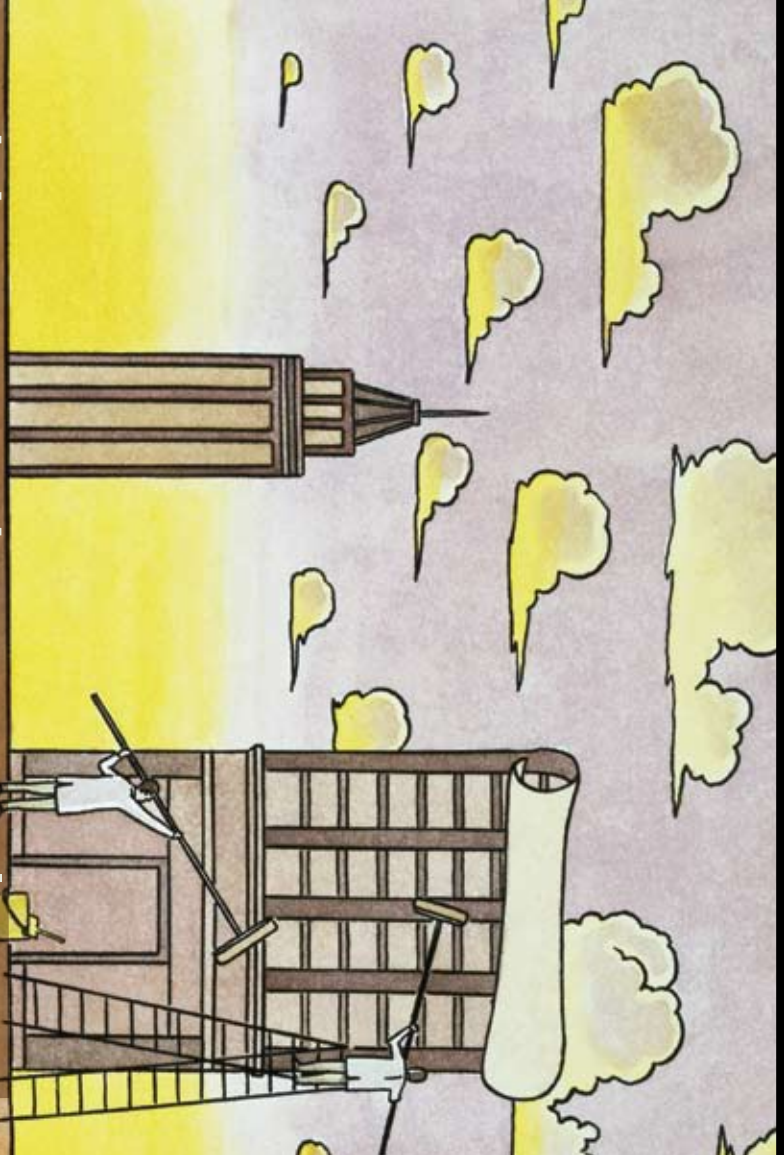


Government Finance

Review

GOVERNMENT FINANCE OFFICERS ASSOCIATION



Rethinking Economic and Community Development



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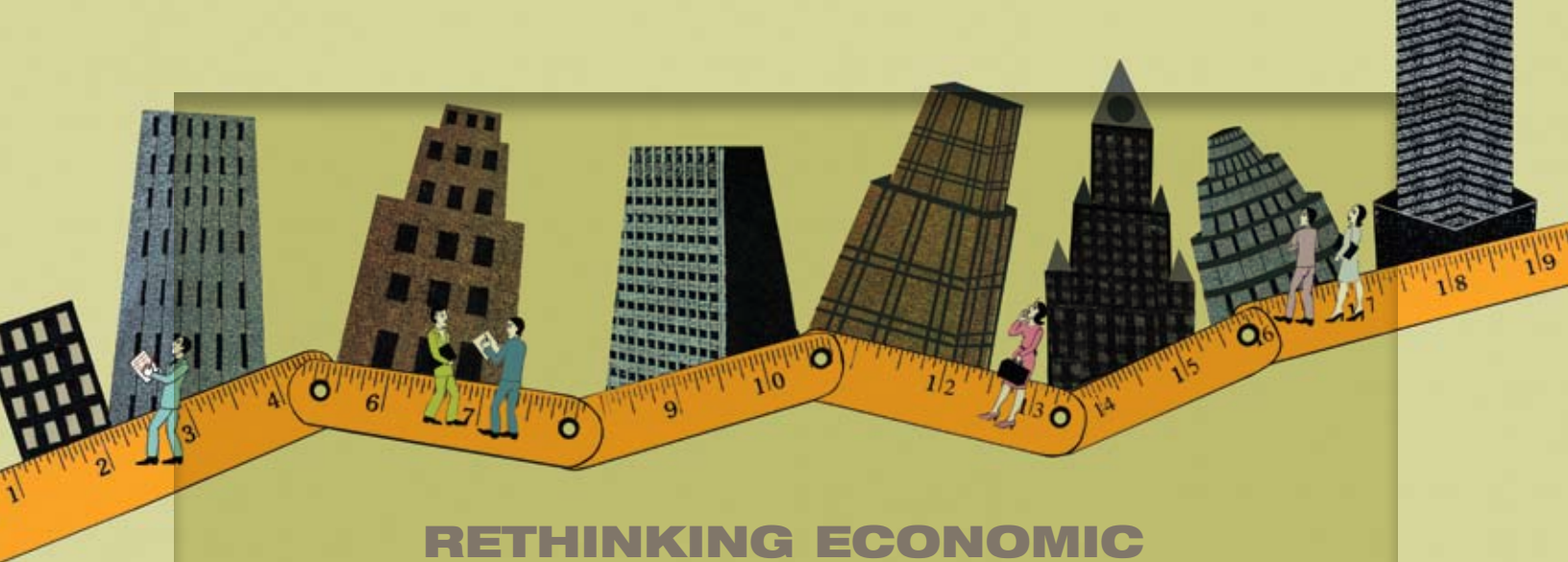


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RETHINKING ECONOMIC AND COMMUNITY DEVELOPMENT

INTRODUCTION

“Among many things the recessionary period emphasized is the tension caused by economic development within jurisdictions,” David MacGillivray wrote in “Enhancing the Finance Officer’s Role in Economic Development” (in this issue of *Government Finance Review*). As the person who best understands the organization’s fiscal resources and commitments, the finance officer is an extremely important and valuable part of any discussion about economic development. Finance officers, who are charged with ensuring the organization’s financial strength, now and in the future, also realize that the local economy must thrive if the jurisdiction is to thrive. As MacGillivray wrote, “a public entity must be financially solid both internally and within its constituent community.” All this means that the finance officer should have a strong role in a government’s economic development planning.

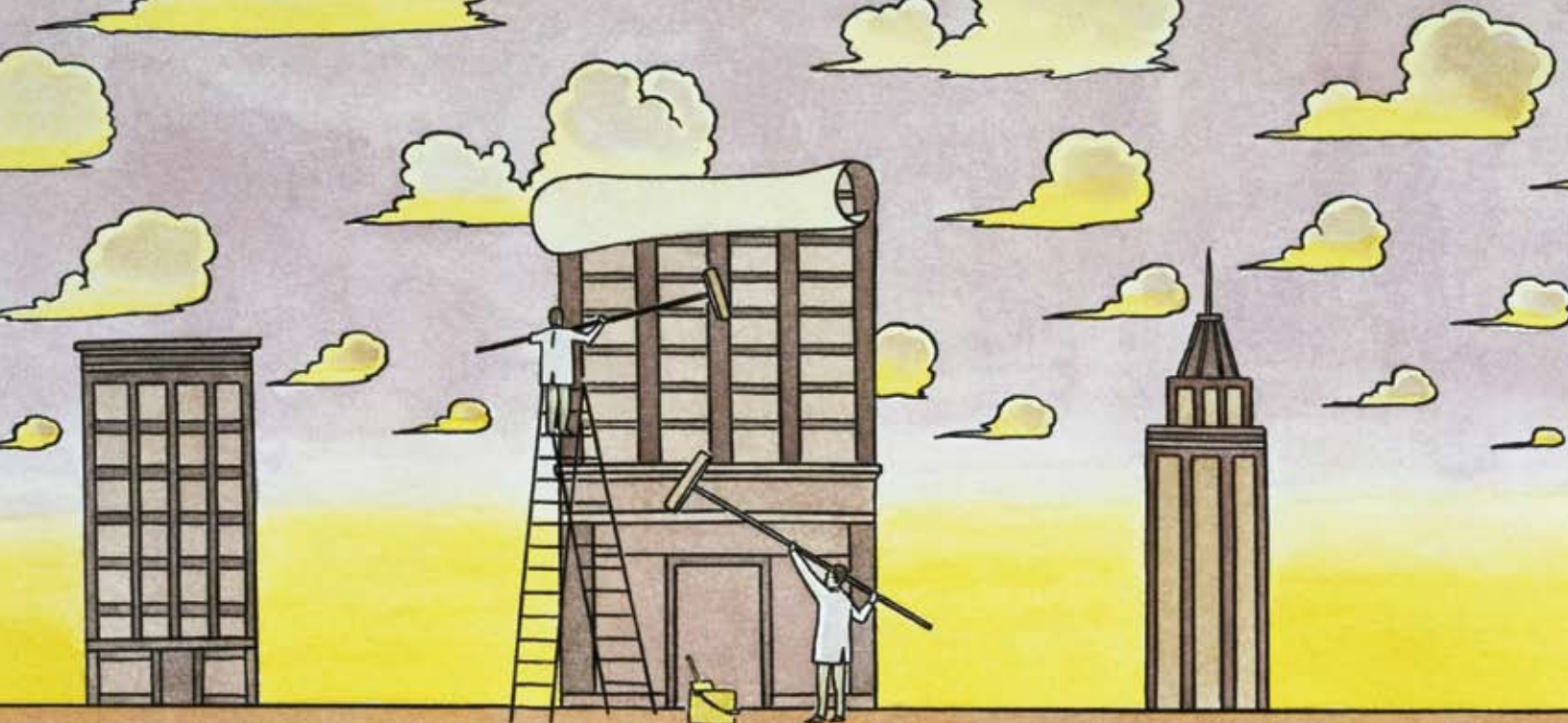
Finance officers can be particularly helpful in watching over the difference between the money that municipalities spend to accommodate new growth and the amount that they get back in the form of property taxes from the developments that they

“Among many things the recessionary period emphasized is the tension caused by economic development within jurisdictions.”

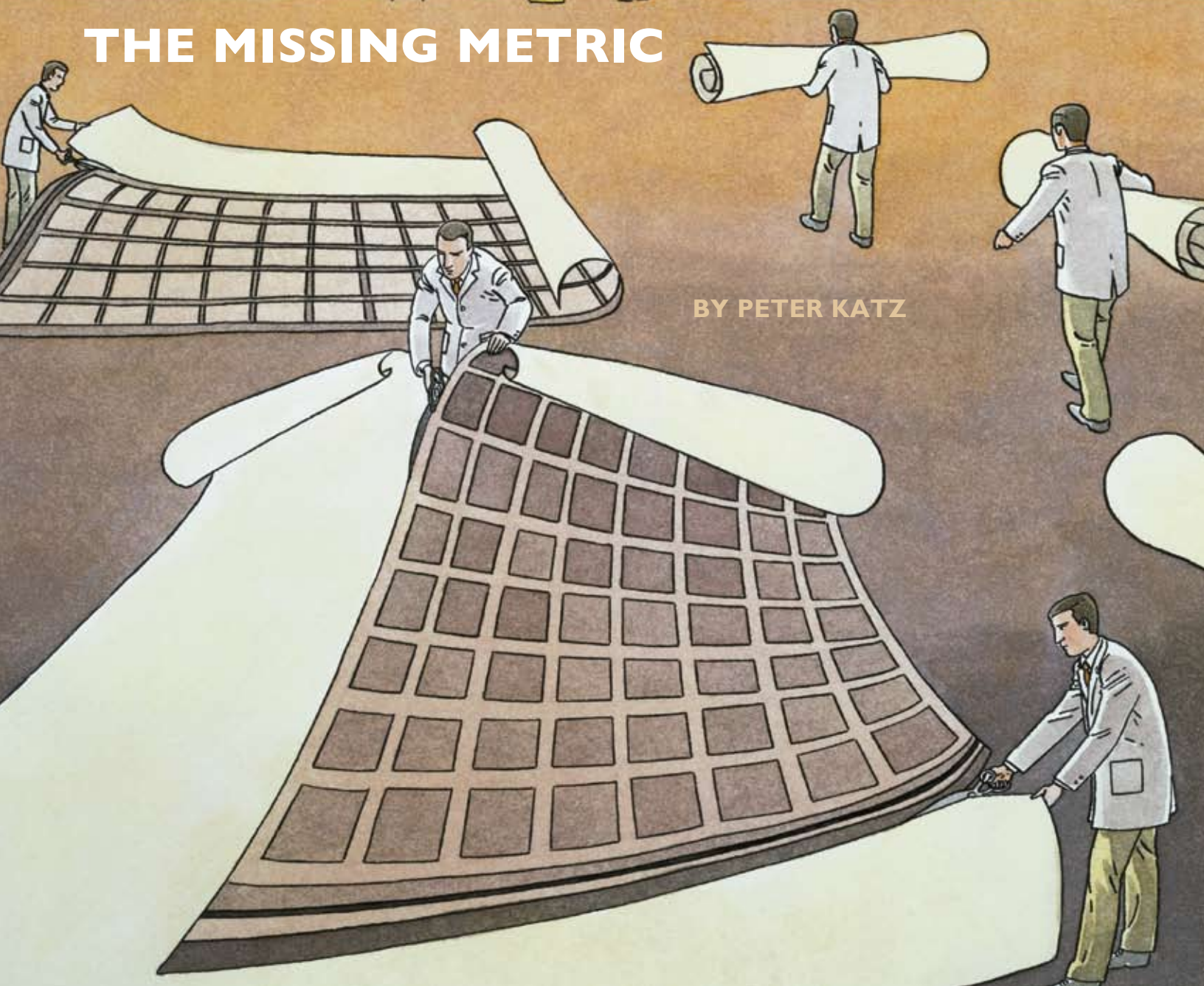
approve. Peter Katz, author of “The Missing Metric,” helped conduct a tax revenue study several years ago in Sarasota, Florida, and a dramatic finding from that study was that one mixed-use downtown building on less than an acre of land was generating more revenue than two of the county’s highest-profile retail centers combined — businesses that occupied 55 acres, altogether.

After analyzing this and many other studies, Katz proposes in his article that local governments could benefit from a scoring system that uses an objectively derived “fiscal-impact quotient” within the development review process to insure that future revenue collections will be sufficient to pay for the initial infrastructure and services that local government provides to support the development.

We have solicited “pro” and “con” opinion pieces about the fiscal-impact quotient concept, and several other articles in this issue of *Government Finance Review* address the idea that development should be structured in a way that pays for itself in terms of local government support. You might agree or disagree with the ideas put forth, but we hope you will find them worth thinking about. ■



THE MISSING METRIC



BY PETER KATZ

Although use-based zoning is widely employed across the United States and Canada to regulate development and manage its impacts, its effectiveness often comes at the expense of the municipality's bottom line. With local governments still reeling from the recent recession, some are looking for ways to systematically evaluate the anticipated fiscal performance of proposed developments when they are considered for approval. Peter Katz shares groundbreaking research on the subject and suggests a new way for municipalities to proactively manage and grow their tax base.

The development review, for a 290-unit office and residential project, took place in spring 2004, at an hour when most of Millville's citizens were already asleep. The name Millville is fictitious, but this story could have taken place in any of a thousand American towns and cities during the boom years of the early 2000s.

The council chambers were packed with citizens, most of whom were there to oppose the proposed development, citing too much density and traffic congestion. They were worried that the project would strain the town's overburdened road system. Another smaller group of citizens had come to support the application. That contingent included members of a regional smart growth coalition, whose comments were focused mostly on the jobs that the new development would bring, along with affordable housing.

An affluent community, Millville once looked like any of a number of fairly ordinary small towns in the region; but while the quiet, tree-lined streets of those other places gave way to urban decay and sprawling strip malls, Millville's small-town fabric had somehow remained intact. One unfortunate result of its appeal, however, was a lack of affordable places to live. Few of those who grew up in the town had the means to stay and raise their families.

In their three-minute testimonies, project supporters pushed back at the opponents of the development, touching on a wide range of fairly technical subjects. They explained how the project's "internal trip capture" might actually reduce vehicle traffic, or at worst, keep it stable, even as the town added thousands of square feet of residential, retail, and office space. Although project backers had hired a respected national consultant to research the data, few of the naysayers believed the traffic counts he presented. City staff said they would need more time to evaluate the numbers.

In the end, the review board turned down the mixed-use development, deeming it "just too dense" for that part of

Millville. The project was only a few blocks from several of the town's most established single-family neighborhoods. Observers saw the decision as a classic tradeoff between Millville's cherished quality of life and the perceived impacts of development.

Reviewing the video of the proceedings the following day, the town's chief financial officer, who rarely attended such sessions in person, noted to her staff that there was little, if any, discussion about the revenue that the development would have generated over its projected life. With a significant decline in the town's commercial real estate revenues, she knew that property taxes paid by the proposed development would be critical to maintaining current service levels in any number of key areas — roads, parks, sewer service, and libraries.

But there was another issue at stake, related to the town's self image. A discussion about revenue as a primary goal of development might have seemed too mercenary to some of the town's citizens. After all, Millville was an upscale community that prided itself on setting a high bar for development quality. Less affluent surrounding municipalities were known to let the quest for additional revenue — particularly sales tax revenue — drive their decision to permit high-impact commercial and industrial uses such as big-box shopping centers. Such projects were usually sited near municipal borders, where they could attract outside customers but offload transportation-related impacts and costs to neighboring jurisdictions, one of which, of course, was Millville. This practice irked Millville's civic leaders, but without a functioning regional planning framework or another forum for resolving intergovernmental disputes, there was little the town could do to address the problem.

Revenue-related issues had come up previously, such as when the review board was considering multi-family developments with units of more than two bedrooms. Reviewers

Making Density Attractive



A street of low-rise mixed-use buildings in Naples, Florida. Significant residential density can be packaged in a form that is compelling to a wide range of citizens. Compact, walkable districts could be widely replicable, even in locations that today seem suburban in character.

feared that such projects would bring a flood of schoolchildren to Millville’s highly rated public school system. The rejected project tried to steer clear of that challenge by limiting its offerings to smaller units aimed at singles and retirees. But that tactic, suggested by the applicant’s attorney, did little to assuage community fears about the development’s size and intensity. Even though the demographic makeup of the surrounding region had become much more diverse in recent years, Millville still saw itself as a “single family kind of place.”

LESSONS FROM MILLVILLE

During the years leading up to the early 2000s real-estate boom, both strategies — siting big-box retail near the edges of town to push infrastructure costs to neighboring municipalities, and biasing the housing mix to discourage families with children — were widely practiced as part of an approach known as *fiscal zoning*. Today, these strategies are seen as problematic because they foster unbalanced settlement patterns. But while the practice of fiscal zoning may be discredited, the problem it was meant to address remains very much with us.

The problem stems from a fundamental characteristic of use-based zoning that’s hard wired into the system, not just in Millville but also in the 80,000 other municipalities across the

nation that employ the approach. With so much of zoning’s focus on managing the impacts of surrounding development, and the main strategy for dealing with such conflicts during the approval process to be simply lowering development density/intensity to more “acceptable” levels, it’s not surprising that the overall economic return in the form of property taxes paid by new development to local governments has suffered.

During the boom years, it was easy to ignore this fundamental characteristic of zoning. But in the lean times that have followed, such issues are increasingly important to municipalities. There is certainly much discussion today about the causes of such problems — “legacy costs” (a euphemism for pension fund liabilities) and a range of so-called “financial causes” are among the culprits most often mentioned by journalists who write on the subject. At the same time, the nearly ubiquitous pattern of low-density suburban development, and the regulatory practices that enable it, are not considered. Until we recognize the significant burden that such practices impose on us, and make changes accordingly, municipalities will continue to struggle to achieve financial stability.

Revenue return from property taxes is the missing metric for communities that want to grow in a way that is healthy, balanced, and economically sustainable. To restore balance

to a system that is now strongly biased in favor of infrastructure intensive low-density sprawl that does not pay its way over the long-term, communities like Millville need to evaluate fiscal performance along with the other factors that they consider when determining the suitability of a proposed development for approval. At the same time, such an evaluation needs to take place within an objective and consistent scoring system. That system, in turn, must mesh effectively with the larger framework of planning and development regulations¹ in use within the community.

CONTEXT: SARASOTA COUNTY IN 2008

Sarasota County, like many other Florida counties, saw a wave of suburban development in the boom years from 1995 to 2007. In those years more than 31,000 acres of land within the county and its incorporated municipalities came under development. As with many other local governments during that period, there was a focus on absolute dollars flowing into the county from large-scale, single-use developments at the suburban edge. But with money coming in from a variety of sources — property taxes, sales taxes, permit fees, impact fees — it was difficult for administrators to determine the contribution of any one development, and to calculate whether revenues received were actually covering the costs local government incurred to accommodate a specific development.

During that period, the county participated in an ambitious program, sponsored by Florida’s Department of Community Affairs — a study that was intended to help localities better understand the fiscal impacts of future development. Indeed, most local governments had few tools for understanding the long-term obligations they were taking on when constructing elaborate infrastructure for the low-density suburban development that was consistent with approved comprehensive plans. Unfortunately, according to the former county administrator, the models used in the DCA study were too coarse to enable an accurate comparison of alternatives.

Responding to state growth management policies and seeking to discourage future sprawl, county officials enacted an urban services boundary in 1997. Its purpose was to channel future growth into areas where the Sarasota County was planning to provide urban services and infrastructure. A citizen-led initiative in 2008 strengthened the growth boundary, requiring a unanimous vote of the county commission to enlarge the land area within it.

Although the boundary constrained the county’s supply of developable land, the three home-rule cities in the county — Venice, North Port, and Sarasota — were able to annex unincorporated county lands inside the urban services boundary. Given such limits, Sarasota County was concerned that future property tax revenues could be squeezed. The county’s financial situation had already taken a major hit in the post-boom economy.

The shortfall resulted mostly from lower property assessments tied to falling real estate prices, coupled with and exacerbated by a slowdown of population growth. A further impact on local revenue collections was the loss of fee income due to a downturn in new construction: Residential permitting activity in Sarasota County went from a high of more than 2,300 newly platted lots in 2005 to fewer than 90 in 2009. Commercial development followed a similar pattern: There were more than 110 projects in 2005 and fewer than 60 in 2009.

With such threats to its future income stream, county staffers started to rethink their approach to community building. When researching new approaches for a comprehensive plan update, they found a unique tax revenue analysis of the Asheville, North Carolina, area.² That analysis included a “revenue profile” that compared property taxes generated by a range of building types in locations around the city.

What made that analysis different from more conventional studies was that the figures were calculated on a *per acre* basis rather than the more typical *per lot*, *per unit*, or *per household* basis. The analysis clearly showed a much greater return from some types of development — mostly close-in, mixed-use properties, both old and new — over more conventional, single-use suburban offerings. Seeing Asheville’s dramatic results, Sarasota County staff requested a similar profile for the Sarasota region. (See “Thinking Differently about Development” in this issue of *Government Finance Review*.)

The data highlighted in the profile is straightforward: It’s the amount of county property tax paid by the owners of each of the profiled properties (information that is readily obtainable from the local tax assessor). The taxes are then divided into the land area occupied by each property to obtain a *tax per acre figure*. The complete revenue profile thus provides an apples-to-apples comparison of the property tax yield for each development that is evaluated.

While the revenue analysis may be straightforward, the cost analysis is more complicated, primarily because municipal services are generally provided and charged for in ways that differ greatly from place to place. Until recently, little research has been available to provide a national perspective on such costs. In June 2013, Smart Growth America released a study, *Building Better Budgets*,³ that showed significantly better fiscal performance for compact (what some call “smart growth”) infill development in existing urban areas versus conventional low-density suburban development, and it saw consistent results in several locations around the nation. (See an excerpt, “Examining the Benefits of Smart Growth,” in this issue of *Government Finance Review*.) Among its findings, the study showed that “smart growth development saves an average of 38 percent on upfront costs for new construction of roads, sewers, water lines and other infrastructure.” It referenced other studies that found the number to be as high as 50 percent. In addition, the *Building Better Budgets* report showed that “smart growth development saves municipalities an average of 10 percent on police, ambulance, and fire service costs.” The study also looked at revenue data. Consistent with the Sarasota findings that follow, the study showed that “on an average per-acre basis, smart growth development produces 10 times more tax revenue than conventional suburban development.”

THE COUNTY'S REVENUE PROFILE

The top three bars of Sarasota's 2008 revenue profile, shown in Exhibit 1, looked at average prices for residential properties obtained from the local board of realtors. The exhibit shows that owners of single-family homes in the unincorporated county pay almost \$3,700 per acre, per year, in property taxes. Multifamily developments such as apartments or condominiums are typically assessed at more than double that amount, yielding about \$7,800 in property taxes, on a per acre basis. Within Sarasota, owners of single-family homes pay an average of \$8,211 per acre in county taxes alone.

Looking at commercial development (the red bars in the exhibit), one sees that the county's new 21-acre big-box discount shopping center annually pays only \$163 more in property taxes per year, on a per-acre basis, than the average single-family home in the city of Sarasota. The big-box center's tax bill of \$8,374 per acre seems low, especially given the controversy that such projects generate when they come before reviewing bodies. The store within the center spins off sales tax, of course, but not as much as might be expected. (Sales tax is discussed in a later section).

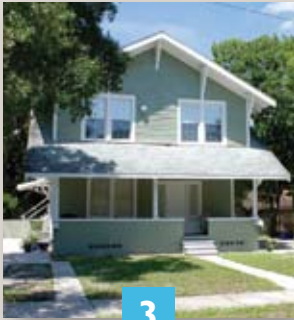
Southgate, an established shopping mall anchored by three nationally prominent department stores, suggests a different story. The 32-acre property, which is located within the city of Sarasota, brings in more than two and one-half times the property tax revenue of the big box center, or \$21,752 per acre. The difference can be attributed to a more central location, a better standard of construction, and the higher merchandise price point set by the upscale tenants. (The latter factor presumably translates into higher rents per square foot, and thus higher property valuations.) A first-tier regional shopping center like Southgate may be the best revenue generator many counties can ever hope to attain, which is why local governments try so hard to woo prestigious national merchants. But it's an achievable goal only if the locality has the demographic makeup to attract such merchants.

MIXED USE: CHANGING THE GAME

Mixed use properties (shown in the green bars at the bottom of the profile in Exhibit 1) perform dramatically better than even the strongest mall in the county when it comes to generating property tax revenue. Take the following examples, all located at or near one intersection in downtown Sarasota, just a few blocks in from the waterfront:

- 33 South Palm Avenue, a two-story building dating from the 1920s, was originally part of a larger hotel complex. Its first floor is a retail store, and the second floor is zoned for offices. The structure generates more than \$90,000 in county property taxes per year, calculated on a per-acre basis.
- The 10-story Orange Blossom Tower was built in 1926 as the American National Bank Building. In the 1930s, it was converted to a hotel and later became a retirement residence. Today, the structure houses condominiums, second-floor offices, and ground-floor retail. It brings in nearly \$800,000 in county property taxes per acre.
- At 17 stories, 1350 Main Street generates more taxes than any other building in the profile. Its arcaded ground floor houses a bank and other retail units, and condominiums occupy the upper floors. Although some units have water views, the building's principal attraction is the vibrant nearby street life that emerged after streetscape improvements were made by the city in the early 1990s. The building generated nearly \$1.01 million in combined city and county taxes in 2008. Extrapolating this earning power to

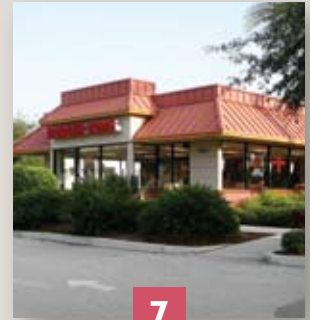
Exhibit I: Annual Tax Yield per Acre in Sarasota County



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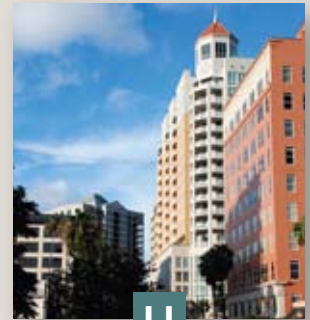
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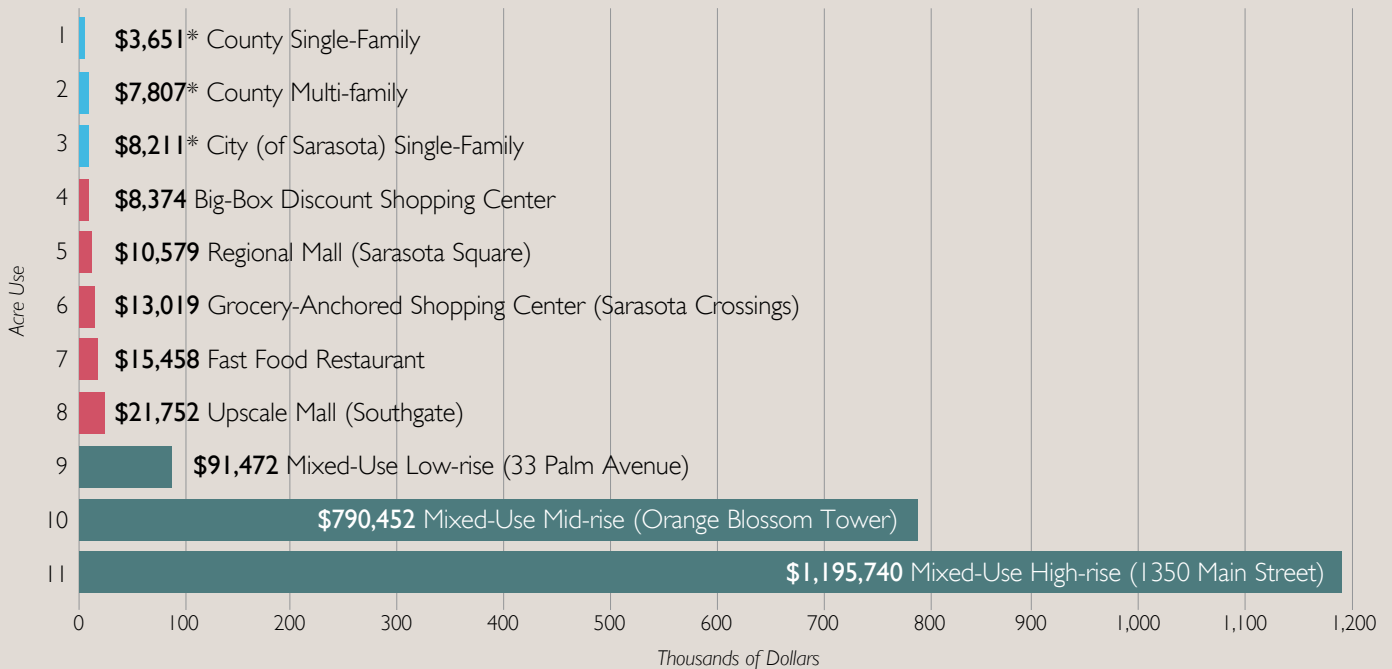
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10



11



■ Residential ■ Single-Use Commercial ■ Urban Mixed-Use

New Urban News; Sources: Sarasota County Government, Office of Financial Planning; Joe Minicozzi, Public Interest Projects. Based on 2008 tax figures.

*Based on average sales price per Sarasota County Board of Realtors, 2008 data.

a full acre site, the same kind of building would generate \$1.2 million in county taxes alone.

OBSERVATIONS FROM THE PROFILE

The most obvious lesson from Sarasota's revenue profile is that mixed-use developments in urbanized areas generate property tax revenue at a much higher rate than do single-use developments in more suburban locations. Specific comparisons are worth noting: On a per-acre basis, the strongest earner in the profile, 1350 Main Street, brings in 142 times more revenue than the newly constructed big-box retail center. It would take both that development and Southgate, the established shopping mall, together occupying 55 acres, to match the property tax contribution of 1350 Main, which sits on just over two-thirds of an acre.

At this point, the obvious question to ask is: What about sales taxes? It's true that a large, high-volume retailer *can* make a significant financial contribution to a town or city. That's why municipalities expend so much effort to lure a productive retailer across local boundaries. But at the regional scale, this becomes a zero sum game. Sarasota County's total retail sales from 2008, the year highlighted in the revenue profile, brought in \$61 million in sales taxes; barring a huge influx of wealthy residents who decide to make most or all of their purchases locally, that number is unlikely to change.

If enhancing revenue is the goal, municipalities are far better off with compact development that generates higher property taxes. A grouping of 60 buildings like 1350 Main Street (a gridded cluster measuring six rows wide by 10 rows deep) would bring in as much revenue as all of the sales tax collected in the county (per 2008 figures).

A quick calculation suggests that such a cluster could easily fit in an area of about 100 acres, including the land needed for streets, alleys, and a small public square or two (see Exhibit 2). By comparison, Sarasota's existing downtown is about 700 acres. True, a large volume of new construction in a confined area is unlikely to happen in Sarasota County, or even the City of Sarasota. Nor is anyone recommending it. But the notion provides a useful point of comparison between two important revenue sources — sales tax and property tax — that are available to local government.

With a new generation of smart growth development showing that greater density can be packaged in a physical form that is compelling to a wide range of citizens, and the fiscal

Exhibit 2: Marking Out 100 Acres of Downtown Sarasota



information that can be gleaned from a community's revenue profile, a strong argument can be made for infill development as a cost-effective approach to community building. With enough citizen buy in, compact, walkable "smart growth districts" could be widely replicable, even in a suburban county such as Sarasota. Enabling them would be a more viable strategy for increasing the county's revenue base than trying to squeeze more sales tax dollars from existing local residents, many of whom are older and living on fixed incomes.

Such compact development also would mean a more rapid payback of public investment. Comparing the return from a two- and three-story garden apartment complex near Interstate 75 (357 housing units on 30 acres) with 1350 Main Street and two other adjacent downtown buildings (a total of 197 units on 1.9 acres), and using standardized infrastructure costs from a study commissioned by Florida's Department of Community Affairs, one sees that residential units in the suburban development will take 42 years to pay back the county's capital infrastructure outlay, versus three years for units in the downtown building. (Revenue from the commercial portions of the downtown properties was excluded for an apples-to-apples comparison.) This comparison does not account for interest on what is, in effect, a long-term loan from government to a private-sector developer. (See Exhibit 3.)

The payback is more rapid, of course, because taller, more compact buildings make more efficient use of a limited footprint and typically require less of the horizontal infrastructure

(roads, water, and sewer lines) that local government pays for. To achieve their high value, however, developers must provide more of the vertical infrastructure (elevators, stair towers, conduit, and structural steel). The more that government can induce private-sector players to spend on a given parcel of land, the more it stands to gain long term, once the development is complete and the higher property taxes begin to flow in.

More and more, as municipalities evaluate competing development proposals on the basis of revenue return and meeting goals in multiple realms — quality of life, quality of place, and economic sustainability — the revenue profile is likely to become an increasingly useful tool for making development choices that are also fiscally sustainable. This is not to suggest, however, that future development in a community should switch to the most intense forms of mixed-use development at the bottom of the profile in a quest for greater revenue. Clearly, a city or town isn't likely to be made up only of such high-yielding buildings, nor would its citizens want it to be. Indeed, most citizens in suburban areas, even when they are aware of the tax consequences, still oppose density if they feel that it threatens the ambiance and perceived value of their own dwellings.

This said, it's important to note that one of the least intense of the mixed-use buildings shown in the profile, the two-story building at 33 Palm Avenue (image 9 in Exhibit 1), still outperforms the county's strongest retail center (image 8) by a factor of more than 4:1, and it outperforms the newly constructed big-box retail center (image 4) by a factor of more than 11:1. Such findings suggest that neighborhoods incorporating a *variety* of development intensities, from towers to mid- and low-rise buildings, can be expected to generate strong revenue streams and at the same time deliver a wide range of benefits including greater walkability and lower parking demand. Lower-rise neighborhoods that feature a few three- to four-story mixed-use buildings at their centers, surrounded by a blend of one- and two-story multi-family buildings scattered among one- and two-story detached dwellings, should, with careful planning, provide a net positive contribution to the municipal balance sheet.

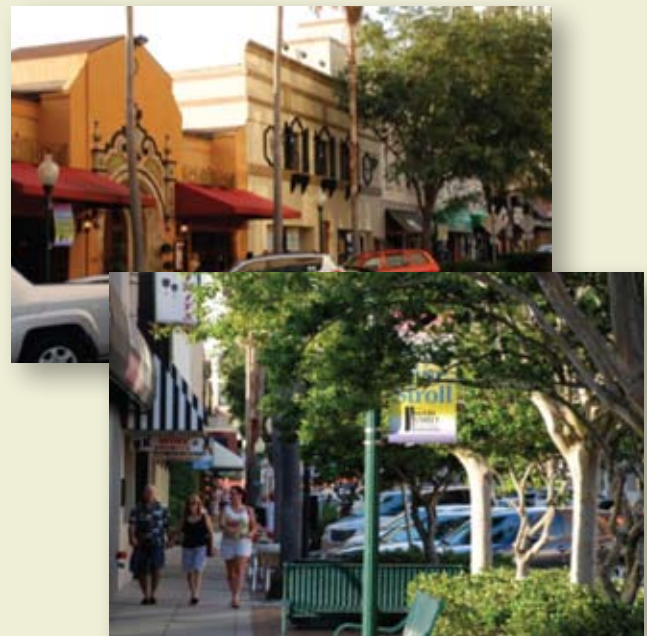
In the end, a generational shift in the marketplace will likely determine the physical composition of future neighborhoods. Driven by aging baby boomers seeking more urban lifestyles and their children, the Millennials, who also favor walkable but perhaps edgier urban locations, market demand will

be stronger in downtowns and close-in locations for some time. Matters of building density and intensity will, of course, remain a concern for urban dwellers, who are concerned with light, fresh air, views, and impacts related to human activity. But as issues related to revenue generation are increasingly linked to matters of building form and scale, communities should strive to hold more complete conversations about the tradeoffs associated with growth.

TOWARD MORE CONSISTENT EVALUATION

The Sarasota revenue profile reveals dramatic property tax disparities within a municipality, and in so doing makes a powerful case for more compact development and for limiting the spread of municipally funded infrastructure. (See

Walkability Matters



Sarasota's pedestrian-friendly downtown streets are a major reason why downtown condominiums, even those without water views, are able to sell for high prices, thus generating enormous tax revenue for both county and city. The quality and variety of local businesses adds value in two ways: Successful tenants generate strong rental income for property owners who, in turn, contribute to municipal coffers in the form of the taxes that they pay. The attractiveness and amenability of such businesses also adds to the market value of nearby residences.

Exhibit 3: Payoff for Downtown versus Suburban Units



1



2



3



4

Property tax revenues on three downtown buildings (images 1-3, above), which occupy 1.9 acres, include a total of 197 units, and have a combined taxable value of \$193 million, pay off Sarasota County's upfront infrastructure costs in just three years. By contrast, a suburban garden apartment complex (image 4) consisting of 357 units that occupy 31 acres and are valued at \$19 million, takes an estimated 42 years to repay the county's initial infrastructure costs. This repayment does not include interest on what is, in effect, a long-term loan. The diagram at the right shows the sites for both. (See Exhibit 2 on page 46 for more information.)



“Thinking Differently about Development,” in this issue of *Government Finance Review*, for more on property tax disparities.) But helpful as the revenue profile is in gaining an overall sense of the earning potential of development types across a municipality, it may be even more useful to create a regulatory “screen” for use in evaluating competing development options for a specific parcel.

Sophisticated new modeling tools enabling these sorts of comparisons have recently been created, and others are under development. Most of the first generation of regional fiscal impact models were developed by intergovernmental agencies such as the Ohio, Kentucky, Indiana Regional Council, the Sacramento Area Council of Governments, and the Capital Region Transportation Planning Agency. As regional planning agencies, such groups share the goal of making better use of increasingly scarce state and federal infrastructure dollars. Two other models offered by private consulting firms were derived, in part, from an early fiscal impact model created by Metro, the elected regional government of Portland, for use in its groundbreaking 2040 Growth Plan.

Some of these models have taken on significant technical challenges: OKI’s Fiscal Impact Analysis Model accounts for the tax rates and service provision policies of three states. One SACOG model, known as the Rural-Urban Connections Strategy, is focused on decisions smaller rural communities face when making a transition from agriculture to urban land uses. In so doing, the RUCS model addresses a broad range of factors including crop prices and federal farm support policies.

FROM ANALYSIS TO REGULATION

How might municipalities go beyond fiscal evaluation to adopt policies and regulations that foster more economically robust communities and regions? And how might such an approach advance a community’s economic development goals by streamlining approvals, rather than adding a further layer of regulation?

Local governments could evaluate projects based on the number of years they take to pay back public infrastructure investment.⁴ As stated previously, the money that local governments spend on roads, water service, sewer, and other infrastructure elements are, in effect, a long-term loan from the taxpayers to the backers of a project to enable it to be built. Such funds are routinely provided with the expectation that the revenue generated by the newly constructed development will, over the long term, more than compensate for government's initial costs.

Common sense, and further review of Exhibit 1, reminds us that while revenue flowing back to local government is variable, it is ultimately linked to the value of a property, which in turn is based on factors such as the value of the land, value of the building, and market demand. The property tax rate is generally derived from the property value multiplied by the municipality's millage rate for that area or type of property. Costs borne by the municipality as a result of the new development also vary, depending on a much greater range of factors, including one-time costs for infrastructure, costs for ongoing services that aren't covered by user fees, and the future replacement cost of infrastructure that wears out or needs to be updated. Although complex, such factors now can be estimated with a reasonable degree of accuracy.

By looking at anticipated property-tax revenues generated by a variety of building types/land uses on a per-acre basis (such as those in the Sarasota study) in a range of locations (closer in and more distant from urban centers), staff can predict the fiscal performance of a proposed development almost anywhere in the region. In theory, such an analytical approach will enable staff to manage the municipality's tax base toward tangible goals, established by policymakers as part of a larger strategic planning process.

DEFINING THE MISSING METRIC

If such a methodology were to become routine, credible, and ubiquitous across jurisdictional boundaries, local government would possess a new and powerful metric for assessing the fiscal suitability of a range of development options at the parcel level. The "missing metric," specifically defined, is the number of years it takes for property taxes to pay back the municipality's up-front investment to accommodate a new development. The figure is derived by estimating the costs for municipally provided infrastructure (capital costs only) for the given property/land use proposal and comparing that

figure to the expected annual property tax. The shorthand term for this new metric would be "fiscal impact quotient."

The basic structure of the analysis tool follows a balance sheet approach, looking at government's investment on one side with anticipated return on that investment on the other. The revenue side of the balance sheet is straightforward, modeling future property tax revenues on the basis of the value of the future development.⁵ The value of the development would be derived by an appraiser, using plans and market studies in the same way that lenders now evaluate a yet-to-be constructed development.

The cost side of the balance sheet will be far more complex, taking into account the municipality's initial expenditure for infrastructure that's needed to accommodate a particular development based on location, servicing needs, proposed land uses, building type, and access requirements. A more nuanced variation of this concept would assign different values for locations that have some existing infrastructure, causing them to score better than places requiring significant new infrastructure. (For example: is the proposed development on an existing street, or will the municipality need to provide a new street or additional capacity for the development to take place?) GIS data of the kind kept by many municipalities could provide information on existing conditions in a form that could be easily integrated into the fiscal impact quotient scoring process.

Regardless of approach, the likely starting point for thinking about fiscal impact quotient calculations would be the way impact fees are currently computed by local governments and consultants. That said, impact fees are problematic in ways that are well known. First, they generally cover only initial capital costs of infrastructure and not the full lifecycle costs. Second, the collection of impact fees is highly inconsistent across the United States. Such fees are specifically enabled in a majority of the states, but not all. In the states that do collect such fees, their uses may be limited. For example, in Arkansas, impact fees can be used to pay for roads, water, sewer and storm water facilities, parks, fire and police facilities, and libraries, but the funds can't be used for solid waste processing facilities or schools. In Illinois, such funds can only be used for roads.

Although it's tempting to address one significant flaw of impact fees by factoring full lifecycle costs (rolled forward through a net present value calculation) into the fiscal impact quotient, such an approach would actually be "double charg-

ing.” Presumably such future expenditures, which are normally experienced over decades and even centuries, will be covered by the hopefully more-than-adequate property taxes paid over the life of a property (screened as it was using the fiscal impact quotient when first approved).⁶ At the same time, initial costs don’t always correlate to full lifecycle costs or the costs of servicing a property over time, so it might make sense to include some fractional factor to represent these costs in order to get a more accurate investment/return score.

If local governments want to attain the more sensitive levels of cost analysis described in the prior paragraph, they may want to look to Canadian municipalities for guidance.

Provinces in Canada enable municipalities to levy development charges⁷ to cover specific costs of growth in a community; this includes not just initial capital costs but lifecycle costs as well. (See Exhibit 4.) Such fees, paid by developers and builders, are specified in a table of charges that vary based on total building size and characteristics, and the location of the building within the municipality. The municipal bylaws that determine fee amounts are required to be updated on a regular basis through a public review process.

The latter point is important: by its nature, fiscal analysis is complicated, highly specific to location, and subjective, based on a wide range of factors. With inconsistent bound-

Exhibit 4: Development Charges in Canada

In Canada, costs related to new growth are paid in the form of development charges, which are clearly specified in development bylaws. Although the practice is enabled at the provincial level, each municipality is free to set its own charges based on local budgets. The upper grouping lists a menu of charges for unit types in a range of locations. The lower grouping breaks out the way the charges are applied to anticipated expenditure categories.



Area	Single, Detached and Semi-detached Dwelling	Apartment Dwelling (2+ Bedrooms)	Apartment Dwelling (<2 Bedrooms)	Multiple Row and Mobile Dwelling	Non-residential General Use	Commercial Institutional Industrial Office Use	Limited Industrial
	Per Unit				Per Square Foot		
1. Inside Greenbelt	\$15,207	\$7,897	\$6,086	\$10,798	\$15.17	\$12.29	\$6.98
2. Outside Greenbelt	23,376	13,970	9,309	17,828	15.17	12.29	6.98
3. Rural - Serviced	13,616	7,418	5,833	10,736	15.17	12.29	6.98
4. Rural - Unserviced	11,438	7,194	4,901	9,021	12.75	10.33	5.86

Category	Total	Roads and Related Services	Sanitary (Waste Water)	Water	Stormwater Drainage	Police
		Per Square Foot GFA				
Non-residential						
Rural - Serviced	\$15.17	\$7.60	\$1.55	\$0.34	\$0.04	\$0.26
Rural - Unserviced	12.75	7.11	0	0	0	0.26
Non-residential Commercial						
Rural - Serviced	\$12.29	\$6.16	\$1.26	\$0.28	\$0.03	\$0.21
Rural - Unserviced	10.33	5.77	0	0	0	0.21
Non-residential Industrial						
Rural - Serviced	\$6.98	\$3.50	\$1.55	\$0.34	\$0.02	\$0.12
Rural - Unserviced	5.98	3.28	0	0	0	0

aries between public service districts and municipalities, it is often difficult to perform “clean” calculations across an entire municipality that will reflect every nuance affecting the pricing of initial costs, lifecycle costs, or the ongoing delivery of services. Recognizing the difficulty of creating a perfect system for fiscal evaluation, the next best thing would be a system derived through a highly participatory process, like the approach taken in Canada, where key stakeholders are involved in the process and thus feel some ownership of the outcome.

OBJECTIVE SCORING VERSUS FISCAL NEUTRALITY

In the past, some U.S. communities, concerned with the negative consequences of developments that didn’t fully pay their way (even with the impact fees that are often charged), have asked developers to submit statements of “fiscal neutrality” to accompany a project application. While the intent behind such a requirement is laudable, the analyses at the heart of such studies are often based on subjective assumptions that can be easily gamed to advance proposals that, once realized, become a financial drain on the community. Further variables in many local governments include the extent to which staff reviews of such studies may be affected by limitations of time and resources, and also political pressure from elected or appointed boards.

In an attempt to depoliticize the approval process as much as possible, the scoring system underlying the fiscal impact quotient should be based on objective criteria than can be independently verified, much like the indexes used to set mortgage rates when they periodically readjust. But like any scoring system that aspires to total objectivity, there will always be glitches that will require adjustment: For instance, high-rise waterfront buildings will score well in terms of fiscal impact quotient, but their towering presence could make it more difficult for nearby properties, particularly those in locations where views are blocked, to achieve scores that would allow them to obtain approval. In the aggregate, such an imbalanced situation could lower a neighborhood’s overall property tax base, so a correction factor would be needed to encourage high-value development of an entire group of parcels, and discourage the “cherry picking” of only the most amenity-rich sites.

Another problem with fiscal neutrality statements, even if it were possible to make them truly objective, is that they’re

typically required only for high-profile projects or plans that are subject to review by elected or appointed bodies. Much development and redevelopment activity in a community results from smaller projects that receive administrative approval because they’re in full compliance with local ordinances. Because they are not otherwise subject to public review, such projects go mostly unnoticed by citizens until they are built. But on a cumulative basis, such routine approvals do fiscal harm to our communities, both because of their sheer numbers and because they exist within a framework of use-based zoning rules that, while hyper-focused on limiting density and impacts, have little or no oversight when it comes to fiscal impacts.

A regulatory screen such as the one proposed in this article could deal effectively with such projects because it’s designed to work at the parcel scale as a routine evaluation that’s independent of other zoning criteria. This said, the use of a fiscal screen within a community’s larger regulatory structure could enable the municipality to relax or even eliminate other, more subjective rules, with the goal of fostering better places with less overall regulation. One further advantage of the fiscal impact quotient approach is its specificity to the local development context. Like the Canadian example above, the metric would be tuned to the specific cost and revenue structure of the municipality as well as specific locational criteria related to the site where the project will be built.

THE FISCAL IMPACT QUOTIENT IN PRACTICE

Despite the higher level of precision that the missing metric promises in managing the community’s tax base, it also raises significant questions about how the fiscal impact quotient would be used in relation to other criteria now employed in development review. For example, would the metric be a *gating factor*, with projects being required to score well before being allowed to proceed to further stages of review? Or would it be used only as a *contributing factor* in the final approval decision, considered along with more subjective criteria such as compatibility with surrounding land uses, anticipated impacts on quality of life, or economic development issues (e.g., the degree to which the proposed development is expected to generate private-sector jobs)? Local governments would need to consider these policy issues.

Another important question concerns the number of years a community sets as its target. A community that is especially strapped for revenue might require five years for full return

of its investment, while jurisdictions that are less challenged might go with 10 or 20 years. In theory, less well-to-do communities needing a quicker payback would insist on a more rapid return, gaining a more robust tax base in the bargain. Such a response would be a welcome change from what sometimes happens in less affluent municipalities that become so hungry for investment that they're willing to overlook obvious red flags related to low projected revenue return, high anticipated future costs to maintain infrastructure, or both.

CONCLUSIONS

The recent economic downturn has led to a greater awareness that local governments need to do more with less. Fortunately, analytical tools such as the revenue profile and new fiscal impact modeling tools can help municipalities better understand what forms of development will enable them to address long-term fiscal challenges. The fiscal impact quotient scoring system takes the concept a step further by incorporating objective fiscal analysis into day-to-day approvals which, in the aggregate, shape the financial future of a community.

With this new knowledge, and a way to link such knowledge to policy and routine development review processes, local government may finally be able to achieve a triple win among three key players:

- Citizens enjoying more vibrant places combining a greater diversity of uses and activities in proximity.
- Developers seeking greater return from a given land asset.
- Municipalities "growing" their tax base with more compact, resource-efficient settlements that return revenue at a far greater rate than the costs they generate.

The approach suggested here is not intended to replace the normal spatial planning processes in place in most communities, nor does it supplant the market forces that determine whether a building, once constructed, will be fully occupied or sit vacant. Indeed, a development application proposed under the scenario described here will likely move forward when criteria related to three distinct realms are satisfied — market demand, the core planning process, and the fiscal impact quotient.

Arguments for achieving denser settlement patterns through a community's development regulations touch on many highly subjective issues and personal choices related to quality of life, perceived impacts of urbanization, economic development, and even the social contract that binds citizens to the

common good. This said, few would argue that government should be subsidizing forms of private development that are known to generate public costs far in excess of the tax revenue that they will generate over their useful lives. The missing metric, now found, gives local government a viable tool for understanding and managing its tax base on a parcel-by-parcel basis. Citizens and public officials can use such a tool to achieve the near-term fiscal sustainability needed following the recent recession and the long-term prosperity to support and enhance the future growth of America's communities. ■

Notes

1. Form-based coding, an emerging regulatory approach that focuses primarily on matters of physical form, has been used to implement developments based on the principles of smart growth and new urbanism. Form-based coding has proven highly effective at the neighborhood scale for both new and infill projects. It is potentially compatible with the fiscal screening approach described here. (Note: The author of this article has also written extensively on the topic of form-based coding and currently serves on the board of the Form-Based Codes Institute.)
2. The analysis was prepared by Joe Minicozzi of Public Interest Projects.
3. *Building Better Budgets: A National Examination of the Fiscal Benefits of Smart Growth Development*, Smart Growth America, May 2013.
4. In the worlds of business and finance, this would be referred to simply as *return on investment*. Linking the metric to years of payback recognizes the municipality's unique role in fostering community growth and emergence in multiple realms, versus the simple economics of profit and loss.
5. Distorting factors such as local variations in millage rates based on land use, or state laws such as California's Proposition 13 that cause owners of similarly valued properties to pay different tax rates based on duration of ownership, lead to distortions that may affect the implementation of a fiscal impact scoring system.
6. More central locations with higher land values are often the places where infrastructure repair and replacement needs are the greatest, so higher taxes in such locations meet an important need. Older neighborhoods that have not held their value are more problematic; the larger cycles of abandonment and revitalization that are normal in cities ultimately bring value to such places if they have intrinsic locational value.
7. The Canadian development charges system is *not* a mechanism for assessing fees for site-specific modifications (such as a change to a street configuration needed for to access a building) required by a development; such costs are generally paid for in their entirety by the private-sector developer.

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REACTION

OVERCOMING OPPOSITION TO MORE COMPACT DEVELOPMENT

BY MARK CALABRIA

The argument of “The Missing Metric” is basically “if only the citizens and politicians were better informed.” I suspect, however, that citizens do have a general sense of the tradeoffs across developments. The problem is that the costs and benefits of development are not evenly spread across the community.

the fringes, with relatively greater political obstacles to development in urban areas. While Katz and I may approach the analysis from different points of view, with different assumptions, I suspect that we would both be in substantial agreement in terms of what an efficient pattern of urban development actually looks like.

Katz’s proposed fiscal impact quotient is at heart a mechanism for overcoming political opposition to dense infill development. In a time of squeezed local government budgets, his hope is that by showing localities in which developments will be the biggest net fiscal contributors (and these are usually the densest developments), then approval for these projects will become easier to achieve. The end result is both better fiscal health for local governments and denser development.

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The imaginary story of Millville, as told by Peter Katz, is sadly one that plays out repeatedly in real cities across America: the political opposition to compact development. Where Katz sees the solution, or at least a solution, in the form of better information and metrics, I believe the ultimate obstacle to denser land development is the perverse incentives facing both local government and its citizenry.

Before getting into our differences, it is worthwhile to emphasize my areas of agreement with the article. As an economist, and one who tends to favor the voluntary cooperation of the market over governmental solutions, I believe that America’s urban areas would actually display higher density than we currently see without extensive zoning and land use regulation. Government both pulls development into the fringes, with such subsidies as our federal highway programs, and pushes development into



REACTION

THE NEW FISCAL ROLE IN LAND-USE PLANNING

BY STEPHEN LAWTON

The argument of “The Missing Metric” is that we could stand back from the fray, examine the facts together, argue our values, and be guided in our policy decisions by quantitative estimates of long-term outcomes.

Our nation and its citizens would be much better off if we could squarely face the enormous economic and financial challenges that result from our settlement patterns. Peter Katz’s fiscal impact quotient is a sensible and welcome addition to an honorable tradition, rooted in Progressive ideals. The argument is that we could stand back from the fray, examine the facts together, argue our values, and be guided in our policy decisions by quantitative estimates of long-term outcomes. The abstractions and jargon of the Smart Growth movement would become mere common sense, uncontroversial and routine.

This Progressive strain of rational assessment and decision making actually underlies much of today’s governmental organization, procedure, and legal framework. It is seen everywhere, as legislative bodies make their findings and administrators follow their guidelines. Unacknowledged but widely accepted, rational assessment is arguably our most valuable gover-

nance legacy from a century of experience reaching back to the early days of large industrial organizations. It is a pragmatic, American style of framing a narrative about how to make decisions.

But in the policy and legislative arenas, rational checklists and quantitative assessments are honored mainly in the breach. Policy is the trophy of power, and land-use policy is mostly a recording of the outcomes of battles fought amongst contending interest groups. Smart Growth advocates have recently joined the fray, contending with industrially organized mass homebuilders, agricultural interests, institutional investors, small homeowners, road builders, retailers, environmentalists, and other interest groups. One group’s checklist is another group’s deadly weapon. Government agencies with land-use authority would need to play very strong roles to assert the

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Overcoming Opposition to More Compact Development

The argument is basically “if only the citizens and politicians were better informed.” This leads to Katz’s solution of trying to better inform the development process. I would agree that citizens and politicians do not have perfect, or even accurate, knowledge of the trade-offs across various developments. I suspect, however, that citizens do have a general sense. The problem is that the costs and benefits of development are not evenly spread across the community. Citizens who live next to the proposed development may bear costs that exceed the benefits. Even if specific projects were beneficial to the community, in a fiscal sense, they could impose net harms on a minority, who then have a strong incentive to protest.

Let’s go back to our imaginary town of Millville. As noted in Katz’s tale, most of the citizens *gathered* were opposed to the development. Such an outcome should not be a surprise, as these voters believed the net impact on them would be negative, even if the property in question had a highly positive net fiscal impact. For those citizens who benefit, the expected benefit could easily be outweighed by the costs of participating in the political process. One need only go back to Mancur Olson’s classic *The Logic of Collective Action* to understand the outcomes we often see in the local development process. I would also refer readers to William Fischel’s *The Homevoter Hypothesis*. My point is not that the introduction of the fiscal impact quotient wouldn’t better inform the development process, but that the political incentives currently driving the process would likely continue to swamp whatever positive impact the fiscal impact quotient would have. And just like any tool, the fiscal impact quotient would likely be used to further the objective of those who wield it.

Recognized is the possibility that instead of easing development FIQ just becomes another layer or obstacle to development. While I appreciate that Katz warns against this possibility, this is a concern that demands additional consideration. Allowing government to decide who gets to develop what will always be a political process. I am all for more “objective” measures and the use of “sophisticated

modeling tools” but we should recognize the limits of such, particularly when there are strong incentives to ignore or abuse them. In the absence of changing those incentives, I remain concerned that widespread use of FIQ would result in less overall development, with resulting increases in rents and property prices.

Perhaps my skepticism regarding the fiscal impact quotient is driven by a difference in both perceived goals and assumptions. Katz posits that “if enhancing revenue is the goal, municipalities are far better off with compact development that generates higher property taxes.” If that’s the goal, then it is hard to argue with his analysis. I, however, do not see the goal of development as one of enhancing revenue. This idea assumes that the private sector exists to enable the public. Rather, I would submit the opposite: Collective endeavors exist to help facilitate our privately held objectives. As such, the presumption behind the approval process should be to help individuals put in place the desired use of their property.

The fundamental obstacle to dense development is that we have vested use rights for the property in the community, rather than leaving those rights with the parcel or property owner. If the concern is that property owners would not take into consideration the cost of public services their development would use, then the approach should be to reconsider the concept of public services. In truth, most of the services local governments provide are actually private services. The benefits of trash collection, educational services, and even roads are largely captured by individuals. As such, these services could be conducted like many other goods that are sold on the open market. If citizen A is responsible for the expense of their children’s education, then citizen B is far less likely to object to citizen A moving into their community. Once we recognize that most of what local governments do is to redistribute income, we can overcome opposition to dense development by reducing the role of local government in the redistribution of income. It will always be rational for citizens to oppose having their wealth taken for the benefit of others, even in the face of more objective and professional information.

I applaud Katz’s effort to improve the development process. Local governments should certainly embrace the fiscal impact quotient as an avenue for streamlining the development

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The New Fiscal Role in Land-Use Planning

primacy of fiscal impact quotients in the frameworks for policy setting and individual land-use decisions.

Complicating the picture are the problems of subsidiarity (the principle that matters should be handled by the smallest, lowest, or least centralized authority that is capable of addressing it effectively) and overlapping jurisdiction, illustrated in Katz's Millville tale. Local land-use authority is constrained and impinged on by a wide set of policies set at higher levels. Federal and state agencies set the most important context through the funding and imperatives of the interstate highway system. State constitutions devolve more or less authority to lower-level jurisdictions. State and federal funding drives many local policy decisions. Even within the local level, agencies with land-use authority must deal with school districts, fire districts, environmental protection agencies, and other entities with important overlapping functions. Again, one group's checklist is often irrelevant or threatening to another with overlapping power. Take the State of California, for example — only a strong state-level (or higher) mandate, backed by broad popular consensus, could harmonize the land-use imperatives of some 3,400 special and school districts, 58 counties, 480 cities, and dozens of powerful state regulatory and service agencies.

Sweeping aside such implementation challenges, an effective, simple, easily understood per-acre fiscal impact quotient would be a valuable innovation, at least within the halls of government. Here is an important assignment to be taken up by financial officers. Indeed, the construction of a properly weighted fiscal impact quotient, coordinated across units of government, would be an opportunity to bring the skills and stature of government financial officers to bear on problems intractable to the planners and economic development staff.

It is difficult to generalize solutions that would be particularly effective across the diverse circumstances of the states. A typical observation would have the high-growth, high-population states along the coasts in one group, and lower-growth, more rural states in another group. Florida, Massachusetts, and California, for example, combine complex, restrictive

land-use frameworks with contentious politics that effectively turn most decisions into discretionary acts. To put it bluntly, the stakes are higher. In contrast, as-of-right decisions are found more often in states with lower growth and different legal heritages. It would seem that the simplifying power of fiscal impact quotient decision making might be less in states with simpler circumstances.

But, outside the halls of government, we must acknowledge that construction of a fiscal impact quotient is essentially the act of experts. The Progressives placed much faith in experts but in recent generations, Americans have certainly lost that faith. To see this, one only needs to spend an evening at a planning workshop or contentious public hearing, where the poor soul presenting the carefully reasoned, factual staff report suffers the indignity of being called a fool by the guy at the microphone, or on the dais, who has just read something on a blog.

Frustration with complex land-use decision making — or, more often, a willful lack of understanding — has recently led to a new strain of nihilist reaction against the institutions of land-use planning. Often, the reaction is understandable. In California, for example, the simple, rational, Progressive idea of reporting environmental impacts in advance of decisions was born in 1972 with the California Environmental Quality Act. CEQA, with its environmental impact report, is almost a direct analog to the disclosure of a fiscal impact quotient.

But 40 years of elaboration, litigation, and legislation have placed the CEQA checklist as the most costly, maddening, and confusing station on the road to securing or improving the value of rights in real property. For many people, the battle of experts fostered by the seemingly simple CEQA scorecard is synonymous with land-use planning itself.

Seeing this frustration, agents of some of the interest groups in the land-use arena have recently promoted the idea that planning, with those untrustworthy experts, can be privatized. Many naïve citizens have even been sold the absurd proposition that planning is an international conspiracy.

But public goods do exist. The chief functions of local government are to settle conflicts and provide public goods. There are no substitutes for this role in civil society. Indeed,

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process. Caution must be taken, however, to insure that the fiscal impact quotient does not become yet another obstacle to development. Ultimately, greater clarity in property rights would improve the development process, along with an increased reliance on the market provision of local services. |

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The New Fiscal Role in Land-Use Planning

these local functions are the strong, pragmatic fibers that have defined and enabled American civil society.

Real estate markets require coordination and mediation. Participants in real estate markets have established and elaborated an essential role for government, especially local government. Modern real estate markets could not function without this role, which should be played as simply as possible, but no simpler than necessary.

However, the postwar financial model for local government has collapsed. Constant growth and expansion is no longer possible. Conflicts over shrinking resources will intensify. Relentless horizontal growth, the norm since World War II, has stopped and will be replaced with a new urbanism. A new model of comprehensive Smart Growth is urgently required.

Smart Growth advocates have a powerful case that development patterns producing sound fiscal outcomes are in almost everybody's interest, and will improve economic outcomes. Government financial officers should step boldly into new roles as honest forecasters and direction finders. Risks are low that financial officers will be seen as taking sides.

Long the quiet enabler of private real estate activity, government must now be the guardian of a more sophisticated, intricate symphony of human settlement and economic activity. Fiscal impact checklists point the way. |

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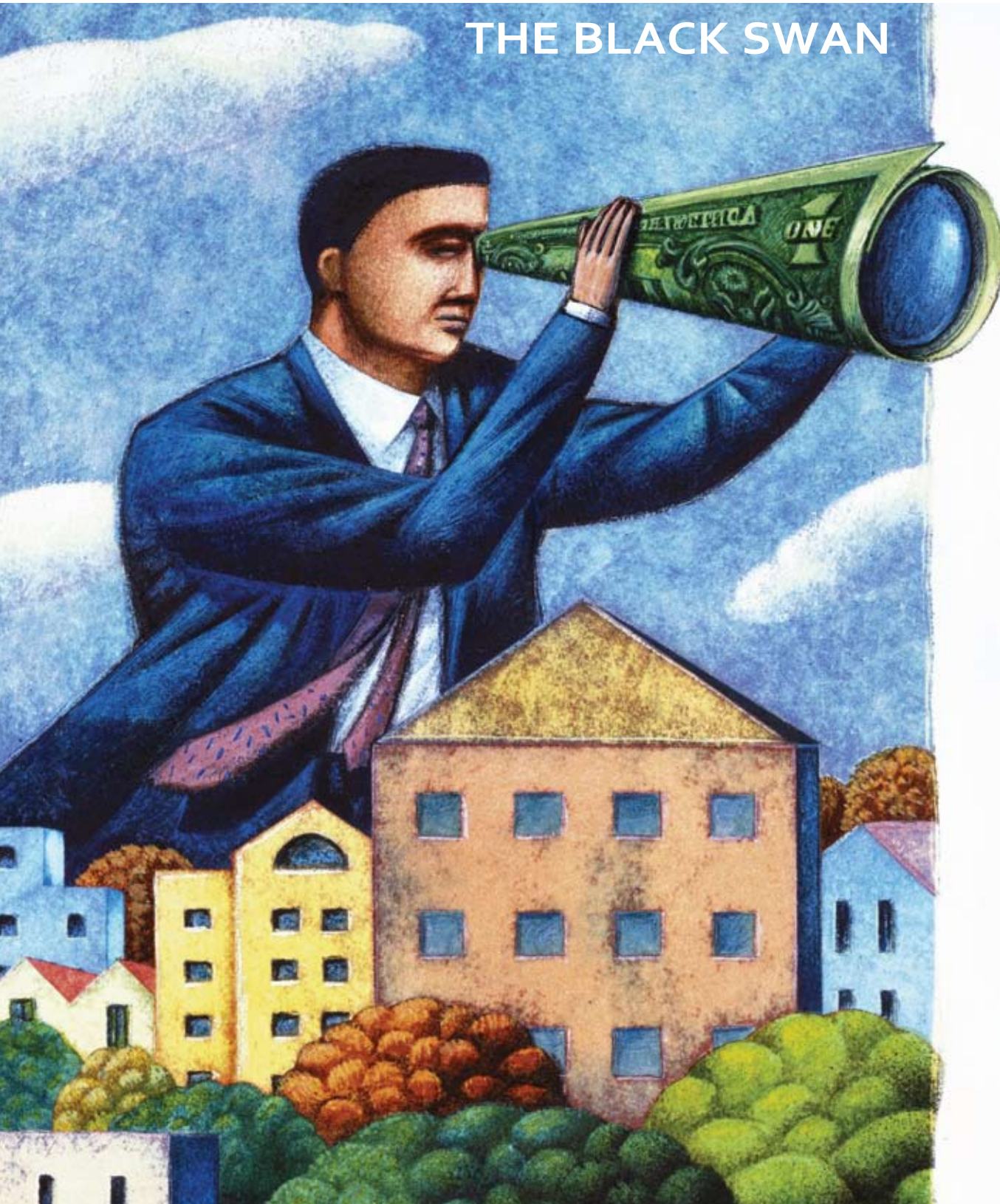
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A N T I C I P A T I N G
THE BLACK SWAN



IM LEY

City and county managers learn that some events can be anticipated and, therefore, influenced, but many others can't be foreseen at all. Municipal managers add value by learning how to anticipate unforeseen problems, more often than not, and to think strategically about the future. This is accomplished not just by managing risk, as many managers do with great skill and competence, but by finding ways to position the community for a better future — facing the unknown as a strategist first, and then as a tactician. This approach, which builds on a base of skills that cross a number of disciplines, is needed in preparing for “black swan”¹ events like the one that Sarasota County, Florida, experienced in 2008, when the collapse of the nation's housing market and the weakening of the financial infrastructure supporting the local real estate economy affected the tax base in ways that no one could imagine.

The trying circumstances that Sarasota faced in the Great Recession and its aftermath highlight the dangers of relying too much on statistical information that is disconnected from the realities of community and place. Not only does such information look backward — not that useful in a black swan context — but when viewed from outside of the context that generated them, such data can hide or muddle the cultural considerations that might shape a more thoughtful and nuanced response.

Before 2008, few professionals in local government gave a second thought to the real estate portion of their financial picture. Indeed, property tax collections were Sarasota County's most reliable revenue component. The sudden reversal was especially surprising after 90 years of federal monetary policy aimed at maintaining stability and growth in the value of the housing market, and, of course, all the associated banking and mortgage underwriting standards and regulations. With so many powerful forces working in concert, such an outcome seemed inconceivable, even in a worst-case scenario. Yet it did happen, and Sarasota County took one of the worst hits in the nation.²

DEALING WITH THE DOWNTURN

Looking back at the Great Recession, it's easy to see opportunities where the county could have prepared better for

the gathering storm. The asset side of its balance sheet had always been relatively predictable, and that part of the financial picture was taken for granted. Once the shortfalls hit, the opportunity for proactive measures in that realm had passed. For Sarasota County, like many other local governments, each year of deeper and deeper cuts led to a shift in focus and energies toward purely financial solutions for resolving the shortfalls. Unfortunately, such solutions offer only a minimal delta of opportunity. Greater effort and even innovation bring diminishing returns.

Looking at how most U.S. municipalities have dealt with the downturn, some common approaches emerge. The response is generally reactive, focused on:

- 1) Managing line items that comprise the expense side of the ledger. The result is usually a reduction in employees, followed by an inevitable reduction in service levels.
- 2) Shifting the way services are paid for, from general revenue to service fees or even increasing taxes.

It is logical and understandable for a community to take such steps in an effort to maintain levels of service in lean times, but this can be a matter of concern from an economic development perspective. If such actions are not done with an eye to matters of regional competitiveness, they can put the community at a disadvantage in relation to neighboring jurisdictions, especially when seeking the investment needed to bolster the community's tax base and help it withstand further shocks.

Few municipalities are acting strategically, and fewer still have more than a fuzzy understanding of the revenue side of their balance sheet. Local government administrators may know the arithmetic (tax rate times the property value), and they may understand the political implications of raising taxes or raising the tax rate, but few have really thought about the structural and non-structural components of their tax base.³

The key premise is this: The tax base the public depends on results from the decisions of many — elected and appointed officials, large-scale developers, and investors, as well as citizen-property owners. The latter group is well served when it encourages and accepts contextually appropriate urban

Before 2008, few professionals in local government gave a second thought to the real estate portion of their financial picture.

development in downtowns and some satellite locations. In profiling the composition of the municipal property tax base, as Sarasota County did in the previously mentioned study (the focus of “The Missing Metric,” in this issue of *Government Finance Review*), the findings can be startling.

The basic takeaway is that traditional downtowns and newly intensified “town centers” — including TODs, or transit-oriented developments — have the potential to offset losses generated by lower-density suburban development that typically does not cover its costs in terms of property taxes, or even impact fees.⁴ The logical conclusion from this observation is that communities can build their way out of revenue shortfalls, and in so doing, achieve greater economic resilience for the long term. The strategy is somewhat problematic for two reasons: First, because it is proactive, and thus best initiated years before shortfalls loom; and second, because it is a significant departure from the usual business of government, which in recent years has been mostly about regulating negative impacts and not about encouraging more sustainable forms of community and economic development.

A NEW STRATEGY

By expressing the revenue consequences of Sarasota County’s development policies in a form that could be easily understood by both financial managers and planning staff, both groups had the information they needed to forge a strategy for managing the county’s tax base, even as the black swans started to circle overhead. Such a cross-disciplinary approach makes sense in a time when financial officers are expected to not just manage the financial resources entrusted to them, but work to actively grow those resources.

What also encouraged Sarasota County’s senior staff members to pursue more urban approaches was what they were learning from new research about the performance of cities in terms of walkability, and its relationship to health, and economic prosperity. Obviously, quality of life remains hugely important when considering such issues; recent experience in many regions, including southwest Florida, has shown that quality of life can be achieved at all levels of density. But as any municipal manager knows, increasing density can be a tough sell, especially in a predominantly suburban county like Sarasota.

The previous point, and the way one addresses it, is key to true economic and community development. Although the perceived impacts of more intense development may

be scary to some, the actual impacts of density done well, as many revitalized downtowns and some newly intensified suburban centers have shown, may be minimal or may be offset by other significant benefits. More and more, local governments are discovering that their citizens can indeed have it all — lower taxes *and* higher levels of service, but only if their leaders — both staff and elected officials — accept the idea of actively managing the municipality’s tax base with that win-win goal in mind. ■

Notes

1. The term “black swan” came to prominence after the 2004 publication of Nicholas Taleb’s book, *Fooled by Randomness*, which documented the role of unexpected events in the financial industries. A later book, *The Black Swan*, published in 2010, extended the concept into realms beyond finance, including science, art, and history. The author’s criteria for such an event is that it be a surprise to the observer, that it have a significant impact on the status quo and it be rationalized in hindsight as something that *could* have been predicted (even if it wasn’t).
2. Because of decreased property tax collections, Sarasota County’s credit was downgraded by six ranks in fall 2011. A municipal “super credit downgrade” is defined as a drop of three or more ranks. In 2010 and 2011, there were 87 such downgrades. A third of these involved cities, counties, or school districts, and the balance were special purpose governments, largely in the housing sector. (See *The Local Squeeze: Falling Revenues and Growing Demand for Services Challenge Cities, Counties and School Districts*; The Pew Charitable Trusts, American Cities Project, 2013.)
3. An exception to this lack of focus on tax-base issues is the considerable effort and allocation of resources that municipalities and their proxies expend to attract major employers. The measure of success with such initiatives is usually jobs and little else. Much has been written on this subject of late, particularly in relation to the oft-quoted figure of \$80 billion spent annually by state and municipal officials to pirate existing jobs from one place and bring them to another, using mechanisms such as tax credits, tax exemptions, and other “economic development” incentives.
4. The pros and cons of impact fees have been debated at great length. Such fees generally cover only initial capital costs, and do so with formulas that look retrospectively at land and/or material costs (which can be highly variable going forward). These characteristics, along with the rational nexus requirement that limits the locations where funds can be expended, and the fact that many states don’t enable the practice, make them problematic as a means of funding the costs of new growth and development.

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THINKING DIFFERENTLY about Development



BY JOE MINICOZZI

Communities often experience some level of disconnect between economic development policy and ensuring sufficient tax revenue to cover the cost of the services the government provides. Suburban projects tend to be favored over denser downtown development, but data from more than 30 jurisdictions across 10 states¹ show that a municipality receives a greater level of revenue from its denser and more walkable urban patterns than its suburban pattern of development. Considering this information provides local government officials with an opportunity to consider development from a different angle.

The studies this article is based on cover municipal revenues per acre across states from California to Maine and Montana to Florida, including wealthy cities such as Mountain View, California, and less affluent towns such as Driggs, Idaho, and Dunn, North Carolina. The data consistently confirm that mixed-use, dense development produces

greater revenues per acre than low-density patterns. In most cases, the proportion of revenue growth is exponential, not proportional, based on density increases. The “per acre” measurement is important; it is similar to judging the efficiency of a car in a “per gallon” basis. Both land and gasoline are finite resources, and comparing the consumption of the resource can be the easiest way to understand the efficiency of the product. This is especially true when annexation is difficult or impossible, limiting the amount of land available.

The data consistently confirm that mixed-use, dense development produces greater revenues per acre than low-density patterns.

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CASE STUDY: SARASOTA COUNTY

Consider the example of Sarasota County, Florida (see “The Missing Metric,” in this issue of *Government Finance Review*), which asked the following question: Can properties and cash-flow be isolated, geospatially, as revenue model? The state of Florida hired a consultant to assess the cost of public facilities for residential properties to help demonstrate the costs asso-

Exhibit I: Costs Associated with Land Development Patterns



This map shows a notable lack of consistency of land valuation on a per-acre basis. The small property (A) is double the value of the parcels across the street (B). There are also notable outliers in the residential neighborhoods.

Land Assessment

Assessed Value Per Acre

Dark Blue	\$ 0.00-\$ 5,000.00
Blue	\$ 5,000.01-\$10,000.00
Light Blue	\$10,000.01-\$15,000.00
Very Light Blue	\$15,000.01-\$20,000.00
Pink	\$20,000.01-\$25,000.00
Yellow	\$25,000.01-\$30,000.00
Orange	\$30,000.01-\$35,000.00
Light Orange	\$35,000.01-\$40,000.00
Dark Orange	\$40,000.01-\$45,000.00
Red	\$45,000.01+

Source: Urban3

Exhibit 2: Comparative Performance of Suburban and Multi-family Housing (Sarasota County, 2009)

	Suburban	Urban
Land Consumed	30.6 acres	3.4 acres
Public Facility Costs	\$10 million	\$5.7 million
County Tax Yield (annual)	\$238,529	\$1.98 million
Payback Period	42 years	3 years
Taxes Generated per \$1,000 in Public Investment	\$238	\$1,756
County ROI	2%	17.6%

See Exhibit 3 on page 28 for more information.

Source: Urban3

ciated with spreading out land development patterns (see Exhibit 1).² Using this report, an apples-to-apples comparison was made between a suburban multi-family unit and a multi-family unit located downtown (see Exhibit 2).

Assuming a finite limit to the downtown example — if tax value and density were cut in half — the suburban ROI would still be much smaller. Projecting this kind of cash flow out 20 years puts the county in the red by \$5 million, using the suburban model, while the urban model shows a profit of more than \$20 million. (These numbers did not account for the revenues that go to the city or the additional services the city must provide.)

Decades of research indicates that municipalities do need to account for costs and revenues within a geographic location.³ In addition to accounting for administrative costs, jurisdictions also need to account for the cost of government “on the ground.” A municipality can be looked at as a very large real estate development corporation; in that light, city administrators would be fund managers for (in some cases) multi-billion-dollar portfolios. Although we don’t think of running a municipality this way, there’s something to the idea.

Following this logic, a “value per acre” analytic was applied to the entire city of Mountain View. This is the hometown of Google, and as an homage, the data were exported into Google Earth, allowing users to experience the value difference in three dimensions. The results were interesting, and logical. (See Exhibit 3.) The downtown area was expected to show a great deal of value, but the

The larger a tract of land, the more expensive it becomes to provide services to it — especially when those large parcels sit on the periphery of the community.

difference between that core area and immediately adjacent neighborhoods is dramatic. It should also be noted that the majority of downtown buildings have fewer than three stories. Additionally, the data show that “downtown scaled values” were popping up in other areas of the community. This analytic helps community leaders identify the high-performance parts of the community and, perhaps, identify new policies to make the best use of those areas. High-scaled value is not limitless, but even adding more of the development patterns that are happening at the transit-oriented developments (TODs) could add significantly to public coffers.

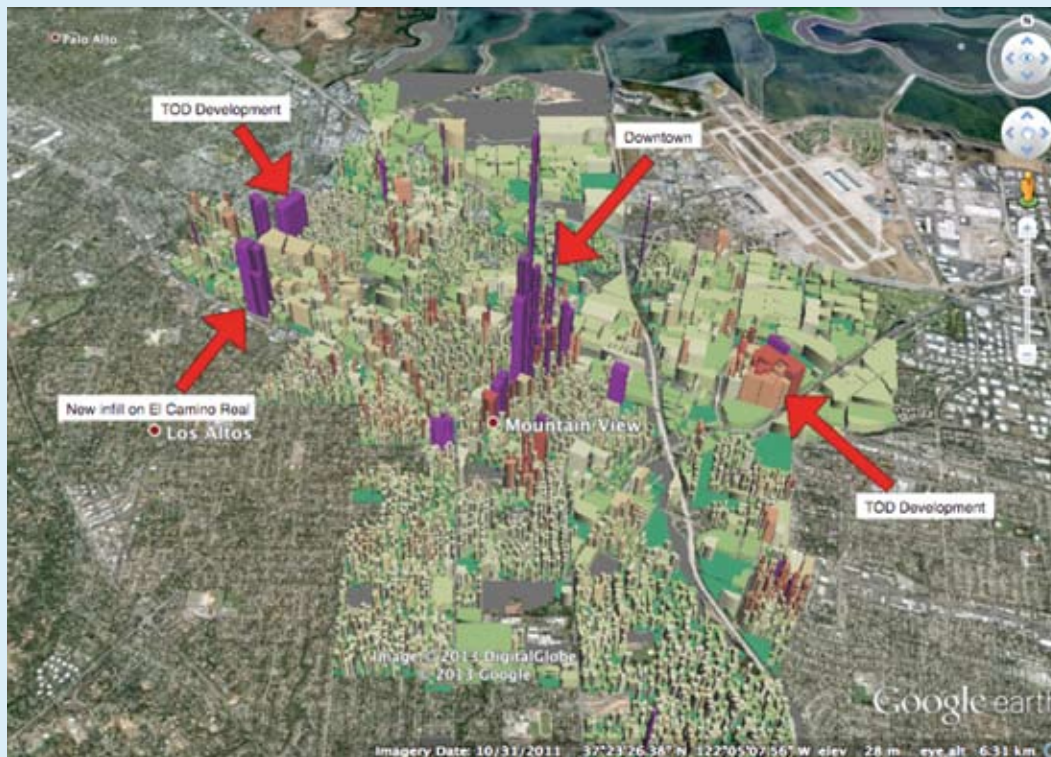
Real estate developers are constantly looking for ways to advance their portfolios by seeking new retail tenants, looking for new properties to develop, and keeping an eye on broader capital markets and real estate trends. Savvy developers understand who is in their marketplace, who their competition is, and even what that market will look like 20 to 30 years into the future. They are also conscious of how all the parts of their portfolios are performing — giving local government officials another way to think about their communities.

THE VALUE OF COMMUNITIES

Thinking differently about how local governments might be run is an argument for how we think of the places we make, and their inherent value. Jurisdictions sometimes make policy decisions that actually undermine their ability to create value. Our taxation system is based obliquely on “value” as a non-invasive way to assess a taxation rate, which is calculated through a complicated rubric that mixes in estimates of market demand and inherent value.

But assessment methodology cannot always bring about the intended consequences. For instance, a basic standard is “the larger the parcel of land, the lower its unit value on a per unit basis.” The rationale is that as the unit of land gets larger, fewer buyers can afford it. Missing from that equation, however, are the public costs tied to that parcel. Land is not like a manufactured item that gets less expensive with each additional unit produced. The larger a tract of land, the more expensive it becomes to provide services to it — especially when those large parcels sit at the periphery of the community. That’s because the farther

Exhibit 3: 3D Depiction of Land Value per Acre in Mountain View



Source: Urban3

The areas of greatest revenues per acre are easy to spot, and the values dissipate quickly. Higher density transit-oriented development also provides this community with impressive returns in along the rail line.

away from the center of the community a piece of land lies, the more roads, pipes, and wires must be put in place to reach that land. Sending fire, police, and medical teams is also more costly. It might make sense, then, to reconsider the common practice of discounting the tax rates for owning that land.

As an example, the community in Exhibit 1 had a distinct dichotomy. On one side of the street, there was a shopping mall and a parking lot, surrounded by streets, totaling three square miles. Across the street from this parcel were smaller commercial parcels, each with about 150 feet of frontage along the road. On a per acre basis, the land under the mall (not including the buildings) was valued at about half the rate of the smaller parcels — the mall received a volume discount, compared to properties that stood literally across the street. Why wouldn't land on one side of the street have the same value as land on the other?

Architecture has similar incentives. When less expensive buildings are taxed at a lower value than more expensive buildings, developers have a direct incentive to erect low-cost buildings with limited shelf lives. Many such buildings are destined to eventually sit vacant — a typical big-box retail store, for example, is designed to last, on average, about 15 years. On a square-foot basis, its taxable assessment is also much less than that of most residential properties in the community.

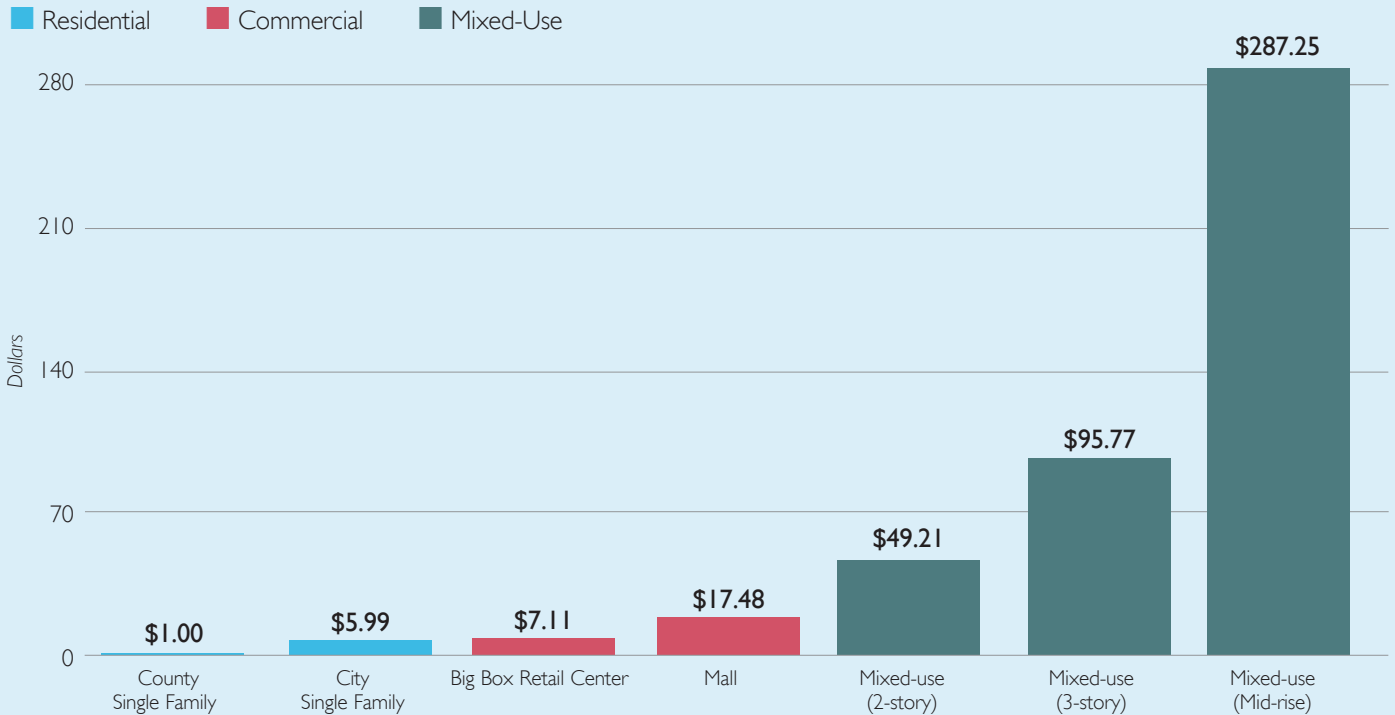
When less expensive buildings are taxed at a lower value than more expensive buildings, developers have a direct incentive to erect low-cost buildings with limited shelf lives.

TIME VALUE AND ROI

Of course, assessors do not create development policy; they just have the unenviable task of figuring out “value” in a real estate marketplace that doesn't always make rational choices. Also, even though they create the pricing structures for public revenues, they are rarely brought into the conversation about the costing variables that are literally at the front stoop of the parcels they're pricing.

Exhibit 4: County Property Taxes per Acre

For every dollar of county taxes a resident pays, the city pays \$6 in county taxes per acre.



Ratio difference of 30 city sample set across 10 states

Source: Urban3

The time value of money and the return on the investment also need to be accounted for. As the Sarasota case demonstrates, investments made in the urban downtown area pay for themselves in just three years, compared to 42 years for development in the surrounding suburban areas. Cities might want to require a faster return for public investments — perhaps 15 years, rather than 40. (See “The Missing Metric.”)

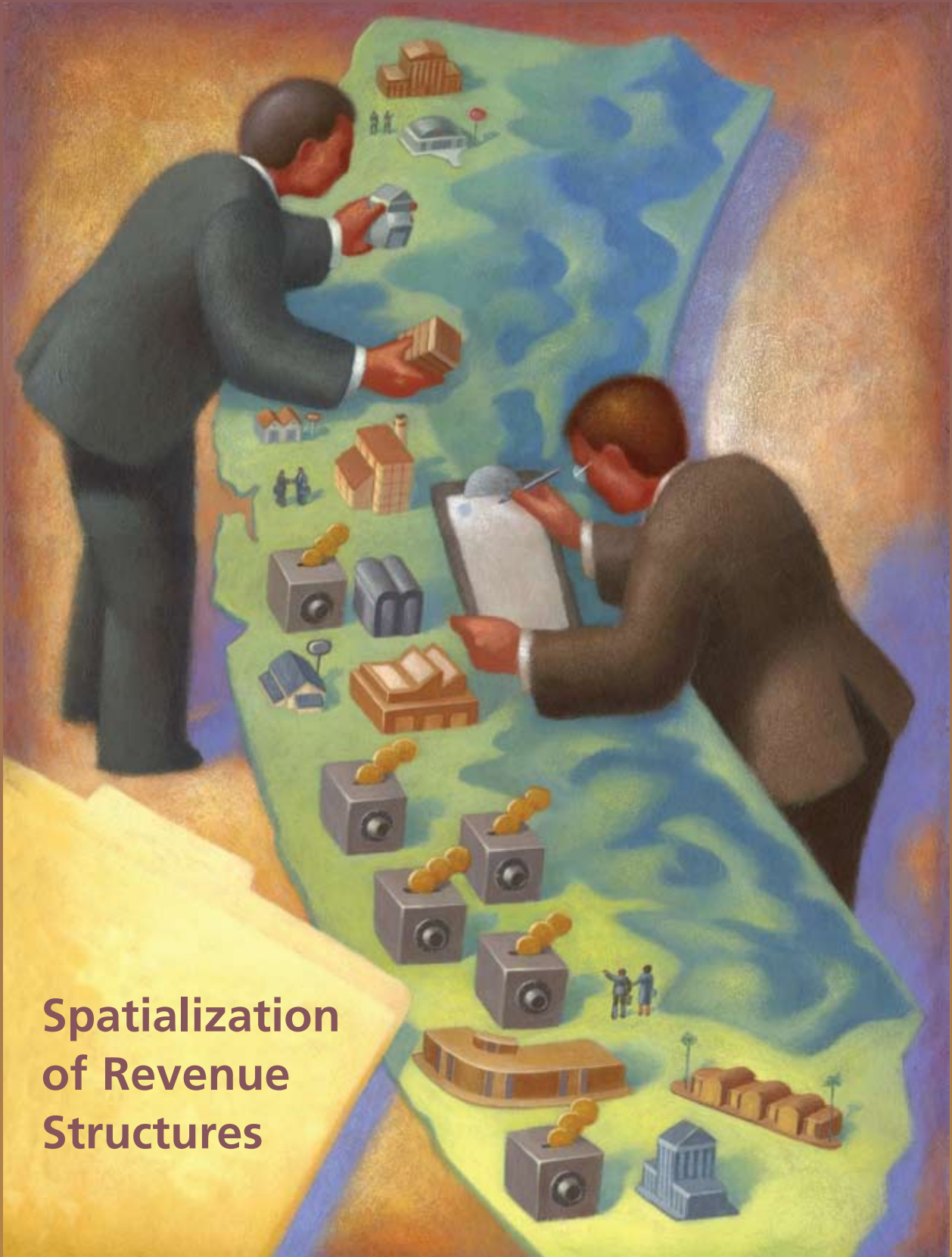
CONCLUSIONS

Jurisdictions need to look closely at their financial models for development and be sure that they are separating out the numbers considered in development decisions. This includes analyzing all the information in a comprehensive manner. Research shows that regardless of the size of the municipality, its most potent property tax-generating areas are its downtown or Main Street. Those parts of the community should, therefore, receive reinvestment commensurate with the revenue they produce, and policy should be adjusted, where necessary, to capture the costs of development patterns within a reasonable time cycle. Doing so will help keep our communities from operating in the red. ■

Notes

1. The information in this article comes from a series of studies performed by Urban3 (see a map of the cities at http://urban-three.com/?page_id=36/). The Sonoran Institute published the first sample set, from the Rockies, in its 2012 “About Town” report (<http://www.sonoraninstitute.org/library/265-abouttown.html>).
2. “The Search for Efficient Urban Growth Patterns,” James Duncan and Associates, Florida. Department of Community Affairs (Governor’s Task Force on Urban Growth Patterns, 1989).
3. A good example is the now-classic report, “The Cost of Sprawl,” commissioned by the Department of Environmental Quality in 1974, and its 2002 update of the same name, by Robert Burchell of Rutgers University’s Center for Urban Policy Research.

JOE MINICOZZI is the principal of Urban3, LLC (U3), a consulting company that specializes in land value economics, property tax analysis, and community design. Minicozzi has served as executive director for the Asheville Downtown Association and as new projects director for Asheville real estate developer Public Interest Projects. His work has been featured at the Congress for New Urbanism, the American Planning Association, the International Association of Assessing Officers, and New Partners for Smart Growth conferences. He received his Bachelor of Architecture from the University of Miami and master’s degree in architecture and urban design from Harvard University.



Spatialization of Revenue Structures

BY MICHAEL A. PAGANO

City government coffers continue to feel the effects of the 2008 financial market and real estate collapse. The lag between property assessments and property tax billing means that property tax receipts could continue to decline for the next year or two, so the fiscal pinch affecting many jurisdictions will likely continue even as the economy grows and property values regain at least some of their lost value. As cities adjust their fiscal policies in response, local officials have an opportunity to redesign municipal fiscal systems.

This article presents a framework for understanding how city officials, including chief financial officers and mayors, think about the location of residential and commercial projects, either explicitly (by taking these factors into account as part of a “fiscal impact analysis”) or implicitly. By its very nature, the decision to undertake development activities in one part of the city or another is rooted in a legacy of decisions made in an earlier era — decisions which formed the city’s social compact with its citizens, residents, and businesses.

FINANCIAL THINKING IN SPACE

Government financial officials are not typically products of urban planning schools, although their behavior and actions are as profoundly interconnected with a city’s urban planning functions as those of the jurisdiction’s department of planning and development. The simple explanation is that cities (and counties, for that matter) derive their general revenues not from the city as an amorphous, intangible concept, but from specific, physical points within the city’s borders. Property taxes are levied on land and structures at particular spots on the map; sales tax collections are typically at a point of sale (that is, a place on the map); income taxes are collected from an individual’s home address; and payroll taxes are collected at a place of employment. All of these general tax sources — property, sales, and income — can be understood by their specific location within the city’s boundaries. The generation of tax revenue is tied intimately to space.

The decision to undertake development activities in one part of the city or another is rooted in a legacy of decisions made in an earlier era — decisions which formed the city’s social compact with its citizens, residents, and businesses.

Tax revenue is a function of the assessed value of real estate and structures, the value of retail sales exchanges, and the wages or income of individuals at a specific place of residence. Consequently, city assessment of development opportunities (whether commercial or residential) must consider the specific location of the development with respect to its revenue-generating characteristics. Indeed, city officials understand the spatial logic of the location of developmental activities in terms of how much revenue a particular project generates for the city’s coffers, as well as how much of a development’s costs might be exported to neighboring jurisdictions. In a book published a decade ago, my coauthor and I referred to this strategy as the “mini-max” imperative of siting development projects and of supporting infrastructure investment: maximize tax revenue and minimize costs.¹ The mini-max incentive embedded within the context of a city’s revenue structure manifests itself spatially in the city’s design, land-use designations, and development patterns, or the spatialization of revenue structures.

THE FISCAL LOGIC OF DEVELOPMENT

No city is entirely dependent on a single tax source to fund all of its operations and service delivery responsibilities. Cities have diversified their revenue structures for the past century as they weaned themselves from a high or total reliance on the property tax. Since then, cities’ budgets have been funded by pursuing a portfolio approach to financial management, including imposing fees for services (e.g., potable water, garbage collection, parking, building permits, transit), levying specific taxes (e.g., restaurant, lodging, amusement, real estate transaction, business incorporation), collecting transfers from other governments (typically in the form of state aid), and generating investment income (e.g., leases from city-owned property, Treasuries). As a consequence of this portfolio approach to developing municipal budgets, U.S. cities on average generate less than one-third of their own-source revenue from the property tax, slightly less than one-fifth from the sales tax, and less than one-tenth from the income tax. The bulk of own-source revenue, approximately 40 percent, is derived from a user fee.²

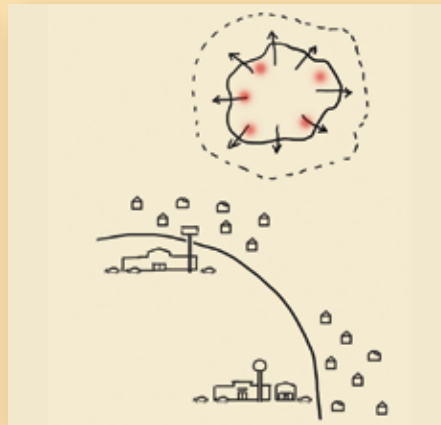
Exhibit 1



Property Tax-Dependent City

- Concentric urban structure
- Clear physical and historical identity
- High-end residences closer to center
- High-end office and retail in center

Exhibit 2



Sales Tax-Dependent City

- Development pressure at urban edges
- Tax dollars drawn across city borders
- Development formulaic
- Urban center languishes

Exhibit 3



Income Tax-Dependent City

- Development less formulaic
- Targeted to higher incomes
- Development locations idiosyncratic
- Results depend on where tax collected

Graphic designed by Steve Price, Urban Advantage

Although cities do not depend entirely on one tax source, they must be aware of the revenue-yield potential of a development site. Therefore, any fiscal impact analysis ought to include an assessment of the site's value to the city. The site's value to the city is intimately linked to, and dependent upon, its location. Ideally, cities that are highly dependent on the property tax would encourage, guide, and direct development projects with a high probability of augmenting the value of real estate in the proximate area of the project away from the perimeter of the city and closer to its center. If the development project is successful in raising property values, the city would reap the benefits by collecting all the incremental property tax; there would be no leakage of these taxes to neighboring jurisdictions. Over time, after the city continually invests in development projects that reap more property tax revenues to the city, a spatial distribution of land-use activities becomes apparent. As cities invest in development projects to increase revenues, there is also an incentive to locate other activities, such as industrial parks on the city's edge, as a means of offloading costs associated with the project (such as congestion and road repair).

The Property Tax City. Exhibit 1 reflects the spatial distribution of activities that an "idealized" property-tax dependent city might pursue. The image at the top of Exhibit 1 resembles

an egg (the city's boundary), with the yolk indicating the location of development activities — especially high-end development that would generate substantial amounts of property tax revenue for the city. Exhibit 1 also suggests a clustering of high-end development, if not in the center of the city, at least some distance from the city's edges. The logic behind directing high-value investments to the city's center is that besides collecting the increased real estate value from the project site, the ripple effects or externalities of project development — which should enhance property values at adjacent sites — can be captured in the form of higher real estate taxes. To encourage high-end investment with high-valued ripple effects at the edge of the city, rather than at the city's center, would mean that a neighboring municipality would benefit from higher real estate values than would otherwise be the case. Unless the city intends to invest in residential and commercial activities that benefit neighboring cities, the city's strategic investment focus ought to be located away from the city's edge.

The Sales Tax City. This particular logic of intense development at the city center is at odds with much traditional development activity, especially by cities looking to expand their coffers by finding more and more consumers of retail goods. Sales tax-dependent cities induce policy officials'

development behavior in a direction quite unlike that of property-tax cities. A finance director of a sales tax-dependent city once told me that his city would no longer try to grow its property tax base. For every single-family detached home that was built, the property tax paid covered only 50 percent of the city services provided to it; this was because the property tax rate was kept low by the state's tax and expenditure limit. In his mind, encouraging out-migration of individuals and in-migration of retail establishments would have been a good development policy. A city manager of another large sales tax-dependent city explained that competition for big-box retail centers creates "Wal-Mart wars" near the city's borders. Possibly a more evocative assessment is that sales tax-dependent cities often become embroiled in auto-mall wars, as the sales tax receipts of cars — especially high-end automobiles — create the salubrious effect of reducing the property tax rate.

The spatial pattern of sales-tax cities tends to build up the city's edges with commercial establishments and encourage non-residents to shop in the city (and, if possible, live elsewhere). The image at the top of Exhibit 2 demonstrates the importance of dispersing commercial activities along the city's edges. What becomes less relevant or important to the revenue-maximizing behavior of city officials is the location of residential properties or office buildings, since neither directly enhances the city's fiscal well-being. The indirect effect, however, might be important, depending on the quality of life the city officials are attempting to provide to their citizens and residents. Good neighborhoods, low public safety costs, and vibrant communities are typically sought-after characteristics. Yet, in some incorporated municipalities, local officials focus nearly all their energies on enhancing the retail sales tax base. A suburban community near Chicago hosts one of the region's largest shopping malls and, as a consequence of its success, has nearly eliminated the property tax for the city's residents. The city has no interest in luring more residents, so it invests little in residential activity.

The Income Tax City. The third idealized urban design is based on a high reliance on income tax (see Exhibit 3). Very few U.S. cities rely heavily on the income tax, and almost

all of them are in Ohio. Those income-tax structures encourage policy officials to search for the employed worker, preferably a highly compensated employee. Cities whose income tax is of the commuter tax variety (Ohio and Kentucky cities, mostly, along with a few others such as Detroit and Philadelphia that have a reduced rate on commuters) motivate public officials to invest in development projects and encourage private investment in job-creating activities. Those cities without a commuter tax (e.g., New York City and Washington, D.C.) need to attract employed, high-income residents. Development of office buildings and high-end residential areas, especially in the city center, should be a top priority so that well-compensated employees live in the city, where they generate the revenue that supports city services.

The three spatial models of residential and commercial activity are idealized and are not intended to match the physical distribution of residences and businesses in any one city. Keep in mind that many cities have evolved over a long period of time that the dominant tax regime may have shifted during that time. Cities that were settled recently are more likely to resemble the idealized models. Nevertheless, city officials today certainly understand the fiscal imperatives that the idealized models represent.

CHALLENGES OF SPACE, DEVELOPMENT, AND TAXES

Creating or inheriting a fiscal architecture has the possibility of influencing urban design in ways unimagined at the time cities were selecting (or were given) their fiscal tools. Indeed, the city's actual fiscal architecture might run counter to the philosophical predisposition of the voters and policy officials. For example, cities that select or rely on the sales tax to provide funds for government operations and capital investment might be pushing their commercial establishments toward the edges of cities because of the imperative to maximize revenues, while at the same time the residents and policy officials of the same city might philosophically desire a more compact spatial distribution of residences and commercial activities to satisfy its increasingly "green" constituents. If some cities extend their boundaries for the purpose of capturing distant and future retail consum-

Cities derive their general revenues not from the city as an amorphous, intangible concept, but from specific, physical points within the city's borders. The generation of tax revenue is tied intimately to space.

ers, are the environmental, transportation, and other costs associated with such activity incorporated in the decision calculus to invest public resources? Or is there tension between those imperatives?

Another challenge is that while cities are increasingly seeking collaborative relations with neighbors in the joint provision of services, typically with an eye toward reducing service costs, the fiscal structures of the cities might be pushing in an opposite direction. What immediate gains would be generated if a municipality that has undeveloped land near its border cooperates with a neighboring municipality? Unless the state requires local governments to adopt a cooperative relationship, the revenue-raising imperative of cities, especially sales-tax cities, might have the effect of discouraging interlocal cooperation.

In other words, the fiscal architecture of a city cannot be ignored when considering investment opportunities, joint provision of services, or land use and zoning adjustments. Fiscal impact analyses, then, should be focused not only on revenues or return-on-investment, but also on the land use and other concerns of the city that might be nudged in a direction counter to the philosophical predispositions of the electorate and policy officials.

SOCIAL COMPACT

The social compact of the last century that bound generations, socio-economic classes, neighborhoods, cities, and regions was formed at a time when the property tax reigned supreme, few user fees existed to charge citizens for consumption of public services (the equipment for measuring consumption, such as water and parking meters, was too expensive to purchase, or the technology for developing equipment to measure consumption was in its infancy), and the property tax was a fairly progressive tax, at the time. Property ownership was often a somewhat accurate measure of wealth. The cost of city services was borne by the property tax and, therefore, by owners of property. Renters probably contributed something toward the property tax liability, especially if rental housing was not a competitive market in the neighborhood or city and industries could incorporate property taxes into the pricing structure of their products.

Although cities do not depend entirely on one tax source, they must be aware of the revenue-yield potential of a development site.

Over time, especially since the mid-twentieth century, cities have created a host of income-generating tools to broaden their revenue portfolios and to more accurately assess a fee for the consumption of certain city-provided services such as water, parking, or building permits. The property tax base has been eroding as more non-profit institutions (e.g., education, health

care, religious) have grown, removing those properties from the taxable base of the city. The sales tax base rarely includes services, the fastest growing area for consumer spending. The income tax base excludes capital gains, except in the important case of New York City. In other words, over time and without a healthy political conversation about the shifting liabilities and tax burdens of the municipal fiscal structures, cities' fiscal architectures have migrated from a near-total reliance on the property tax a century ago to one that resembles a portfolio, with a variable combination of general taxes (in almost all cases, including the property tax), anchored by a heavy reliance on user fees and charges.

CONCLUSIONS

Conditions are ripe for an open and honest political dialogue about new financial structures for municipalities. By taking advantage of this opportunity, cities and their residents will come out ahead. It is time to reconsider the social compact of the last century in light of shifting tax portfolios, demographic changes, transformation of the underlying economy, the forces of globalization, and an irrepressible resolve to enhance the human condition. When considering financial policy options, public officials should fully consider the city's fiscal architecture in relation to the ways these policies will affect the physical form of the city as it grows and changes. ■

Notes

1. Ann O'M. Bowman and Michael A. Pagano, *Terra Incognita: Vacant Land and Urban Strategies* (Washington, D.C.: Georgetown University Press, 2004). See especially chapter three, "City Policymaking: Exploring the Land-Tax Dynamic."
2. Michael A. Pagano, "Creative Designs of the Patchwork Quilt of Municipal Finance," in Gregory K. Ingram and Yu-Hung Hong, *The Changing Landscape of Local Public Revenues* (Cambridge, MA: Lincoln Institute of Land Policy, 2010), pp. 116-140.

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Examining the Fiscal Benefits of Smart Growth

Studies by a number of state and local governments have found that a smart growth approach would improve their financial picture.

A number of local governments across the country have done studies comparing development strategies to understand their impact on municipal finances. These studies generally compare development scenarios and help local leaders make informed decisions about new development, based on the associated costs or revenues. Many found that a smart growth approach would improve their financial picture, whether by saving money in upfront infrastructure construction costs; reducing the cost of ongoing services like fire, police, and ambulance; or by generating greater tax revenues in years to come. This article excerpts *Building Better Budgets: A National Examination of the Fiscal Benefits of Smart Growth Development*, the first report to aggregate those comparisons and quantify how much other communities can expect to save on average by using smart growth strategies.

This article focuses on three aspects of the differences between smart growth and conventional suburban development: the cost of upfront infrastructure, the cost of providing ongoing services, and the tax base created by additional

development. The information comes from 17 case studies at varying levels of government.¹

UPFRONT INFRASTRUCTURE

In general, smart growth development costs one-third less for upfront infrastructure. The Smart Growth America report concluded that smart growth development would cost an average of 38 percent less than conventional suburban development for upfront infrastructure. Some studies have put this number as high as 50 percent.

All development requires infrastructure to support and supply it. The studies included in this article primarily refer to roads, water lines, and sewer lines, which account for most of the infrastructure cost associated with new development. Smart growth development patterns require less infrastructure, meaning upfront capital costs, operations, maintenance, and, presumably, cost for eventual replacement are all lower. Smart growth development also often reuses existing infrastructure, lowering upfront capital costs even more.

- In the City of Champaign, Illinois, a smart growth approach to future city development could cut the upfront cost of infrastructure from \$123 million to \$71 million — a savings of \$52 million, or 42 percent, over 20 years.²

This article is adapted from *Building Better Budgets: A National Examination of the Fiscal Benefits of Smart Growth Development*, a May 2013 report prepared by Smart Growth America with the assistance of Strategic Economics. It is available at www.smartgrowthamerica.org.

- In the City of Mount Pleasant, South Carolina and Phoenix Arizona a smart growth approach for specific development projects could save between 32 percent and 47 percent in upfront infrastructure costs.³
- The State of Maryland found that following a smart growth approach would save approximately \$1.5 billion per year statewide on new road construction through 2030, reducing overall costs by 28 percent and the costs to local governments by 60 percent.⁴
- In the State of California, a smart growth approach could reduce infrastructure costs by \$32 billion, or 20 percent, statewide through 2050.⁵ The same study conducted a more detailed analysis of small-lot single-family developments and found that locating such a development in a smart growth location would cut the cost of infrastructure in half.⁶
- In rural areas with 10- to 40-acre ranchettes, the infrastructure savings associated with smart growth patterns are likely much higher, perhaps as much as 65–75 percent.^{7,8}

The survey determined one-third savings in upfront infrastructure costs by compiling the estimated savings from case studies considering infrastructure costs.⁹ The upfront savings figure is a conservative average reflective of available data on the matter. The case studies compared urban and suburban growth between a smart growth and a conventional suburban development. Case studies examining fiscal impacts of rural development scenarios were excluded because their geographic differences produced significantly different savings, as noted in the final point above.

ONGOING DELIVERY OF SERVICES

Smart growth development saves municipalities an average of 10 percent on ongoing delivery of services.

The survey concluded that smart growth development saves municipalities an average of 10 percent on ongoing public services such as police, ambulance, and fire service.

Many public services are extremely sensitive to a community's pattern of development because the geographical configuration of a community — and the way the community is connected geographically — profoundly affects service delivery. A smart growth pattern will, at the very least, save operating costs simply because service vehicles can drive fewer miles. In some cases, the actual number of vehicles and facilities can be decreased, along with the personnel required to provide those services.

- The City of Charlotte, North Carolina, concluded that the cost of serving a smart growth neighborhood is approximately one quarter of the cost per capita of serving a conventional suburban neighborhood.¹⁰ Based on Smart Growth America's estimates, a smart growth approach could eliminate the need for two future fire stations in Charlotte, saving the city \$13 million in capital costs and more than \$8 million per year in operating costs.¹¹
- In Champaign, a smart growth development scenario for the city's future growth would cut service costs by 23 percent, or \$19 million, over 20 years.¹²
- The City of Fresno, California, found that a smart growth approach would reduce service costs by nine percent.¹³

- A new study of the City of Nashville, Tennessee, found a 13 percent decrease in service costs in a smart growth scenario.¹⁴
- The savings on services in rural areas are much higher, perhaps as much as 85 to 90 percent.^{15, 16}

The survey determined an average of 10 percent savings in service delivery costs by compiling the estimated savings from case studies considering service costs.¹⁷ Services considered across studies were not consistent, and levels of service and economic conditions vary. However, all case studies consistently demonstrated a cost reduction in delivery of services examined when pursuing smart growth development. The overall savings figure is a conservative, rough average of savings reflective of available data.

TAX REVENUE PER ACRE

Smart growth development generates 10 times more tax revenue per acre than conventional suburban development. The survey concluded that on a per-acre basis, smart growth development patterns produce far more tax revenue than conventional suburban development. Tax revenue, for the purposes of this article, typically refers to property taxes and sales taxes, and in some instances licensing fees and other small sources of revenue. Property tax in particular is an extremely important source of revenue for most communities. In a 2010 U.S. Census survey of local government budgets nationwide, 48 percent of revenue from municipalities' own sources came from property taxes, and 10 percent came from sales taxes, though the relative importance of these taxes varies across the country because of state tax laws.¹⁸

- In Nashville-Davidson County, Tennessee, a smart growth project in a brownfield location would generate twice as much revenue per unit — and 42 times as much revenue per acre — as a conventional suburban development in a greenfield location.¹⁹ This study examined property tax from the project sales tax likely to be generated by its residents, and other miscellaneous taxes generated by residents and businesses.
- Fresno concluded that a smart growth development strategy would generate almost one and a half times as much revenue per acre as a conventional suburban development scenario in greenfield locations. This conclusion holds despite the fact that the market for downtown development in Fresno is relatively weak.²⁰ This study examined property tax from the project and sales tax likely to be generated by its residents.
- Analysis by the statewide planning effort Vision California found that on a per-acre basis, smart growth development could produce three and a half times as much tax revenue as conventional suburban development.²¹ This study examined property taxes from the new development, sales taxes likely to be generated by new residents, and miscellaneous taxes such as vehicle license fees from new residents.
- A study for the City of Raleigh, North Carolina concluded that a six story, smart growth building downtown produces 50 times as much property tax revenue per acre as an average big box store. Even a three story residential building produces more property tax revenue per acre than a major shopping mall.²²

These studies typically included both residential and commercial development, though in some cases it was only one or the other. The per-acre measurement of tax revenue is extremely important because land is a precious commodity for every jurisdiction. It is true that in some cases the total dollar amount of tax revenue in conventional suburban settings can be very large, but those conventional suburban developments consume large amounts of land. Many U.S. cities have a constrained land supply and must husband their land resources carefully to protect their solvency. Increasingly, counties — especially counties in or near metropolitan areas — are also land-constrained. In addition, increasing the per-acre tax yield from property that is developed will reduce the pressure to either increase taxes or allow additional development on land that is currently used for low-density housing, agriculture, or other activities important to a community.

TURNING DEFICITS INTO SURPLUS

Smart growth development's potential for lower costs and higher revenue means this strategy can sometimes become a steady source of surplus for a municipality. These communities know firsthand:

- In Sarasota, a smart growth residential project required \$5.7 million in infrastructure while generating \$1.98 million in property tax revenue per year. By contrast, a comparable conventional suburban residential product required \$10 million in infrastructure while generating \$239,000 in tax revenue per year. Thus, it would take three years of county tax revenue to

pay back the smart growth infrastructure cost — but 42 years of county tax revenue to pay back the suburban infrastructure cost.²³

- An analysis of Champaign found that a smart growth scenario generated a \$33 million surplus to the city, while a conventional suburban scenario generated a \$19 million deficit. This was true even though the conventional suburban scenario generated \$19 million more in aggregate revenue over 20 years, yet its costs are so much greater as to negate any surplus. As with other studies, on a per-acre basis, the smart growth scenario generated twice as much revenue as the conventional suburban scenario — about \$48 000 per acre over 20 years, compared with \$23,000.²⁴ Revenues in this analysis included primarily property tax funds but also motor vehicle taxes sales taxes and other sources of tax revenue.
- A study of Nashville-Davidson County found that a smart growth development project downtown produced a net surplus of \$1,930 per unit, or 48 times the surplus produced by conventional suburban development of \$40 per unit. On a per-acre basis, the smart growth project produced a net surplus of \$115,720 per year, or 1,150 times the surplus produced by the conventional suburban development (\$100 per acre).²⁵ The tax revenue analyzed was mostly property tax but also sales tax likely to be generated by the project's residents and other miscellaneous taxes.

The research above suggests that in some cases, conventional suburban development can create a small operating surplus for local governments pro-

viding services. These operating surpluses are highly dependent on home prices, tax rates, impact fees, assessment districts and other factors that can vary greatly. As the Champaign example suggests, in many cases, the only way a jurisdiction can make up the difference between a smart growth alternative and a conventional suburban alternative is to target high tax producers such as expensive homes.

The survey compiled the savings from case studies considering revenue and generated an average. Only the case studies that examined both property tax and sales tax were included.²⁶

While some case studies included fees and other small sources of revenue, these have only a minor impact on overall revenue. As mentioned previously, the majority of revenue for a municipality is generated through sales and property taxes. Case studies yielding extreme tax revenue differences between development scenarios were considered outliers, and therefore were not factored into the average.

Overall this analysis would be stronger if more data were available. Smart Growth America found only four municipalities that have studied the ability of different development patterns to generate a surplus. The fact that so few surveys are available clearly shows that more towns, cities, counties and states could benefit from taking a hard look at their development strategies.

CONCLUSIONS

This research clearly shows that smart growth strategies cost less upfront and improve revenue over the long term. Every community is different, and not

SMART GROWTH SAVINGS FOR RURAL COMMUNITIES

Most research comparing smart growth and conventional suburban development is based on the metropolitan context — comparing a suburb to a city neighborhood, for example, or different development scenarios in a suburb. But recent research suggests that the fiscal impact of smart growth is even more beneficial for rural areas.

A consulting firm conducted three fiscal impact analyses for rural areas in the Intermountain West: Beaverhead County, Montana; Gallatin County, Montana; and Natrona County, Wyoming. All three of these analyses yielded the same result: A smart growth approach would dramatically lower the cost of infrastructure and result in much higher revenues that cover more of the cost of both infrastructure and operating expenses.

For example, Natrona is a county of 5,300 square miles with 75,000 residents, where Casper is the county seat. The consultant examined three different development scenarios, each of which would theoretically build 500 new homes in the community: A “ranchette” scenario in which the homes are built on 35-acre lots; a “rural exurban” scenario in which the homes are built on 6-to 10-acre lots; and a “metro infill” scenario in which the homes are built on one-acre lots located within or adjacent to existing cities such as Casper.

The results of the analysis were dramatic. On infrastructure, the metro infill scenario cost approximately one-quarter the cost of the ranchette scenario and one-third the cost of the rural exurban scenario. As for operating costs, the metro infill scenario would cost only 12 percent of the cost of the ranchette scenario, and 15 percent of the cost of the rural exurban scenario.

In addition, projected tax revenue was significantly higher for the metro infill development scenario, which would cover 90 percent of the required capital cost, compared with only 25–31 percent for the other two scenarios. On the operating side, the metro infill scenario would cover 68 percent of operating costs compared with only 8–10 percent for the other two scenarios.

In other contexts, a subdivision of one-acre lots might not be considered “smart growth.” But when compared to the rural sprawl scenarios that are characteristic of the Intermountain West, the financial advantages of even one-acre lots are enormous.

all communities’ outcomes will be the same; however, this research consistently demonstrated lower costs and higher revenues from smart growth development.

These strategies can improve public balance sheets for decades to come. With at least one-third of local govern-

ment spending sensitive to the geographic patterns of development, that could amount to billions of dollars each year in savings for local governments nationwide. Most important are the decisions each community makes about its financial future. Every community can use these national figures to

inform their decisions about whether to grow in different, perhaps more beneficial, ways. ■

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