practical case concerning Almada municipality in Portugal, to get more concrete and solid conclusions concerning the targets of this thesis.

2. LITERATURE REVIEW

The first step of this literature review was trying to understand how, generally, the local governments structure their revenues system. Despite the fact that each country has its specific realities and differences, it is noticeable that every local financing system is complex and gives an important role to the taxation of land and property (Youngman, 2016). It is also considered that the local taxation should be based on *benefit principle*, in order to be more effective and equitable. According to this principle, the tax gets higher according to the amount of advantages that a property can enjoy (Morais de Sá, 2014), such as public infrastructures (like hospitals or schools) or public services (like electricity or water supply).

Then, on the following picture it's possible to see how the local financing system is structured in general:

According to the fiscal decentralization and the theory of *fiscal federalism*, local governments should be responsible to charge their own taxes and fees, because they should be responsible for the costs related to their own jurisdiction (Oates, 1972; Veiga, 2007). That's why it's noticeable on figure 1 that local own revenues are based on local taxes and fees.

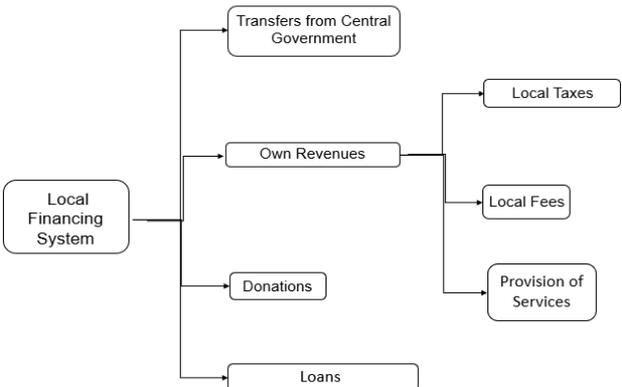


Fig. 1 - General structure of local financing systems

So, it is important to see how the amount of revenues provided by local taxes and fees is variable in different countries and contexts, as the figures 2 and 3 show:

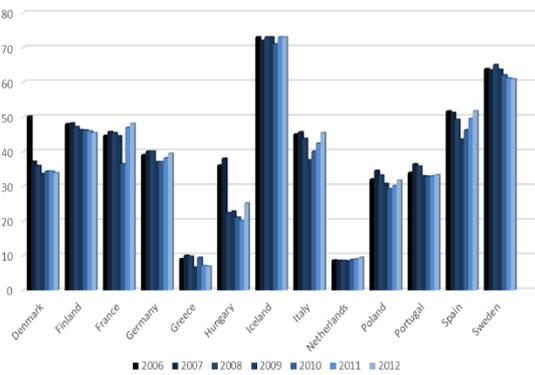


Fig. 2 – Local revenues provided by local taxes (%)
Source: OEDC (Fiscal Decentralization Database)

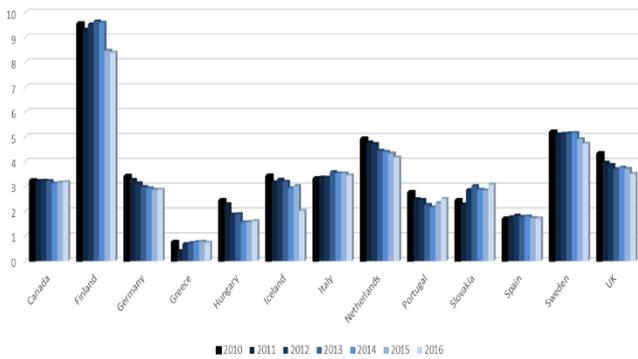


Fig. 3 – Local revenues provided by user fees (%)
Source: OEDC (Fiscal Decentralization Database)

This way, it's easy to conclude that these fiscal instruments are extremely important regarding the autonomy and independency of the cities, in a financial perspective. However, it is relevant to acknowledge specifically which taxes and fees can be the most appropriate. So, the following picture shows how important is the function of the taxation of the land and property:

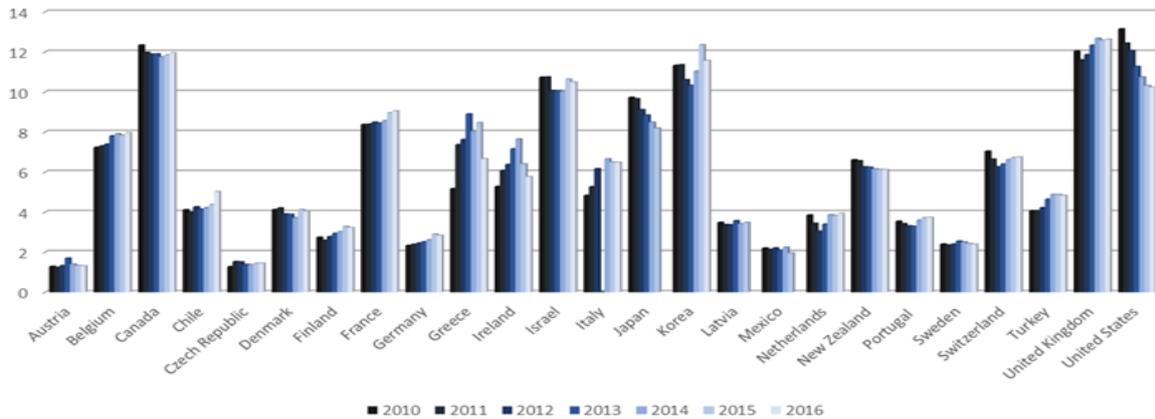


Fig. 4 – Percentage of local revenues provided by the taxation of the land and property (%)
Source: OEDC (Fiscal Decentralization Database)

Here the figure 4 displays the big proportion of revenues that this kind of taxation can provide to the municipalities.

Through this international studies, it became clear that there are two main instruments which are useful for the local financial sustainability and the land policies: the Land and Property Tax and the Development Charges/Impact Fees.

Regarding the land and property tax, this tax is mainly efficient because the houses and the land can never change location, it's impossible for a property to move away to another municipality with less taxes (Slack, 2011). Thus, it can also act well as a land policy and to control the real estate speculation (Correia, 1993). Furthermore, De Cesare (2012) argues that, besides the *benefit principle*, this tax must be equitable, universal, simplified and neutral.

Regarding the development charges/impact fees, these fees should also be guided by the *benefit principle* and they are usually charged just once to the private promoters who want to build and develop a certain urban area, in order to pay the costs related to the urban growth (Slack, 2011).

Nonetheless, it is still needed to take a look at the current financing system of Portugal, so the adaptation of these two fiscal instruments can be well succeeded. According to the local finances law of the 3rd of September of 2013, the main ways of financing municipalities in Portugal are: taxes and fees regarding the land and property, other fees and fines, circulation tax, “derrama” tax, loans and government funds.

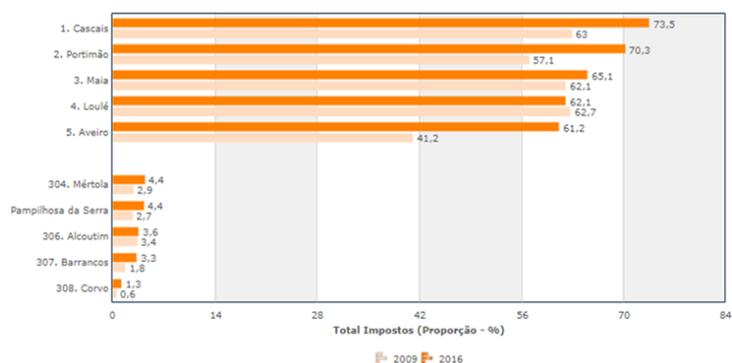


Fig. 5 – Revenues provided by land and property tax (IMI) and transaction tax (IMT) in Portuguese municipalities (Source: PORDATA)

However, as the figure 5 displays, most of the revenues come from the land and property tax (called IMI, in Portugal) and the transaction tax (called IMT, in Portugal). So, it is possible to conclude that the Portuguese financing system for cities is still very based on philosophies of urban growth, that's why the tax based on property transactions (IMT) has a big impact on big Portuguese cities such as Lisbon or Oporto. It is also possible to see how inadequate this system is in the Portuguese municipalities nowadays by the way its expenditures and dept have been high:

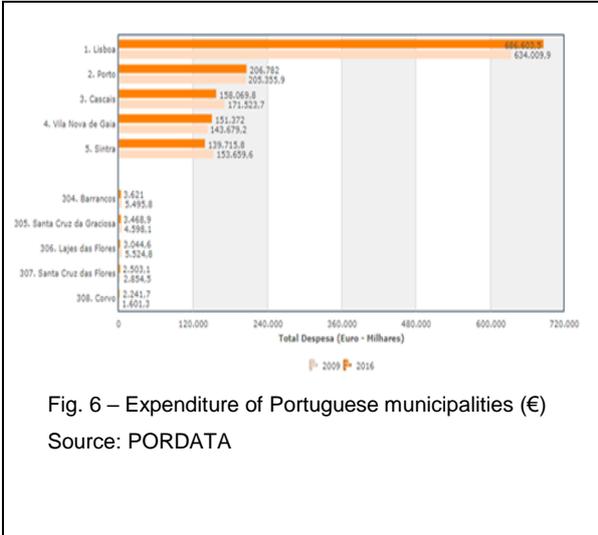


Fig. 6 – Expenditure of Portuguese municipalities (€)
Source: PORDATA

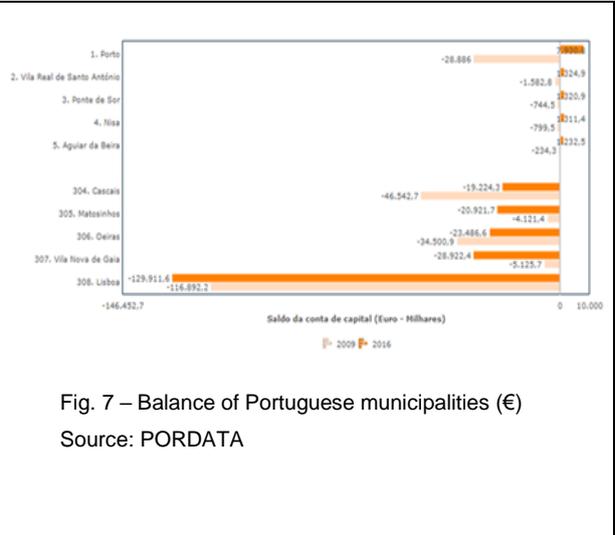


Fig. 7 – Balance of Portuguese municipalities (€)
Source: PORDATA

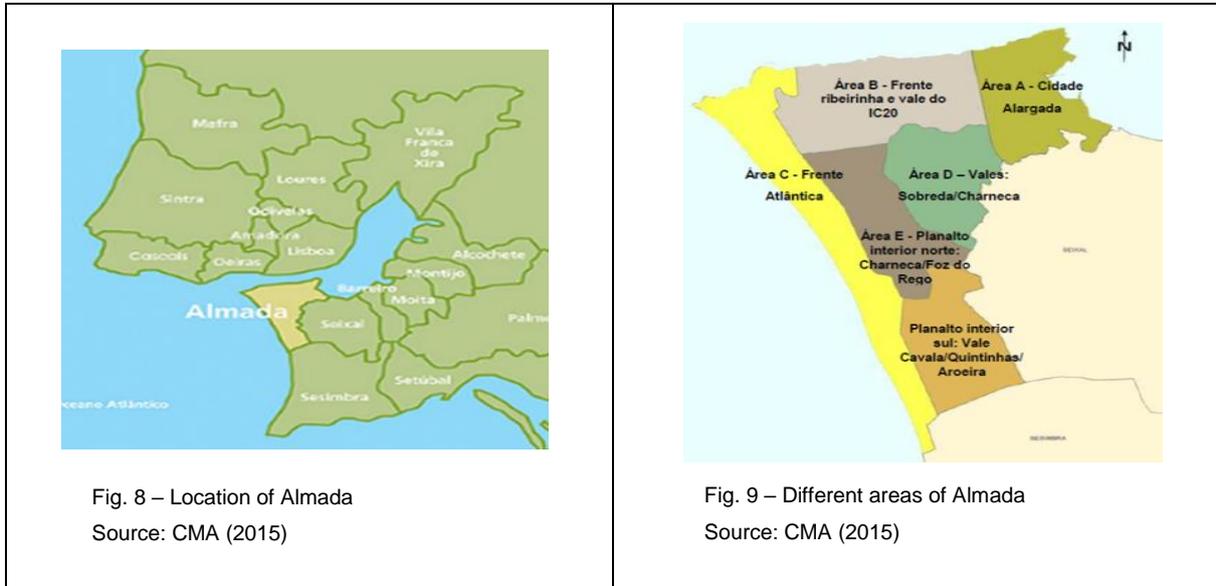
These pictures can show how serious the situation is on most municipalities. The expenses and debts are too high in almost every local jurisdiction of Portugal, which causes a big dependence on transfers from the central government. On the other hand, the big cities such as Lisbon and Oporto are always on a better situation, due to their big dimensions and urban dynamics.

To finish this chapter, there are some gaps and omissions which are relevant and may concern for the rest of this study, such as: the unpredictability of the economy and reality, the gaps on the evaluation model of the land value, the restrictions of higher laws and rules, the high expenses and debts of municipalities, the dependence on central government funds and the poor articulation between land and property taxation instruments and the urban plan policies.

From all these gaps, the most important ones are the unpredictability, the evaluation of land value and the poor articulation between land and property taxation instruments and the urban plan policies. About the unpredictability component, this problem derives from the real estate speculation, which can make the taxations on land and property dependent on urban expansion policies (especially the transaction tax), which was the mistake of several municipalities. Concerning the evaluation of land value, the main problem is that the current methods are still very linked with the soil market values, which doesn't make sense according to the *benefit principle*. This might be a problem since the spatial component of IMI is the one which has the biggest weight on the charged value. Finally, it is noticed that in Portugal the financing methods of the cities are still more focused on getting revenues, instead of acting also as urban politics, therefore, the developments charges (TMU in Portugal) and the land and property tax (IMI) must be modified in order to achieve more this aim.

3. METHODOLOGY – CASE STUDY

As a practical case to study and apply the knowledge of the previous chapters, it was chosen the municipality of Almada, Portugal. Almada is a good example because: it has a big population, it's located close to the capital of Portugal (Lisbon), the urban and expansion dynamics were very high on the last decades, the evolution of the real estate market have followed the demographic and economic evolution and also because it's a very heterogenic territory, with many different areas (as the figure 9 shows).



Regarding the heterogeneity of Almada, the main differences between the six areas are:

Area A: very urban and populated area where the main city center and the consolidated part are held. It includes the zones of Almada, Cova da Piedade, Pragal, Cacilhas, Laranjeiro and Feijó.

Area B: place with many rural and empty places, where the main attraction is the University.

Area C: costal area where the beach is located, therefore it has a developed tourism and it also has another urban center, Costa da Caparica.

Area D: very urban zone with few empty spots, where the urban dynamics are strong. The only problem is the big amount of urban areas of illegal genesis.

Area E: area with reduced population, many empty spots and urban areas of illegal genesis.

Area F: it is also an area with reduced population and urban areas of illegal genesis like the Area E, but it has a growing tourism area in Aroeira, with a growing dynamic market of the real estate.

So, the municipality master plan (MMP) takes this spatial differentiation in consideration. However, if on the last decades the population was growing up considerably, and therefore the urban expansion policies were the basis of the MMP, nowadays with a reality of urban and population contraction, the MMP has been reviewed and modified since 2008 (CMA, 2008 and 2015):

Table 1 – Main goals of the MMP of Almada, before and after the revision (CMA, 2008 and 2015)

Main goals of the old MMP of Almada (before 2008):	Main goals of the old MMP of Almada (after 2008):
<ul style="list-style-type: none"> • Consolidation of Almada/Cacilhas/Cova da Piedade area as municipality center and expansion through the axis of Pragal/Monte da Caparica and Cova da Piedade/Laranjeiro; • Development of Costa da Caparica and Charneca as second urban centers; • Development of touristic areas next to the ocean; • The constraining of the industrial expansion on Frente Ribeirinha; • Development of green areas in Vales area. 	<ul style="list-style-type: none"> • Regeneration of public spaces • Protection of ecological areas • Improve the accessibilities and the articulation of the territory • Restrain the urban expansion • Improve the mobility (expanding the metro network, for example) • Reduce the empty spaces of the territory, to reduce the scatter occupation

These new targets of the municipality of Almada will be the goal of the future articulation between the instruments of taxation of the land and property and the political strategies of this local government concerning the territorial management.

4. RESULTS AND DISCUSSION

After taking a look into the reality of Almada and its land policies, it's important to evaluate how the finances evolved and to see what is needed to change on the financing model, also to make use of the instruments of taxation of the land and property to contribute to the new territorial ambitions of this municipality.

Then, the revenues and the expenses of this local government are verified in first place:

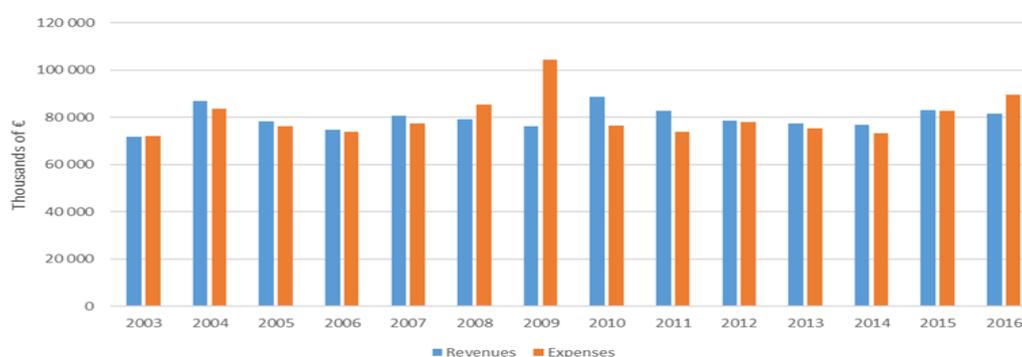


Fig. 10 – Evolution of the revenues and expenses of Almada (€)

Source: Portal Autárquico

So it's clear that besides the effects of the urban decrease and the economical crisis of 2008, the revenues of Almada managed to be almost always enough to face its expenses. Therefore, the next figures show how the direct taxes contributed to the revenues of Almada, and how they have been changing during the last years:

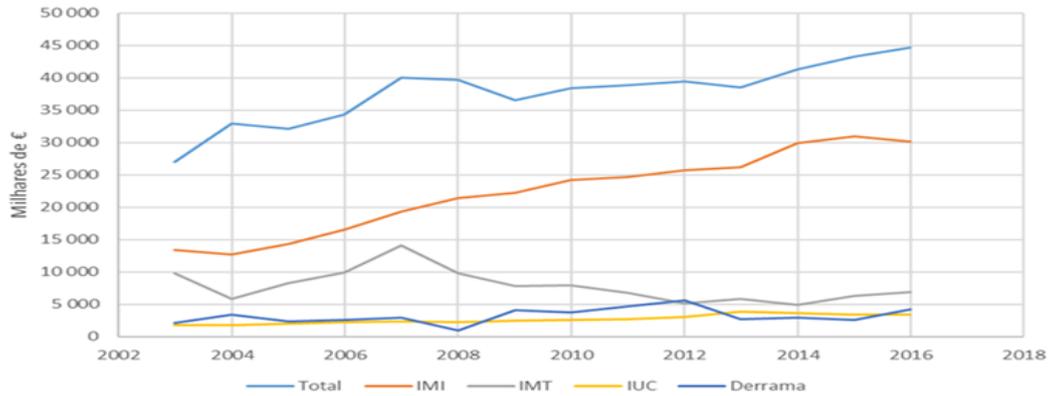


Fig. 11 – Evolution of the revenues from direct taxes in Almada (€)

Source: Portal Autárquico

Here it's conclusive that the land and property taxation (IMI) had, generally, an increasing volume of revenues, despite the crisis on the real estate market, the bad economic situation and the decreasing of population of Almada. On the other hand, it's noticeable that after 2012, there was a big increase of incomes from IMI due to the general reform of the evaluation of properties and soils, which was held in Portugal in 2012. On the other hand, the transactions tax (IMT), was decreasing a lot during the year, until it remained with very few impact. This demonstrates how the IMT is too much dependent on the real estate market. Concerning the other two direct taxes (circulation tax and "derrama"), their impact is so residual that is not necessary to be discussed on this paper. However, it became clear that IMI was the main reason for the increase of income from direct taxes and that was responsible for countervailing the declining of IMT. The following picture illustrates the importance achieved, in percentage (%), by the land and property tax in this local jurisdiction, comparing with the other direct taxes (IMT, IUC and "derrama"):

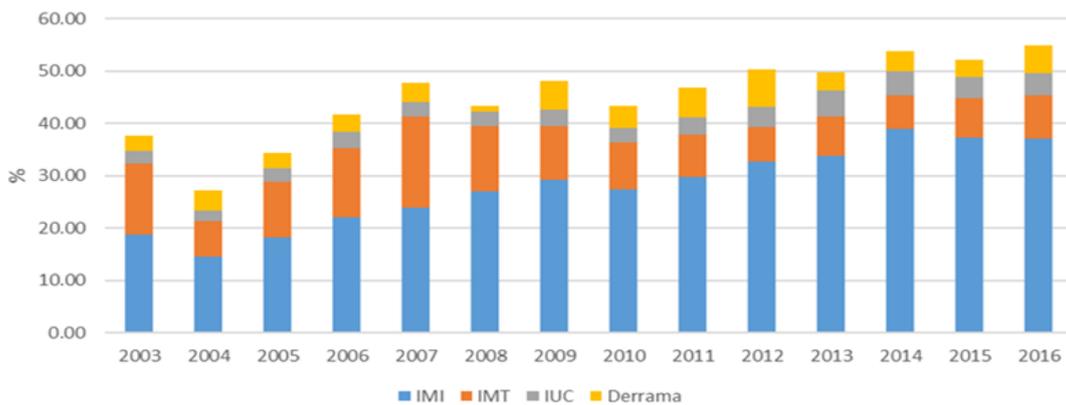


Fig. 12 – Importance of each direct tax on the recipes of Almada (%)

Source: Portal Autárquico

Besides the big influence achieved, financially, by the land and property tax, it is also relevant to observe the role of the development charges/impact fees (TMU) on this case of study:

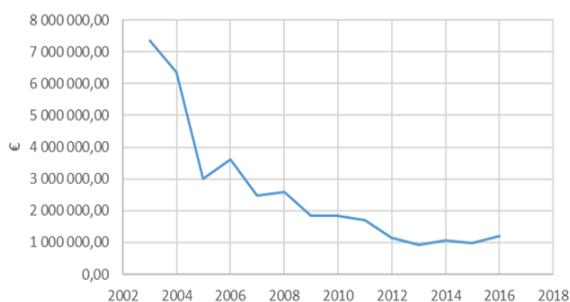


Fig. 13 – Evolution of the incomes from the development charges, TMU (€)

Source: Portal Autárquico

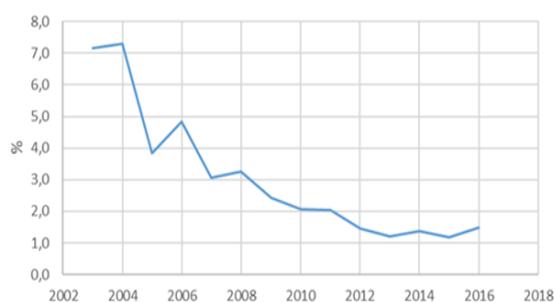


Fig. 14 – Evolution of the impact of the development charges, TMU (%)

Source: Portal Autárquico

As it's illustrated on the figures 13 and 14, this fee suffered a big reduction on its volume of incomes, due to the already mentioned fact that the current financial model of Almada, like the rest of Portugal, is still based on urban expansion philosophies. This fee is supposed to contribute for the production and maintenance of urban facilities and services (Baptista e Silva, 1989), like it did in the past. However, since the early 2000 years, these revenues have been decreasing because the population and the urban growth stopped raising. Consequently, there is a need for a reformulation of the development charges/impacts fees, because nowadays the reality of Almada doesn't match with the dynamics of the real estate market or with the expansion of the urban areas. Therefore, the new base of this fee (TMU) needs to suit the target of urban restraint displayed on the reviewed MMP of Almada.

Despite the new reality and challenges that Almada faces in the present and future, it can still be noticed that this municipality has remained with a high level of independency from the central government. The following figure proves that:

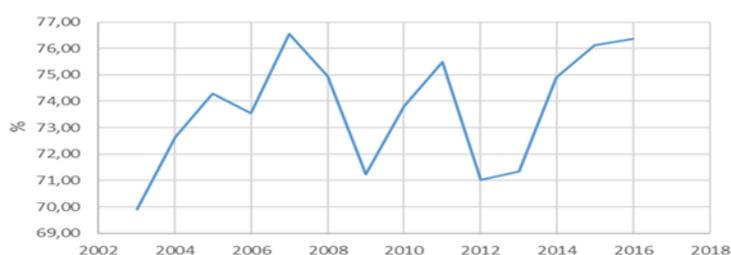


Fig. 15 – Level of independency towards the central government transfers

This stability of the independence level from the central government is due, like it was concluded before, to the stability of the revenues from the land and property tax. That's why Almada was able to have a coefficient of autonomy above 70%. Thus, these results revealed that the land and property tax is able to work in both realities, in a scene of construction growth and in an urban contention case. Besides that, it's a tax where the revenues can be predictable, since there is a big amount of properties in Almada (which gives a wide range for taxation) and also because this kind of taxation lasts during many decades (during a life-cycle of a building). On the other hand, the TMU must be redefined, since it can also have powerful effects if based on the right framework.

5. RECOMMENDATIONS FOR A NEW MODEL OF LOCAL FINANCING FOR ALMADA

According to the results obtained from the case of study and also from the considerations regarding the international experience and the literature review, it is now possible to present a solution for the local financing system of Almada. On this solution, the philosophy of the *benefit principle* and the urban contention politics will be the rational basis for the given recommendations.

Thus, the modifications needed on this financing system should be focused on the reformulation of the land and property tax (IMI) and the development charges/impact fees (TMU), since these two proved to be the most efficient tools, as well as the easiest to redesign. These instruments should also take in consideration the new purposes of the MMP of Almada, as well as the heterogeneity of the territory, because it is also aimed that these instruments can work as urban planning tools.

This way, both fiscal tools shall be redesigned mainly through their spatial component. On IMI through the localization coefficient, since it has the biggest weight on the charged value of this tax, and on TMU through the spatial differentiation along the territory.

Regarding the land and property tax (IMI), the main recommendations are:

- Exempt this tax, for a couple of years, for promoters who develop renovation of old buildings in areas where the local government wants to promote the urban regeneration, such as Costa da Caparica or the historical center of Almada;
- Improve the evaluation methods of land value;
- Reduce the localization coefficient in areas where it is needed to reduce the empty spaces on the territory;
- Promote the legalization of urban areas of illegal genesis;
- Raise the weight of IMI in houses used as second residence in Aroeira.

Regarding the development charges (TMU), this fee shall be used to pay for the production and maintenance of urban facilities which benefit the properties and its owners. Therefore, it should be divided in two components:

1. New construction component;
2. Maintenance component.

This way, the main suggestions are:

- Raise the new construction component in Vales Interiores, where the urban dynamics have been very active;
- Raise the maintenance component in area A (Cidade Alargada), where is needed more rehabilitation and regeneration measures;
- Raise both components in Aroeira, since the tourism and, therefore, the real estate have been raising there;

- Reduce, for some years, both components in areas where the real estate market is very low and where the housing occupation is disperse, such as Frente Riberinha and Planaltos Interiores;
- Keep the records updated and watch the modifications of the land. This action can be achieved through modern geographical information systems.

With these recommendations for the IMI and the TMU, it's believed that the new financing model of Almada can be more suitable regarding the present and future framework, as well as it can be more efficient and more sustainable financially. Furthermore, the MMP can be more easily executed.

6. CONCLUSIONS

This paper aimed to give contributions to the problematic of the sustainability of the financing systems of the municipalities, as well as intended also to explore how the land and property taxation instruments could work as land policy tools. Thus, this study revealed that the most suitable tools for those purposes are:

- Land and property tax;
- Development charges/Impact fees.

However, these two instruments need some changes since they were based on urban growth policies for many years, scenario which is no longer the main framework in Portugal. So, these taxations should be based on urban regeneration and contention policies, in order to be more effective and contribute to the cities financing autonomy.

The land and property tax is considered the safest one regarding revenues, since it's more stable towards the changings of the economy, it's predictable and also able to provide the biggest amount of recipes on a local scale, providing more guarantees to the municipalities. Here the localization coefficient takes the main role, it can provide more revenues or it can act as a land tool. However, this coefficient still follows the soils market value, which doesn't match with the *benefit principle* defended on this work, so this issue should be object of study on future works.

Concerning the development charges/impact fees, this tool requires a better spatialization approach. This way, the taxation can be more efficient and fair, and can also facilitate the urban management procedures. It can be concluded that a good adaptation and redesign of these fees are essential, since it is believed that these kind of fees should be the main help for financing the production and maintenance of public urban facilities and services.

To sum up, these two instruments can contribute to the local financial autonomy and for the objectives of the municipalities master plans with a series of incentives and penalties spatially and strategically planned. In addition, it is also highly recommended good land value evaluation systems, based on the *benefit principle*, and updated records of the soils, so the taxation values can be more correct.

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