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# Linking Vision with Capital

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**Challenges and Opportunities in  
Financing Smart Growth**  
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- expands the markets for housing and mortgage credit, particularly for underserved populations and communities; and
- assesses the costs and benefits of homeownership.

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**LINKING VISION WITH CAPITAL:  
CHALLENGES AND OPPORTUNITIES  
IN FINANCING SMART GROWTH**

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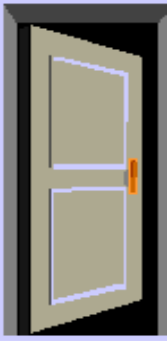
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## THE INSTITUTE PERSPECTIVE

In 2000, the Research Institute for Housing America (RIHA) supported a groundbreaking partnership between the Mortgage Bankers Association (MBA) and the U.S. Conference of Mayors (USCM). RIHA was asked to frame the challenge of linking vision with capital, as mayors and mortgage bankers searched for solutions to the challenges of financing smart growth and urban revitalization. RIHA immediately partnered with Robert W. Burchell and David Listokin of Rutgers University's Center for Urban Policy Research, asking them to bring a national perspective to the deliberations and, ultimately, to author this report.

The partnership convened four urban forums (in Charlotte, Rochester, Minneapolis, and San Francisco) to address issues on sprawl and growth pressures.

Two common themes emerged: 1) the need for market innovation and new products to finance new growth patterns and redevelopment, and 2) the continuing need for tools and subsidies for affordable housing. Thus, the central question arising out of all the deliberations is how the real estate finance community can lend and invest in ways that support local leadership's vision for building and/or rebuilding their communities.

In comprehensively addressing this question, this report fills an important void in urban research. Researchers and policy experts have produced a popular and professional literature that decries sprawl and prescribes how development should look. However, only recently has a literature emerged that grapples with the practical aspects of how to make "smart lending" a viable business proposition. This report is the first comprehensive look at obstacles facing smart growth projects and what the two essential parties—local government and the real estate finance community—can do to make smart growth work.

At its core, smart growth is a set of policy initiatives designed to change the way the market allocates economic activity over space within metropolitan areas. Smart growth prescriptions are not radically new ideas; they typically represent a group of ideas now put into a coherent policy framework. Despite charges to the contrary, smart growth done right is *not* growth control, nor is it imposition of a government regulatory regime on a purely private market. Rather, smart growth seeks to change the way the public and private sectors interact in the course of development.

Many argue for smart growth as a means to promote important public policy goals, such as rectifying regional disparities in growth, rationalizing public investment, and preserving open space. Burchell and Listokin add another important dimension by benchmarking the potential savings over the next quarter of a century from implementing smart growth policies—collectively as much as \$250 billion in public and private costs.

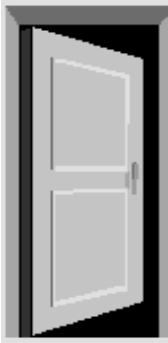
Unfortunately, good public policy, backed by solid arguments, has often foundered on apathy, inertia, prejudice, and preferences. What gives smart growth political legs, however, is that it responds to a very deep-seated reaction among voting suburbanites to a loss in their quality of life. With sprawl, commute times increase; schools and roads become overburdened; open space disappears; housing choice diminishes. Middle-class suburbanites see their quality of life threatened and are increasingly demanding their local leadership do business in a different way.

So why should lenders care? Many of the challenges to increased lending for smart growth are attributable to the success of the current development and real estate finance models. Despite its imperfections, the overall American real estate finance model works well in attracting Wall Street capital to Main Street homes and businesses. Why change a model based on current patterns of metropolitan development that will continue to dominate the American scene?

Because smart growth is not simply a passing fad. While conceding that sprawl will continue to dominate, the authors make a compelling case that smart growth policies will increasingly frame a significant and growing number of local real estate markets. The authors point to numerous examples of smart growth policies already in place across the country, from former New Jersey Governor Christine Todd Whitman's program to acquire one million acres of open space to twelve states that have adopted comprehensive planning and growth management legislation. Projected population increases in the next twenty-five years will only increase the growth pressures leading localities to adopt smart growth measures.

Burchell and Listokin outline a series of challenges that face "smart lending," generally identifying differing (and often unknown) risks associated with this style of development. They show that lending and government practice and procedures designed for traditional development patterns need retooling to do business in a smart growth environment. They thoughtfully lay out a very practical agenda to promote new lending business, combining experimentation, risk-sharing, procedural reform, and product innovation. One of Burchell and Listokin's most insightful contributions is to show that the growth of the surrounding region dictates the priorities and types of smart growth policies most appropriate for cities.

The growing demand for smart lending presents lenders with an unparalleled chance to chart their future business growth. Smart growth represents a significant and growing market segment in which local leadership will increasingly ask lenders to do business. The real estate finance industry has an opportunity to work in partnership with local leadership to ensure the continued, competitive flow of lending and investment. The lender's challenge is to anticipate the future market now, expand the capital market paradigm to embrace the new urban form, and become a true local partner to link vision with capital.



## I. INTRODUCTION

Smart growth creates a supportive environment to redirect a share of regional growth to central cities and inner suburbs. At the same time, growth pressures are reduced in rural and undeveloped portions of the metropolitan area. Public and private strategies shift the demand for growth from outer suburban and peripheral areas to existing central cities and inner suburbs so that growth is more evenly spread and takes advantage of existing infrastructure. By more evenly distributing growth and taking advantage of sunk infrastructure investment, the regional economy is strengthened, residents' quality of life is enhanced, and outer-area natural resource systems are protected and restored (Burchell et al. 1998).

Smart growth is not new; this set of practices draws from past growth management, land preservation, and community development practices and influences in the United States. Smart growth has staying power because it is a sensible approach, has a growing national commitment, and is in tune with the new demographic demand for central places by retirees and immigrants (Burchell, Listokin, and Galley 2000). In this report, we add to the understanding of smart growth's importance by quantifying the potential impact of implementing smart growth techniques.

This report also provides a missing component of the smart growth literature, highlighting barriers and potential solutions to **financing smart growth**. We outline an agenda that can harness the strengths and capacities of the real estate finance community and the local public sector to mutually advance the wider and more efficient use of smart growth principles. Joining these two groups highlights an overlooked but essential partnership to achieve the practical tasks that make smart growth possible.

We identified the techniques discussed in this report from our research and from four smart growth forums<sup>1</sup> held around the country under a Mortgage Bankers Association of America and the U.S. Conference of Mayors partnership. The forums brought together chief executive officers of local government and the real estate finance community, as well as other key community leaders. This collaboration, along with our ongoing research, has produced the first real delineation of the challenges and techniques to financing smart growth.



Another missing and related component of the smart growth literature is a more sophisticated discussion of how smart growth techniques must vary by the type of growth experienced locally. While it seems intuitive that cities in faster-growing regions require different smart growth strategies than in slower-growth cities, this difference has been overlooked in the literature and debate. The experience of the four diverse forum cities (Char-

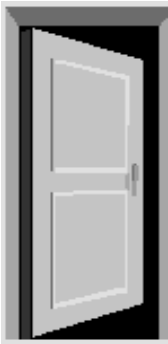
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***Our ongoing research has produced the first real delineation of the challenges and techniques to financing smart growth.***

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lotte, North Carolina; Minneapolis, Minnesota; Rochester, New York; and San Francisco, California) highlighted the importance of understanding and thinking about locational differences as we thought about effective strategies. We use this insight to develop an integrated set of techniques and establish pri-

orities, based on different growth trajectories, that the real estate finance community and local government leaders can apply to achieve the goals of smart growth.



## II. THE DIMENSIONS OF SMART GROWTH: WHAT IS IT, WHERE IS IT, AND WHAT GROWTH ARE WE TALKING ABOUT?

### A. What is Smart Growth?

Smart growth encompasses five basic activities. The first is ***control of outward growth movement***. Growth is managed either between public jurisdictions—usually an urban growth boundary (UGB)—or within a political jurisdiction—occasionally a UGB, but most often an urban service boundary (USB). UGBs typically discourage most types of growth beyond a geographic point. USBs allow growth to proceed only if requisite services can be publicly or privately provided.

Smart growth also ***encourages growth back into slow-growing and more central places***. This involves targeting public employment; expanding tax bases; upgrading of public services and infrastructure; working with the needs and desires of community residents and representatives; and making meaningful changes in the quality of life of these areas (Burchell, Dolphin, and Galley 2000).

The third activity ***focuses urban design to help old and new neighborhoods to function***. This involves mixing housing types and land uses, the creation of meaningful central places, and the introduction of new forms of open space and access to neighborhoods. Strategies here consist of such activities as bringing the building shell closer to the sidewalk, locating off-street parking in the back and providing for on-street parking in the front, breaking up blank walls of buildings with windows and entrances, and using upper floors to accommodate professional offices and housing (Bohl 2000).

***Preserving natural resources*** is the fourth activity. This activity secures, for the public benefit, agricultural and environmentally fragile lands. Further, it reduces the overall amount of lands converted in development. Preserving natural resources includes such approaches as establishing agricultural and environmental trust funds, down-zoning in peripheral areas, clustering of development in these same areas, and purchasing easements to provide public access to the protected lands.

Finally, smart growth requires ***reorienting transportation to reduce dependency on the automobile***. This fifth smart growth activity introduces higher

densities to make various types of transit feasible. Further, it locates new development and redevelopment with services and public transit. These strategies aim to make regional trips non-automobile and local trips non-motorized.

## B. Where Is Smart Growth Taking Place?

Localities are pursuing smart growth by controlling ***peripherally bound growth*** in Lexington, Kentucky and Portland, Oregon, cities having the two oldest UGBs in the United States. Development is permitted exclusively within these UGBs; growth is not allowed outside these boundaries. Princess Anne County in Virginia, Richland County in South Carolina, Martin County in Florida, Denver County in Colorado, and numerous other counties have instituted USBs restricting development outside the boundaries unless public services are in place or private developers provide them with their proposed development. The entire state of Florida requires that permission for development be granted only with concurrent public service availability.

Twelve states (Florida, Georgia, Hawaii, Maine, Maryland, Minnesota, New Jersey, Oregon, Rhode Island, Tennessee, Vermont, and Washington State) have adopted comprehensive planning and growth management legislation that recommends locations for more or less growth. New Jersey's most recent state plan (March 2001) specifically maps five planning areas where more and less growth should take place. Maryland encourages growth in priority funding areas through "smart growth" grants to locally complying jurisdictions (Burchell, Dolphin, and Galley 2000).

***Inner-area revitalization***, an often overlooked element of smart growth, is being undertaken in Atlanta, Georgia. Due to failure to comply with federal water-quality standards, the city is increasing the number of building permits it issues, while Atlanta-area suburban municipalities must limit their growth. In Houston, Texas, to foster city growth, urban neighborhoods can qualify for infrastructure grants to bring urban systems up to par with suburban systems. In Sacramento, California, the City/County Redevelopment Agency actively assists developers with in-city housing by acquiring land and upgrading city services on that land.

In San Antonio, Texas, the city created a development-incentive toolkit for central city developers that offers impact fee waivers, tax abatements, and

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expedited/one-step permitting for selected neighborhoods of the city. In Seattle, Washington, the city offers multifamily tax abatements to developers of market housing in certain areas (Bohl 2000). Myrtle Beach, South Carolina uses a portion of the hotel/motel tax to provide for widening roads and other traffic relief on the Grand Strand (Burchell et al. 1997b).

States also promote inner-area revitalization with their policies. All fifty states have issued executive orders requiring first consideration of existing buildings and urban sites to accommodate additional office space for public employment. The New Jersey Department of Community Affairs provides tax credits for developers rebuilding urban infrastructure as part of their development proposals.

**Urban design** also supports smart growth on a scale that varies from large to small and from region to neighborhood to street. At the **regional level**, New Jersey's 2001 State Plan and Maryland's 1998 Growth Management Act provide for a series of incentives to develop in centers in rural areas and in redeveloped neighborhoods in urban areas (Burchell, Dolphin, and Galley 2000). In Baltimore, Maryland, smart growth replaced high-use public housing projects on super blocks with row houses more connected with the urban street grid. Each residence has its own street space, with front and rear entrances and yards. With on-site commercial uses mixed in with the more central blocks, the **neighborhood** once again becomes the focal point for convenience-oriented activities (Bohl 2000).

At the **street level**, the city of Norfolk, Virginia transformed barracks-style lower-income residences in the Diggstown neighborhood into physical recreations of local architecture. Front porches and individual lots with front and rear yards mimic the local architectural vernacular. Streets were changed to reflect a better sense of local neighborhood.

Change from the regional to the neighborhood level presents diminishing levels of return. As the area scale diminishes, the ability to effect change also wanes (Bohl 2000). At the street level, Diggstown is more subject to the vagaries of local economy than the neighborhood-scale project in Baltimore or the center-scale projects anticipated by the New Jersey State Plan.

Smart growth related to **land preservation** encompasses various measures. For example, the California Futures Model predicts the probability that lands of various types will be converted by development, and models the

impact of interventions by the California Department of Natural Resources to acquire these threatened lands (Landis 1995).

Smart growth preservation efforts also include measures spawned by the voter initiatives of the late 1990s. In 1998, voters approved 72 percent of 240 state and local ballot measures related to the protection or improvement of parks, open space, farmlands, historic resources, watersheds, greenways, and biological habitats (Burchell et al. 1998). In 1999, former New Jersey Governor Christine Todd Whitman suggested and received voter approval to acquire one million acres of farm and environmentally unique lands for future protection. These lands, representing 50 percent of the

remaining developable land in New Jersey, would be purchased at no lower than 1999 market rates (Burchell, Dolphin and Galley 2000).

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***Federal legislation such as ISTEA and TEA-21 encourage state and local efforts that foster intermodalism and reduced auto dependence.***

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Smart growth also involves transfer-of-development-rights ordinances adopted by numerous states, municipalities, and counties in the Northeast and

West. These ordinances preserve land at one site by permitting more or different types of development at another site. The owner of the land at the second site pays the owner of the first site not to develop his or her land with the second site's increased value conferred by its ability to support more or different development (Rose 1975).

Smart growth's ***transportation reorientation*** dimension shifts the motorized trip profile of geographic areas from single-occupant automobile trips to other forms of motorized trips (car and van pools, bus, and rail), and from motorized to non-motorized trips (walking and bicycling). A new commitment by the various states' departments of transportation to bus and rail demonstrates the first shift. Maryland and New Jersey have both increased their budgets for heavy rail commuter lines (MARTA and NJ Transit) each year since 1990. Ridership has increased exponentially each year over that period of time. Cities such as San Francisco, California; Rochester, New York; and Corpus Christi, Texas are experiencing similar investment and ridership levels on bus lines (STPP and CNT 2000).

Employers can assist workers to save on transportation costs. A federal transit commuter benefit allows employers to grant a tax-free \$65 subsidy per month to workers for a monthly transit pass or for a car or van pool program (STPP and CNT 2000). Similarly, Maryland's Commuter Choice Tax Credit offers businesses a 50 percent tax credit for the cost of subsidizing their employees who travel to or from a work site by bus, train, or van pool.

An innovative Seattle initiative encourages city residents to take non-motorized trips. The city encourages families to get along with one car. The program, "Way To Go Seattle," pays participating households \$85 per week to leave their car parked for six weeks and to keep a diary of other transportation they use and the cost of that other transportation (STPP and CNT 2000).

Federal legislation such as the Intermodal Surface Transportation Efficiency Act (ISTEA) and its successor, the Transportation Equity Act for the 21st Century (TEA-21), encourage these and other state and local efforts that foster intermodalism and reduced auto dependence.

### C. Where is Population Growth Occurring?

Growth occurs in response to increased housing and employment demands resulting from the forces of natural population increases, immigration, and regional shifts. In 2000, the United States was a country of 281 million people. The South represented 36 percent of the population (100 million). The West and Midwest were about equally split with 22–23 percent each (63 million and 64 million, respectively). The Northeast represented 19 percent (54 million).

In the past forty years, the United States grew by about 100 million people, with 80 million of that population increase occurring in the South and West. In 1960, the South and West comprised 83.1 million people, or 46.3 percent of a U.S. population totaling 179.3 million. In 2000, the South and West contained 163.5 million people, or 58.1 percent of a total U.S. population of 281.4 million (table 1) (U.S. Department of Commerce 1985, 2000). By 2025, estimates are that the United States will grow by another 82 million people (Woods and Poole Economics 1999). Seventy million of this increased population will live in the South and West. The sum of this regional growth over the past forty years and projected over the next twenty-

**Table 1. Population in the United States  
(in thousands)**

| <i>Year</i> | <i>Total</i> | <i>Northeast</i> | <i>Midwest</i> | <i>South</i> | <i>West</i> |
|-------------|--------------|------------------|----------------|--------------|-------------|
| 1950        | 151,326      | 39,478           | 44,460         | 47,197       | 20,190      |
| 1960        | 179,323      | 44,677           | 51,619         | 54,973       | 28,053      |
| 1970        | 203,302      | 49,061           | 56,589         | 62,812       | 34,838      |
| 1980        | 226,546      | 49,135           | 58,866         | 75,372       | 43,172      |
| 1990        | 248,718      | 50,811           | 59,669         | 85,454       | 52,784      |
| 2000        | 281,422      | 53,594           | 64,393         | 100,237      | 63,198      |

**Source:** U.S Department of Commerce, Bureau of the Census, *Statistical Abstract of the United States* 1985 (Table 12), 2000 (Table 27); Table 4, Resident Population of the 50 States, the District of Columbia, and Puerto Rico.

**Table 2. Housing and Employment Growth  
2000 to 2025**

|                      | <i>Change<br/>(in millions)</i> | <i>Share<br/>(%)</i> |
|----------------------|---------------------------------|----------------------|
| <b>Housing units</b> | 25.0                            | 100                  |
| Northeast/Midwest    | 5.6                             | 22                   |
| South/West           | 19.4                            | 78                   |
| <b>Employment</b>    | 40.0                            | 100                  |
| Northeast/Midwest    | 13.4                            | 34                   |
| South/West           | 26.6                            | 66                   |
| <b>Housing units</b> | 25.0                            | 100                  |
| In central city      | 3.0                             | 12                   |
| Outside central city | 22.0                            | 88                   |

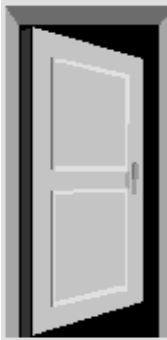
**Source:** Woods and Poole Economics 1999

five years means that, in 2025, the South and West will have a population that exceeds the entire U.S. population that existed in 1950: 150 million.

The United States is projected to grow by 25 million housing units and 40 million jobs between 2000 and 2025 (Woods and Poole Economics 1999) (table 2). As with population, more than three-quarters of the projected growth in housing units and nearly two-thirds of the employment growth will occur in the South and the West. Close to 90 percent of the housing-unit growth is projected to take place outside of central cities given the continuation of historical growth patterns.

In sum, sprawl has been the dominant urban form, promoted directly or indirectly by government policies, consumer preferences, and business practice. As demonstrated by this discussion, though, smart growth is not simply a passing fad in planning. All levels of government are, to varying degrees, directly or indirectly beginning to promote smart growth principles. More and more real estate markets are coming under smart growth regimes, challenging local leadership to work with the real estate finance community to ensure the continued, competitive flow of lending and investment.





### **III. WHY SHOULD WE WANT GROWTH TO BE “SMART”?**

#### **A. Growth is Good, But Smart Growth Costs Less**

Growth provides Americans with housing opportunity and amenities that most would agree constitute a high quality of life. Most Americans hope and expect to own a home that will appreciate in value, is in a safe location, offers a good school system, and has a relatively low property tax cost. Traditionally, growing areas held down property tax increases by expanding tax bases and providing acceptable levels of local public services (Wolpert and Danielson 1992), strategies that contribute to sprawl and to depressed central areas.

Yet the resulting urban form is not preordained. Growth can happen without depleting outer-metropolitan natural resources or inner-metropolitan neighborhoods, resulting in savings for all. This is fundamental to the understanding of smart growth. Smart growth is desirable because it saves resources for state and local governments, individual developers, and occupants of real property. These savings occur through more efficient and responsible development of land, part of a larger commitment to conserve society’s resources for both this and future generations.

Although this is a noble objective, a less idealistic but more compelling reality is that the United States is unlikely to want to pay for two underutilized systems of infrastructure—one in the cities being abandoned, the other in rural areas that can never be fully occupied. Publicly elected officials may be unwilling to commit their constituencies to the tax toll or assessment increases necessary to support this dual system of infrastructure. Locally elected officials are recognizing the fiscal conservatism inherent in this approach and increasingly are onboard for the potential savings achieved through smart growth.

Among other goals, smart growth is touted as an approach that saves resources and tax dollars. These savings occur from reduced and more efficient consumption of land and capital infrastructure, property development, and public services. But what are the specific savings that result from reduced and more efficient consumption of agricultural and environmental lands, roads, and other basic development utilities? How much

**Table 3. Smart versus Traditional Growth Savings**

| <i>Area of Savings</i>           | <i>Savings per Dwelling Unit</i> | <i>Total Savings over 25 Years</i> |
|----------------------------------|----------------------------------|------------------------------------|
| All lands (acres)                | 0.124                            | 3,099,000                          |
| Land cost                        | \$619.79                         | \$15.49 billion                    |
| Agricultural land (acres)        | 0.0694                           | 1,735,000                          |
| Frail environmental land (acres) | 0.0341                           | 852,000                            |
| Local roads (lane miles)         | 0.0036                           | 91,000                             |
| Local road costs                 | \$1,325.08                       | \$33.13 billion                    |
| State roads (lane miles)         | 0.0001                           | 3,000                              |
| State road costs                 | \$106.49                         | \$2.66 billion                     |
| Water laterals (#)               | 0.0902                           | 2,255,000                          |
| Water lateral costs              | \$185.52                         | \$4.64 billion                     |
| Sewer laterals (#)               | 0.0966                           | 2,416,000                          |
| Sewer lateral costs              | \$167.45                         | \$4.19 billion                     |
| Housing costs                    | \$5,791.78                       | \$144.79 billion                   |
| Nonresidential costs             | \$861.25                         | \$21.53 billion                    |
| Fiscal impacts                   | \$964.02                         | \$24.10 billion                    |

**Note:**

Amounts are expressed in 2000 dollars, per residential unit, multiplied by 25 million units for U.S. growth from 2000 to 2025. Dollar savings are \$250 billion, or \$10 billion/year (\$10,000/dwelling unit).

does smart growth save on the residential and nonresidential property development costs? On the costs to provide basic public safety, public works, and public education services?

Evidence gathered in alternative-growth studies conducted by Rutgers University can help answer these questions and project the results nationally (Burchell 1992, 1997a, 1997b; Burchell and Listokin 1994; Burchell and Moskowitz 1995; Burchell et al. 1999). The figures in table 3 represent the pooled results of the findings in New Jersey, the Delaware Estuary, Michigan, South Carolina, and Florida.

These findings are then applied to national growth of 25 million housing units over the twenty-five-year period 2000 to 2025. An average difference in resource consumption between two future development scenarios (sprawl versus smart growth) is created, reflecting the numerous localities and conditions in which these studies have been undertaken. This average difference is expressed per residential unit (and associated nonresidential growth) and is applied to the future growth, cited above, of the United States housing stock over the next quarter-century. While not a scientific sample, the studies have been conducted in diverse locations, including slow- and fast-growth states, rural and developed locations, and large and small jurisdictions (Burchell et al. 2000).

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***Smart growth could save as much as \$250 billion (in 2000 dollars) over a 25-year period.***

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With its emphasis on close-in development, infill, a mixing of land uses, and cluster development, we estimate that smart growth could save as much as \$250 billion (in 2000 dollars)

over a 25-year period. Three-quarters of the savings would be in the form of housing and development cost savings to developers, new home buyers and commercial building tenants. Another 15 percent would be in road savings to local and state governments. About six percent would be in land savings to local and state governments. Finally, four percent would be in development utility savings, again to land developers and occupants of new structures.

## B. Smart Growth Plays Out Differently over the Metropolitan Geography

The following analysis attempts to put in context the revitalization realities in urban counties in the South and West versus the Northeast and Midwest Census Regions of the United States. This research demonstrates that urban revitalization in different regions of the United States is not equally achievable. Urban revitalization strategies, a portion of them financial, must be applied differently and have different priorities according to the overall magnitude of growth in a region. Strategies applied to an urban area in the Charlotte, North Carolina, metropolitan area may have

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priorities vastly different from those applied in the Rochester, New York, metropolitan area. This becomes apparent only when the differences in overall regional growth are seen and their impacts quantified.

The analysis that follows shows the differences in growth taking place in different regions of the United States. For illustration purposes, projections are made for a 25-year period (2000–2025), assuming that recent migration, income, and spending patterns continue to hold for this period. Projections are made assuming that growth through an urban growth boundary or urban service area can be redirected to other counties in the metropolitan area. This produces more households, more income, more jobs, and more nonresidential space in urban areas; however, as the analysis will show, this does not happen evenly. More growth in the South and West produces far more households, income, employees, and nonresidential space in urban locations than reduced growth does in the Northeast and Midwest. This requires different revitalization strategy emphases for urban areas in the different Census regions. Urban revitalization is not a “one size fits all” activity. The growth of the surrounding region affects the health of the urban area, and the urban revitalization strategy applied must reflect this reality.

Growth projections obtained from a Rutgers University study for the Transportation Research Board of the National Academy of Sciences (Burchell et al. 2001) are combined with information on the distribution of household income to show the differential effects of growth in regions. Although this information is for illustrative purposes only, it clearly sets the frame within which urban revitalization strategies are applied. Urban areas in the Northeast and Midwest need income and tax base transfusions; similar areas in the South and West must, as their primary urban investment strategy, deal first with the impact of groups competing for urban space and then with sources of financing. These are very different situations that require very different forms of revitalization attention.

The Rutgers University study cited above examined where sprawl actually was occurring. The study found that, of the 3,100 counties nationwide, sprawl, defined as significant low-density, single-use, residential and/or nonresidential development in rural or undeveloped counties, was taking place in only 740 of the 3,100 counties. Fully three-quarters of U.S. counties were either declining or growing too little to be characterized as sprawl

**Table 4. Counties in the United States that Are Sprawling and Those in which Sprawl Can Be Controlled**

| <i>Type of Counties</i>    | <i>Rural and Undeveloped</i> | <i>Suburban and Rural</i> | <i>Urban Center and Urban</i> | <i>Total</i> |
|----------------------------|------------------------------|---------------------------|-------------------------------|--------------|
| Total Counties             | 2,726                        | 265                       | 100                           | 3,091        |
| Nonsprawl Counties         | 2,128                        | 121                       | 100                           | 2,349        |
| Sprawl Counties            | 598                          | 144                       | 0                             | 742          |
| Sprawl-controlled Counties | 345                          | 64                        | 0                             | 409          |

**Source:** Burchell, R. W.; G. Lowenstein; W. R. Dolphin; C. C. Galley; A. Downs; S. Seskin; K. Gray Still; and T. Moore. Forthcoming 2001. *Costs of Sprawl 2000*. Washington, DC: National Academy Press.

counties (2,130 counties), or were already too developed to be able to sprawl in the future (220 counties).

Of the 740 counties that were sprawling, if an urban growth boundary were created in each metropolitan area where they were located, growth in 410 of the 740 counties could be controlled sufficiently that the counties would no longer be considered sprawling. Outer-county growth would be redirected to inner counties without causing the inner county to sprawl (Burchell et al. 2001) (table 4).

For the period 2000–2025, shifting growth within an area close to this size would control sprawl for 2.5 million of the projected 23 million new households.<sup>2</sup> Of these 2.5 million households, 1.8 million could settle in urban counties instead of developed suburban counties.<sup>3</sup> The income associated with these 1.8 million urban-bound households (table 5) is approximately \$82 billion (table 6), or about \$45,000 per household (in 2000 dollars).<sup>4</sup>

**Table 5. Household Redistribution in the United States under a Controlled Growth Future**

- 2.05 Million households *out* of rural counties
- 0.45 Million households *out* of suburban counties
- 0.70 Million households *into* suburban counties
- 1.80 Million households *into* urban counties

**Source:** Burchell, R. W.; G. Lowenstein; W. R. Dolphin; C. C. Galley; A. Downs; S. Seskin; K. Gray Still; and T. Moore. Forthcoming 2001. *Costs of Sprawl 2000*. Washington, DC: National Academy Press.

**Table 6. Household Income Shifts, United States 2000–2025 (billions of \$)**

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**Uncontrolled versus Controlled Growth Future**

| Area                  | <i>Uncontrolled</i> | <i>Controlled</i> | <i>Difference</i> |
|-----------------------|---------------------|-------------------|-------------------|
| <b>Rural</b>          | 372                 | 278               | – 94              |
| Northeast and Midwest | 90                  | 74                | – 16              |
| South and West        | 282                 | 204               | – 78              |
| <b>Suburban</b>       | 402                 | 409               | + 7               |
| Northeast and Midwest | 95                  | 95                | 0                 |
| South and West        | 307                 | 314               | + 7               |
| <b>Urban</b>          | 271                 | 353               | +82               |
| Northeast and Midwest | 44                  | 58                | +13               |
| South and West        | 227                 | 295               | +68               |
| <b>TOTAL</b>          | 1,045               | 1,040             | – 5               |

**Source:** Rutgers University, Center for Urban Policy Research, February 2001

**Table 7. The Impact of Sprawl-Redirected Households on Urban Household Income and Retailing**

| <i>Category</i>                                | <i>Total</i> | <i>Northeast/<br/>Midwest</i> | <i>South/<br/>West</i> |
|--|--------------|-------------------------------|------------------------|
| Additional Urban Households (millions)         | 1.80         | 0.45                          | 1.35                   |
| Household Income (\$ billions)                 | 82           | 13.4                          | 68.6                   |
| Consumption Income (\$ billions)               | 65           | 10.5                          | 54.5                   |
| Employees Supported (thousands)                | 800          | 130                           | 670                    |
| Low- and Moderate-Income Employees (thousands) | 190          | 30                            | 160                    |
| Space Supported (millions of sq. ft.)          | 225          | 37                            | 188                    |

**Note:** See appendix table 1.

**Source:** Rutgers University, Center for Urban Policy Research, February 2001

One can argue whether \$82 billion is a large or small number compared to the \$1.05 trillion in household income associated with the growth of 23 million households. However, assuming that consumption income is 80 percent of household income, this represents \$65.4 billion in spending<sup>5</sup> that could support 625,000 new employees<sup>6</sup> across the various components of consumption (food, housing, apparel, transportation, health care, entertainment, and the like) (table 7 and appendix table 1). Of the redirected 625,000 new employees, approximately 170,000 employees would be low and moderate income.<sup>7</sup> The shift of households to urban counties would also support 225 million square feet of commercial space related to consumption,<sup>8</sup> or the equivalent of building a new regional shopping mall in

every U.S. city with more than 100,000 population. Clearly, for urban areas experiencing nonresidential decline, these are very welcome numbers.

This is not the whole story, however. These figures demonstrating the potential impact of a smart strategy for urban counties are certainly impressive in the aggregate. When these numbers are sorted by region, and thus implicitly by faster-growing versus slower-growing metropolitan areas, the numbers show disparate trends.

Less than one-sixth of the \$82 billion shift in household income to urban counties (\$13.4 billion; see table 7) would go to counties in the Northeast and Midwest—locations of slower-growing metropolitan areas.<sup>9</sup> Nearly one-third, or 72 of the 225 cities nationwide with populations in excess of 100,000, are located in the Northeast and Midwest. Yet there are twice as many cities of 100,000 or more in the Northeast and Midwest—32 percent—compared to the income flow from the population shift to urban counties in these regions (16 percent).

On average, though, cities in the South and West are growing at three times the ratio of cities in the Northeast and Midwest. Thus, five-sixths of the potential urban income flow (\$68.6 billion; see table 7) goes to faster-growing locations rather than their counterparts in the Northeast and Midwest.

In sum, smart growth patterns of development will not happen everywhere, since existing development bounds the relevance of smart growth. Furthermore, the impact of smart growth plays out very differently, depending on the region, and, by implication, the area's population growth. In a later section, we differentiate the problems of and strategies for financing smart growth in cities based on this disparity in regional growth rates. We first explore the nature of the challenges and potential solutions to financing smart growth in a broader sense.





#### IV. FINANCING AND SMART GROWTH: THE CHALLENGE

Despite its obvious importance, the financing dimension of smart growth has, with few exceptions (Gyourko and Rybczynski 2000; Leinberger and Davis 1999; Leinberger 2001), been paid little heed. The smart growth discussion has centered on such topics as urban growth boundaries and regional tax-base sharing. The smart growth dialogue has involved government officials, planners, neighborhood groups, and many others. The smart growth community, however, has largely omitted such topics as how to secure construction and permanent financing for smart growth. Furthermore, local planning and zoning efforts and broader policy debates have not typically included representation from the real estate finance community. These omissions are an oversight, for scholars do present evidence of smart growth development encountering financing problems (Nelson 2000, 4):

What happens when a community embraces smart growth? Banks are often unwilling to underwrite it. Take the example of Ridenour in suburban Atlanta, located at the intersection of two major highways on one of the largest tracts of vacant land in the vicinity. Ridenour is a mixed-use development on 88 acres composed of 64 single-family detached homes, 80 town houses, 124 condominium units, 350 apartments, 500,000 square feet of office space, 112,000 square feet of retail space, and a village center composed of a hotel, a nursing home, day-care facilities, and bed-and-breakfasts. The whole project will cost \$280 million to build, but local banks are willing to finance only the residential element. The \$32 million needed for the town center has not been secured.

We need to begin thinking about ways to bridge this gap between local leaders' vision for the development and redevelopment of their communities and the business realities and incentives and capital market structure facing real estate lenders and investors. To do this, we first need to understand how smart growth developments appear to those who evaluate and price risk. As a starting point, we suggest that ***lenders and developers may shun smart growth because they view it as riskier than and different from alternative investment opportunities for a variety of reasons.***

1. ***Smart growth embraces higher density and, in other ways, a different development pattern.*** Smart growth development in suburbs, such as new towns, higher-density single-family and multifamily, and “new urbanism” projects, run counter to the traditional low-density, Euclidean-zoned, tract model of suburban development. This departure from the conventional suburban approach may evoke concern from the real estate community.

Interestingly, lenders view new urbanist suburban communities as riskier than redeveloping central neighborhoods using these principles. Gyourko and Rybczynski (2000), after surveying real estate practitioners, found that the “lender/investor community was adamant that suburban greenfield sites [compared with new urbanism projects that infill urban locations] were much riskier—so much so that many would not even consider investing in them” (p.737).

Community groups may fight smart growth development such as higher-density suburban housing. In Charlotte, North Carolina, adjacent property owners contested proposals for multifamily condominiums that would counter sprawl on NIMBYism (Not In My Back Yard) grounds. In Litchfield, Connecticut, a proposed 138-unit townhouse development on a 77-acre site already zoned for multifamily housing was opposed as being “too dense”—and this in a community of 51 square miles populated by 8,800 persons. The “safe” investment in places like Charlotte and Litchfield is single-family detached housing on large lots—but that perpetuates sprawl.

2. ***Smart growth encourages mixed use and, in other ways, a different product type.*** Smart growth encourages mixed-use development and a variety of housing types. However, “the development of multiple uses—or multiple product types—in a single project is viewed (by developers, financiers, and investors) as inherently more difficult to evaluate and implement” (Gyourko and Rybczynski 2000, 723). The developer of the mixed housing/retail, transit-served, Belmont Dairy project in Portland, Oregon—a prototypical smart growth development—bemoaned the fact that “debt lenders did not understand mixed-use projects” (Fannie Mae 2000, 4).

3. ***Smart growth projects preserve and expand housing opportunities for traditionally underserved communities and families.*** Two challenges emerge because of this. Such projects, by necessity, often involve subsidies, generally in short supply and complicated to secure, that must be incorporated in

the underwriting process. These projects also typically have a mix of incomes, also presenting an underwriting challenge for many lenders.

Affordable housing is typically produced in the United States through a layering of **federal subsidies**, such as the Community Development Block Grant (CDBG), HOME monies, the Low Income Housing Tax Credit (LIHTC), and the historic Investment Tax Credit (ITC). **State subsidies**, such as below-market-interest-rate (BMIR) financing from state housing finance agencies (HFAs) and state tax credits, are also typically involved. Finally, **local assistance** often includes subsidies like that provided by the Miami-Dade County housing surtax, as well as local property tax abatement, often in the form of payment in lieu of taxes (PILOT). Mixed-income housing preserves affordability for lower-income families by drawing on these subsidies, and often additionally cross-subsidizes them from higher rents charged for the market-rate units.

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***We need to begin thinking about ways to bridge the gap between local leaders' vision for the development and redevelopment of their communities and the business realities and capital market structure facing real estate lenders and investors.***

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The result of these measures is that smart growth development including affordable housing and/or mixed-income housing is compli-

cated. Such development involves many entities that impose varying and often conflicting requirements and submission schedules. Mixed-income housing also contains features, such as long-term affordability restrictions, that make the underwriting of such projects challenging and different from more traditional projects.

4. ***Smart growth projects tend to be large and complex.*** New town, multi-family, mixed-use, and mixed-income developments that typify smart growth tend to be on a greater scale and more difficult. Other smart growth characteristics add to the complexity. Smart growth may encompass reclamation of brownfield sites, a process that is inherently challenging. Smart growth attempts, through rehabilitation, to maximize continued use of the existing stock. Yet, relative to new construction, rehabilitation is more difficult because one is dealing with a “used canvas” rather than the clean slate of new construction.

Further, compared to conventional development or sprawl, development-site assemblage for smart growth is often more burdensome. Whereas conventional development is unfettered because it uses the easiest and cheapest sites—often farmland at the metropolitan periphery—smart growth targets specific areas, such as infill and transit-served neighborhoods. For these reasons, smart growth projects trend toward greater size and complexity. That scale and complexity may be beyond the “comfort range” of standard mortgage underwriting.

5. ***Smart growth projects may involve legal complications*** that add to financing stress. In urban neighborhoods, delinquent taxes, mechanics’ liens, and estate and other legal issues commonly frustrate conveyance of clean title. Brownfield sites may present title problems. Other legal issues may add additional complications. For instance, to qualify for a PILOT, a neighborhood may first need to be legally declared as “blighted.” To garner a historic ITC, a historic district may have to be “designated,” and so on. Traditional investment opportunities do not typically face as many legal obstacles and procedures.

6. ***Smart growth projects typically have large up-front costs.*** Infrastructure provision illustrates the nature of this problem. Smart growth developers often have to provide infrastructure up front to accommodate multifamily development on greenfields and inner-area revitalization. Porter (2000, 4) observes that “although infill sites supposedly are already served by basic infrastructure, builders frequently find it necessary to upgrade water and sewer lines, improve streets and sidewalks, and provide landscaping.” Over the long term and from a broader societal perspective, smart growth can demand less infrastructure compared to sprawl (e.g., fewer publicly supported roads need to be built in the region). However, in the short term, and from a developer’s perspective, smart growth demands concurrent infrastructure and therefore more initial capital investment.

Other smart growth features—smart growth’s emphasis on better design (e.g., new urbanism), targeted site assemblage, brownfield reclamation, and rehabilitation holding costs—can increase, compared to traditional sprawl projects, the up-front expenses borne by the developer. Given the time value of money, the more substantial the up-front outlays, the greater the challenge to the developer and lender. If smart growth is perceived as riskier for these reasons (e.g., the nurturing of a market, the complications of mixed

use, and higher up-front expenses), developers and lenders will demand a higher rate of return—and that makes it harder for a project to pass financial muster.

**7. *Smart growth challenges the conventional wisdom about where to develop, and that can give an underwriter pause.*** Smart growth encourages redevelopment in cities and older suburbs that, in the post-World War II era, the market has largely bypassed. A potentially large, latent consumer

demand may exist for these close-in locations. Aging baby-boomers, immigrants, and others are drawn to close-in areas proximate to work and offering adult life-style amenities (e.g., museums, theaters, and restaurants). Even with this potential demand, these “new market” locations must be nurtured—a daunting proposition. Under-

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***The fundamental challenge to financing smart growth is the view that it is riskier and different from alternative investment opportunities.***

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writers may be uncomfortable—without compelling evidence—approving developments proposed for cities and older suburbs.

These areas confront staggering macro physical, economic, and social problems, such as rampant decline in population, tax base, and public-service quality. Rochester, New York, for example, lost one-third of its population between 1950 and 1990. The city’s property tax base declined by \$0.5 billion in the last ten years, while surrounding suburbs have gained \$1.5 billion in tax base. Challenging macro forces fundamentally impede redevelopment in Rochester and sister older communities.

Micro quality-of-life issues also constrain redevelopment. For instance, the need to concurrently provide urban retail stores ranging from supermarkets to dry cleaners can frustrate urban residential infill. National chains may be wary of urban locations. In contrast, retail generally is readily provided by the development community in greenfield, suburban locations. Given these issues, it is understandable that, absent compelling evidence to the contrary (e.g., a national chain committing to a downtown location), underwriters lean toward the conventional wisdom that favors suburban development and remain wary of proposals for cities and older suburbs.

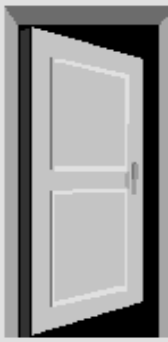
8. ***Smart growth must deal directly with quality-of-life issues.*** In many cities, urban revitalization cannot begin because streets are crime-ridden and public schools are not educating students. The quality of life (QOL) in some neighborhoods is so poor that they are regarded as not worth investing in. Potential new residents will not move where they do not feel safe. If they have a choice, families will shun neighborhoods with failing public schools. Business owners will not relocate where either there is not a viable market and/or they cannot keep their premises secure. Without addressing these issues, smart growth finance is irrelevant. No finance will be needed, because there will be no business to finance.

In sum, the fundamental challenge to financing smart growth is the view that it is riskier and different from alternative investment opportunities. Smart growth is riskier because it embraces higher-density, mixed-use, and mixed-income development, whereas the market is more comfortable with lower-density, single-use, and market-rate units.

Underwriters often manage risk through compensating rate adjustments where a premium is required for riskier investments. But that begs the question of the exact scalar of smart growth's heightened risk. How long will it take to bring back a city or older suburban neighborhood? How long will it take the National Park Service to approve the design for a historic ITC, or for a state housing finance agency to grant an LIHTC, or for a redevelopment agency to declare a neighborhood blighted? How long will it take to clear title on a brownfield site? How much longer (or shorter) a time period will be needed to sell out a "new urbanism" project, compared with a conventional development? How long will it take for neighborhood QOL to show significant gains? Since the answers to these and other questions confronting smart growth projects are not readily known, lenders find it difficult to determine the appropriate risk premium.

Smart growth finance also tends to be idiosyncratic rather than standardized, leading to further financing tensions. The lending industry is increasingly characterized by standardization and routinization. (These trends are most pronounced in single-family underwriting.) Making capital a commodity contributes to the efficiency of the current mortgage industry and explains such recent trends as automated underwriting with credit scoring. Yet smart growth projects, with their custom-crafting of mixed uses, mixed incomes, layered subsidies, and the like, run counter to a standardized financing regime.

Thus, the challenges of smart growth financing are its perceived higher risk and different and idiosyncratic nature relative to alternative investments perceived as safer and more standardized—or at least whose risk can be more readily gauged. Multi-pronged strategies must be used to address these fundamental challenges.



## **V. LINKING VISION WITH CAPITAL: REALIZING THE BUSINESS POTENTIAL OF SMART GROWTH**

This section explores how local visions of smart growth can be linked with the capital necessary to realize this change in land use. Our prior discussion has highlighted that local leaders around the country are pursuing smart growth principles. Given the extent of activity on the ground and the strong incentive for localities to pursue smart growth strategies, we clearly see a developing segment of the marketplace where real estate lenders will increasingly do business.

To jumpstart new market practice supportive of smart growth, we first establish the importance of involving lenders in the process, and then review numerous strategies that can help local leaders and the real estate finance community to work together. These strategies are not encyclopedic in their coverage, but rather touch on a number of critical activities to link the smart growth vision with debt financing. Ideally, this review will foster continued dialogue, further study, and experimentation to solve the problems we have identified above.

### **A. Lenders Must Be Involved**

Smart growth advocates must recognize the fundamental importance of securing debt financing. Lenders are reticent about funding projects they do not understand; therefore, government and community leaders must learn lenders' concerns and work with them. Such awareness is often not the case. For instance, a long-range vision plan that would counter sprawl in Charlotte, North Carolina included government, developers, neighborhood groups, and many others—but not lenders. The U.S. real estate finance market, at \$6 trillion, is the largest debt-sector market in the world. Local leaders must recognize the challenges they face as they seek to tap into this large pool of potentially available funds.

At the same time, lenders should recognize the market potential of smart growth. It is not just a planning fad but an on-the-ground reality in at least a dozen states. It will not replace traditional development, but this report demonstrates that a significant segment of current and future growth—



and lenders' business—may potentially be conducted in a smart growth context.

Smart growth offers a multibillion-dollar business opportunity to lenders. Financing for smart growth encompasses the full range of financing requirements. It includes both construction and permanent lenders from the commercial and residential segments who originate these loans, as well as the various secondary market businesses and enterprises that package and sell these mortgages. Activities that require financing span development, purchase, and rehabilitation.

We envision the real estate finance industry's participation in smart growth as a partnership with other key players—local, state, and federal governments, the full gamut of the real estate community, other private-sector

entities, and community and nonprofit groups. Only a partnership arrangement can address the myriad challenges to growth that we identified in the last section. The following discussion explains how such a strategic partnership can link

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***Lenders should recognize the market potential of smart growth.***

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the smart growth vision with debt financing. We sketch a general set of strategies in the subsequent discussion, with a more in-depth examination of some specific options provided in the appendix.

## B. What Can the Smart Growth Community Do?

The economic, legal, and institutional framework in which lenders operate is critical to their willingness to finance smart growth projects. Thus, whenever local governments can responsibly act, they should structure the lending environment to be consistent with reasonable underwriting standards and to provide lenders with a “clean” collateral position.

1. ***Policies can be established to address liability issues that stymie the reuse of such parcels as brownfields.*** Governments have promoted brownfield reclamation through regulatory relief (e.g., liability limitations) as well as with public subsidies. The broad policy of holding all “potentially responsible parties” liable under the law for the costs of remediation and cleanup

needs to be revisited, due to its dampening effect on lender and investor interest.

Various states have provided financial incentives for brownfield cleanup. Maryland provides site-testing funds and other incentives for the redevelopment of properties with real or suspected environmental barriers. New Jersey developers can recover up to 25 percent of the cost of remediation, once the redevelopment project begins to realize new tax revenues in an amount sufficient to cover the cost of remediation. Minnesota's Voluntary Investigation and Cleanup (VIC) program helps to reclaim brownfields by limiting the liability of parties (e.g., property owners, developers, and lenders) voluntarily investigating site contamination and cleaning such sites. VIC also allows partial cleanup plans for those wishing to develop a portion of a larger site. The latter provision allows a developer to avoid the often staggering costs of having to clean up an entire brownfield. At the federal level, some have called for tax credits for brownfield reclamation.

**2. *Technology and innovative processes can address title problems that be-devil smart growth redevelopment.*** Computerizing title records can facilitate title searches. Fast-take property-tax foreclosure by a city (see appendix) can wipe out tax, mechanics', and other liens that often cloud titles on inner-city properties.

3. Building-code reforms (see appendix) can encourage the smart growth theme of maximizing the life of the existing stock. New Jersey crafted and adopted separate regulations for building rehabilitation and reaped the benefit of lowered renovation costs (with estimated savings of 10 to 20 percent) and expanded rehabilitation investment (NAHB Research Center, Inc., 1999). As part of its smart growth initiative, Maryland is revising its building code to support renovation. The New Jersey and Maryland revisions, as well as the Nationally Applicable Recommended Rehabilitation Provisions (NARRP) developed by the Department of Housing and Urban Development (HUD) (see appendix) are "smart codes" that merit consideration by other jurisdictions interested in increasing finance for rehabilitation.

**4. *Streamlining the development permitting process can enhance the flow of real estate finance to support smart growth development.*** Since time is money, regulatory efficiencies that cut time and add certainty make smart growth development more attractive to lenders. As part of the "Building Homes in

American Cities” initiative, Tampa, Florida streamlined its permitting process and is adopting a fully electronic application and inspection system. Chicago, Illinois permits builder self-certification of pre-approved home designs, thus bypassing a series of administrative reviews. Finally, Houston, Texas allows private inspections to augment the city’s overworked inspectors (Porter 2000).

**5. *Shortening and simplifying the development process makes it easier to obtain real estate financing from lenders.*** Particularly for urban redevelopment,

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***Government is in a unique position to enact policies in a manner supporting smart growth goals.***

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land assembly has always presented a great deal of uncertainty that can discourage financing. Government is in a unique position to enact policies and conduct its own real estate business in a manner

supporting smart growth goals. For instance, the following activities bear consideration (also see the appendix on Land Banking):

- The federal government can use its surplus-property disposition and property sales to proactively support smart growth (e.g., offer surplus property in downtown areas to historic preservation organizations).
- State government can create property disposition parallel to federal actions and can also enable local government (when such authorization is necessary) to effect condemnation, fast-take, land banking, and other activities (see below) to assemble sites for redevelopment.
- Local government can apply condemnation, fast-take, land banking, and other approaches (see appendix) to acquire parcels, resolve legal and other issues, and then write down the cost of the assembled properties (using CDBG and other funds) to for-profit and nonprofit developers initiating smart growth-furthering projects.

Numerous cities are already pursuing similar strategies (Porter 2000). **Chicago** assembles and attractively packages properties under Home Start, City Lot, and other programs. **Houston’s** redevelopment authority land banks tax-delinquent properties for new housing. In **Sacramento, California**, city/county redevelopment and Capital District agencies acquire surplus and

other lands for housing. Cities *not* doing land banking can miss out on valuable opportunities. For instance, Rochester, New York lost a \$100 million nonresidential facility to its suburbs because it couldn't provide a "50-acre site, ready to go."

**6. Local governments can locate and invest in infrastructure in ways that enhance the collateral values behind smart growth loans.** Just as the private infusion of capital in adjacent areas can create and enhance property values, targeted public investment can reduce risk by creating more upside potential for loan collateral. Localities often spatially target normal investments and services, or even special subsidies that enhance the value of specific properties. This enhanced value, in return, makes lending in support of smart growth objectives a better bet for private lenders.

Jazzland, a 140-acre theme park in an economically depressed area of New Orleans, was developed with a \$10 million grant from Louisiana's Infrastructure Development Fund, a \$25 million Section 108 HUD loan guarantee, and \$65 million in conventional financing and developer's equity. Other state governments provide tax assistance for infrastructure improvements. New Jersey recently announced a plan for state tax credits to private companies that upgrade the infrastructure in New Jersey cities. These investments will support new urban development anticipated as a result of adoption of the New Jersey State Plan, which discourages sprawl and encourages redevelopment in centers.

Localities can also provide support for infrastructure through the tax codes and fee schedules of local governments (Porter 2000). They have frequently used tax increment financing (see appendix) to provide or reduce the cost of infrastructure. Minneapolis, Minnesota has used this technique to fund garages and other improvements. Houston, Texas adopted Tax Increment Reimbursement Zones and city reimbursement of developer infrastructure costs to encourage in-town development. San Antonio, Texas similarly opted for Tax Increment Reinvestment Zones. As part of the "Building Homes in America's Cities" initiative, Chicago, Illinois waived fees for infrastructure, as did San Antonio. St. Louis, Missouri levied a half-cent sales tax to fund infrastructure improvements and found that strategy "to be useful in spurring housing development" (Porter 2000).

**7. Local governments can improve the quality of life in communities targeted for smart growth efforts, creating the environment where commercial and**

**residential lenders can safely project sufficient economic activity to justify lending.** Investments in QOL improvements often accompany contemporary downtown improvement. These investments create a more favorable climate for real estate finance in support of smart growth objectives by making increased economic activity possible.

To attract shoppers to its “Center City,” Portland, Oregon formed a special improvement district (SID) to improve security (including building a new police substation and establishing a privately funded patrol force), improve sidewalk cleaning, and promote centralized marketing. Similarly, SIDs provide security, cleaning, and other services for the 16th Street Transit Mall

in Denver, Colorado and for Seattle, Washington’s Waterfront and First/Second Avenue Corridors, making these areas places that are more desirable to visit.

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**The public sector can do the pilot lending that establishes a track record of profitability in smart growth investment.**

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Cities in the Southwest are also moving to address quality-of-life issues. As part of the National Association of Homebuilders’ “Building Homes in America’s Cities” initiative, Houston, Texas organized a “Neighborhoods to Standard” program that focuses on improving public facilities and services, such as better trash removal and street repairs (Porter 2000). Other cities that are part of this initiative have taken similar actions to improve the neighborhood QOL, including San Antonio (“Neighborhood Sweeps” program, combining city cleanup and improvements) and Chicago (grants for home facade improvements).

**8. Placing public employment and facilities also can revitalize community economies, making adjacent properties and businesses stronger candidates to get loans.** All levels of government can locate facilities in areas targeted for smart growth measures. By enhancing the economic viability of surrounding properties and businesses, these actions facilitate more lending in these areas. The federal government has existing directives to locate facilities in, or otherwise support, urban, central business district (CBD), historic, and other areas that smart growth measures typically seek to revitalize. These federal mandates include the 1976 Public Buildings Cooperative Use Act (General Services Administration should acquire space

in historic properties), the 1978 Executive Order 12072 (give first consideration to space needs in CBDs), and the 1996 Executive Order 13006 (locate federal facilities in urban/historic locations) (see appendix). Localities should reexamine these various directives in light of their smart growth objectives to see if they effectively support smart growth goals.

In a parallel vein, state government can consider enacting mandates to similarly locate state facilities in CBDs. Maryland, Oregon, and Vermont have enacted such executive orders and legislation. For example, a 1994 Oregon Executive Order directed all state agencies to give preference to downtown locations (see appendix).

HUD's "Officer-Teacher Next Door" program provides an innovative example of linking public employment to efforts to revitalize communities. This program gives professionals more of a stake in the neighborhoods where they work. HUD expects that a heightened stake, as well as the physical presence of police and teachers, will ultimately improve public safety and educational services. The resulting increase in neighborhood stability can improve prospects for residential and commercial lending by demonstrating a market and removing perceived risk factors.

**9. Localities can employ public financing for unusual or difficult development that supports smart growth.** The public sector may want to provide temporary or bridge financing, or can do the pilot lending that establishes a track record of profitability in smart growth investment that is particularly challenging to private lenders. For instance, to encourage the adaptive reuse of obsolete office buildings to housing, Maryland offers gap financing.

### C. What Can the Real Estate Finance Community Do?

**1. The real estate finance community can develop and disseminate information on appraisal techniques that can capture the value of smart growth development.** The financing of a potential smart growth project can be stopped in its tracks if the appraisal of the proposed development used for loan purposes falls short, or at the extreme, is less than the cost of construction. The generic problem is that both the comparable sales and income approaches used to estimate value may not capture the true value of a smart growth project. The resulting "appraisal gap," for instance, is a particular problem when a pioneering smart growth initiative is

contemplated, such as a new single-family subdivision planned in a city that has not witnessed such construction for years.

The private sector can help address this problem by developing and disseminating information on appraisal techniques that are appropriate for smart growth projects. Major lenders and financial organizations like appraisal organizations and finance trade associations can develop pilot programs in targeted smart growth areas—projects that would explore alternative appraisal techniques in such situations. For example, the area from which comparable sales (“comps”) are selected may need to be expanded. When new for-sale housing was built in Detroit, Michigan, a few years ago,

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***There are myriad pilot programs designed to experiment with mortgage terms and to extend the reach of the mortgage industry.***

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appraisers had to look at suburban comps. A pilot program could also consider the valuation of reclaimed brownfields and mixed-use, adaptive reuse, and rehabilitation projects. Appraisal organizations can create a brochure suggesting “best practices” (e.g., selecting comps and valuing brown-

fields) regarding smart growth appraisal policies and practices.

Major lenders and the government sponsored enterprises (GSEs) can include procedures that recognize and further smart growth techniques in their appraisal process guidelines. Lenders can establish an internal smart growth quality-control function for appraisals ordered through their offices. Many lenders already have such mechanisms in place for fair housing and other concerns. For example, appraisal reports for denied loans could be selected randomly to see if any patterns emerged highlighting criteria that might unnecessarily block sound smart growth lending.

The public sector can promote innovation in appraisals by providing information on pending public infrastructure improvements, parallel private investments, and other data crucial to making accurate predictions underlying the income approach. Information on the growing job market and public riverfront improvements in Rochester, New York can bolster the valuation of redevelopment projects in that city, such as Chevy Place. Housing market studies commissioned by such cities as Columbus, Ohio and San Antonio, Texas, and a homeownership Internet Web site developed by

Cincinnati, Ohio demonstrate to builders and appraisers the reality of in-city demand for housing, helping to address appraisal shortfalls (Porter 2000).

**2. *Participating in and expanding pilot programs for smart growth financing can establish a track record that can be used as the model for regular loan programs.*** There are myriad pilot programs designed to experiment with mortgage terms and to extend the reach of the mortgage industry. Freddie Mac and Neighborhood Housing Services of Chicago (NHSC) developed the “Family Plus” program—a joint NHSC/Freddie Mac pilot program that targets a significant portion of Chicago’s inner-city neighborhood housing stock, specifically owner-occupied two-, three-, and four-unit flats (Listokin and Wyly 2000). There is no income ceiling for program participation. The program offers a thirty-year, fixed-rate mortgage made by a participating lender and a fifteen-year second mortgage at 5 percent, made by NHSC. This combination enables the borrower to reduce the overall cost of his or her mortgage money and to avoid private-mortgage insurance. A Fannie Mae “Living in Philadelphia” pilot makes available a market-rate first mortgage with a layering of assists, including a soft-second mortgage from the City of Philadelphia and an unsecured bank loan granted by the Pew Trust.

By sharing risk to stabilize and revitalize older neighborhoods, pilot programs such as Family Plus and Living in Philadelphia foster smart growth. Other pilots that support other characteristics of smart growth, such as transit-oriented development, deserve consideration. The \$127 million pilot Location Efficient Mortgage<sup>SM</sup> (LEM<sup>SM</sup>) described earlier (see appendix) is a prime example. The LEM<sup>SM</sup> assumes reduced transportation expenses and therefore increased housing debt capacity. Expanded debt ratios increase the home-buying capacity of consumers who purchase housing in compact, transit-served, mixed-use, and similar areas favored by smart growth.

Pilots also can be extended to further smart growth. For example, the LEM<sup>SM</sup> concept might be expanded to rental housing. Tenants in location-efficient neighborhoods need to spend less on transportation and, arguably, should have a heightened ability to meet their household obligations, including rent. This more potent rent-paying capacity should translate into better rent rolls and, derivatively, better financing availability and terms through normal underwriting procedures. However, to the extent that renting agents



restrict tenants with minimum income criteria, property managers could give credit for transportation savings and lenders could recognize and encourage such adjustments. Similarly, underwriting changes may be appropriate for construction loans or in making forward commitments when projecting the rent levels that will be servicing the project's debt.

More generally, the lending industry, partnering with government and foundations, may wish to consider pilot programs that, with creative loss protection, public subsidy, and other means, offer attractive financing for smart-growth-furthering projects that (1) are located in cities, older suburbs, and rural centers, or other places with existing infrastructure; (2) are within a local urban growth boundary, rather than outside; (3) are located near mass transit; (4) reclaim brownfields; (5) are part of a mixed-use project; (6) further mixed-income objectives; and/or (7) further environmental protection and the preservation of other critical resources.

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***The overall character of smart growth endeavors may more than offset any perceived negative effect.***

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***3. Lenders can develop new mortgage products tailored to the context of smart growth situations.*** The LEM<sup>SM</sup>, offering higher debt-to-expense ratios for housing in transit-oriented and similar smart-growth-oriented neighborhoods, illustrates new products that could support smart growth objectives (see appendix).

***4. Enhanced loan and collateral flexibility can further smart growth.*** For example, some lenders may have a minimum commercial loan amount reflecting underwriting and other origination costs. Yet such a minimum may preclude lending for small-scale commercial projects that can enhance the value of larger smart growth projects. Other flexibilities can help, such as the minimum housing unit size necessary to qualify for mortgage insurance or to be salable to the secondary-mortgage market. Housing unit size affects marketability, but the overall character of smart growth endeavors may more than offset any perceived negative effect. For instance, studio apartments in a downtown revitalization area done right may be in high demand.

5. ***Flexibility in underwriting processes can open smart growth lending opportunities.*** For instance, a recent Federal Reserve Bank of Minneapolis report indicated that mixed-use financing is sometimes impeded by the common practice of lenders having separate commercial and residential underwriting departments and/or appraisers (Bennett 1999). To take advantage of the business opportunity of smart growth, as the Federal Reserve report notes, “Lenders with separate commercial and residential loan departments may need to develop a team with the expertise to analyze mixed-use projects” (Bennett 1999, 4).

6. ***Lenders might also consider outsourcing specialized functions to more efficiently do smart growth projects.*** In Chicago, lenders were interested in doing purchase–rehab loans, but were daunted by the construction oversight of these loans. These loans could cost a bank as much as \$5,000 to \$10,000 per loan to supervise the rehab, since they involved considerable administration and typically were made on a limited scale by any one lender (Listokin and Wyly 2000). To meet this challenge, Chicago lenders partnered with the Chicago Neighborhood Housing Services (CNHS), which did the rehab construction supervision for numerous banks. By doing this in volume, CNHS was able to perform the function on a cost-efficient basis.

7. ***Limited and targeted nonresidential components in loans primarily residential in nature also can promote smart growth.*** For instance, the Federal Housing Administration (FHA) Section 221(d)(4) loan program already allows nonresidential space to 10 percent of a project, while the FHA Section 220 program allows up to 20 percent. Additional nonresidential cap flexibility is available in these programs at the HUD regional office level, and could be used to promote smart growth objectives.

While the GSEs, such as Fannie Mae and Freddie Mac, are by charter limited to residential lending, they also include a limited fraction of space and rents to come from nonresidential uses of the collateral (Gyourko and Rybczynski 2000, 774). For example, Freddie Mac’s Multifamily Streamlined Refinancing Program caps nonresidential rents and nonresidential square footage of eligible projects at 25 percent of the total effective gross revenue and 25 percent of total project improvement square footage, respectively. Still, like FHA, more flexibility to make residential loans with attached ancillary commercial activities at higher percentages on an exception or pilot basis would promote specific smart growth objectives.

#### D. What Can the Two Communities Do Together?

1. ***A key area of partnership to facilitate funding for smart growth projects is creative and targeted risk-sharing arrangements that would manage the risks associated with unknown outcomes of new and innovative projects.*** Programs can be designed to provide third-party recourse, co-insurance, and/or “soft second” mortgages that will provide primary mortgage lenders more comfort in financing what are perceived as particularly risky smart growth projects. This strategy is a classic case of how government involvement can address information problems (i.e., unknown risk) that may be blocking market development.

This will often entail a partnership approach. For example, the Self Help Community Advantage™ (SHCA) program, a partnership between a non-

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***Affordable housing is an integral component for achieving the vision of smart growth.***

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profit organization, a foundation, and Fannie Mae, purchases nonconforming mortgages from selected lenders, and SHCA retains full recourse (Quercia, Stegman, and Davis 2000). This arrangement allows lenders to make loans that ordinarily

would not be salable to the secondary market (e.g., mortgages with extremely high debt ratios and/or LTV ratios) since they can sell these loans to SHCA. (See appendix.)

A similar risk-sharing arrangement characterizes many “soft” mortgage programs. For example, the Little Haiti Housing Association (LHHA) is rehabilitating abandoned housing in Miami, Florida, and selling these units to lower-income families with the aid of soft second and third mortgages. Miami-Dade County’s surtax on housing transfers funds the soft second loans; a grant from the Federal Home Loan Bank Board’s Affordable Housing Program (Listokin and Wylly 2000) finances the soft third mortgages. These two loans reduce the LTV of the first mortgage to about 50 percent—a very conservative level—and that lessened risk encourages first-mortgage lenders to finance LHHA’s inner-city home purchases.

**2. *Lenders need to gain familiarity with and work with government affordable housing assistance in the underwriting and loan pricing process.*** Public sector subsidies generally are necessary to support the mixed-income and affordable housing integral to most smart growth efforts. Lenders may be unfamiliar—and therefore wary—of the mixed income character of some smart growth developments. In addition, they may be unfamiliar with the more complex financing arrangements that characterize both affordable homeownership and rental programs. Many lenders, however, have learned that loans made under these programs not only help in meeting their regulatory requirements, they also can be good business. Mixed-income neighborhoods require efforts to preserve housing affordability. Affordable housing is therefore an integral component for achieving the vision of smart growth. Lenders' willingness to learn about and work with these programs and subsidies is critical for smart growth efforts to succeed.

**3. *Lenders and local community leaders need to collaborate to better integrate existing federal and state affordable housing programs with smart growth efforts.*** Existing governmental policies supporting low- and middle-income housing could target smart growth areas. For instance, the federal government is already an important resource for affordable housing through such programs as Section 8 and the Low Income Housing Tax Credit (LIHTC) (see appendix). The LIHTC can support smart growth in a mixed-income setting through such potential actions as:

- Revising LIHTC regulations that foster mostly low-income projects (i.e., the higher the project's low-income percentage, the greater the tax credit) with a more flexible scale (some percentage of the tax credit allocation favoring mixed income developments).
- Having the LIHTC allocation (based on a per capita amount) more closely follow real increases in construction costs. Recent reforms have moved in this direction.
- Offering a bonus LIHTC allocation for states adopting smart growth.
- Reconsidering state Qualified Allocation Plan (QAP) criteria that may foster sprawl-inducing projects; conversely, adding bonus QAP points for smart-growth-fostering projects (see appendix).

- In a similar vein, the rehabilitation investment tax credit (ITC), already useful to smart growth, could be modified to further support this style of development. Potential changes (see appendix) include lowering the investment requirement and extending the types of properties qualifying for the ITC.

State governments also provide various affordable housing resources, such as BMIR financing from their HFAs. Local government can apply CDBG, HOME, HOPE VI, local bonding authority, tax increment financing, property tax relief (see appendix), and other supports to foster mixed-income affordable housing.

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**Lenders and governments can partner to provide favorable financing terms.**

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**4. *City financing programs that address affordability problems need to be recognized by lenders and carefully integrated into their underwriting processes.*** For example, Chicago's Home Own-

ership Program 3 (CHOP 3) helps first-time homebuyers with closing costs, down payments, and other transaction costs. When eligible borrowers' qualifications and/or appraisals limit the size of their loan to less than the purchase price of the home they wish to buy, CHOP 3 assistance can help bridge the gap (Listokin and Wyly 2000). Likewise, inclusionary zoning, coupled with density and other bonuses, can help promote mixed-income housing. Under these innovative arrangements, developers offer affordable housing—typically 10 to 20 percent of a project's total units—in return for such benefits as the right to build more (density bonus) or to enjoy accelerated land-use processing. Jurisdictions across the country have these policies, ranging from California to New Jersey.

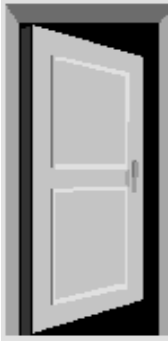
Lenders need to understand and account for the value created by these practices in their lending policies. They also need to recognize and properly price for affordability restrictions incorporated as deed restrictions that may negatively affect future collateral values.

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5. ***Likewise, lenders and smart growth advocates may seek to link existing Individual Development Account (IDA) programs to local lending efforts that support smart growth.*** The premise of IDA programs is governments and foundations should support and encourage household savings for socially beneficial purposes (e.g., to purchase a first home or to start a business.) Typically, program participants' savings, usually in accordance with a structured plan, are matched by contributions from either foundation or government funding. This approach could support smart growth by offering a bonus supplement if the IDA is used in a smart growth location, such as buying a unit in a mixed-income, mixed-use, and/or transit-served neighborhood (see appendix).

6. ***The public sector and the lending community can join together to help city workers live in the communities in which they work.*** Financial aid can be provided to participants in such programs. Alternately, programs can be designed, often through risk-sharing or guarantees, to involve demonstrably less risk than normal, market-based lending. Under these terms, lenders and governments can partner to provide favorable financing terms.

HUD programs, such as "Officer-Teacher Next Door," provide an excellent example of this approach. Seattle, Washington offers a "Hometown Home Loan" providing low-cost loans for employees in Seattle schools and hospitals (Porter 2000). People's Bank, a regional New England lender, offers mortgage programs for municipal employees in approximately twenty distressed Connecticut cities, among them Bridgeport, Hartford, and New Haven (Listokin and Wyly 2000). Under the People's Bank program, fees are waived and other incentives are given. Participating cities leverage People's program with their own affordable homeownership programs that provide low-interest loans for closing costs and other purposes.



## **VI. SMART GROWTH AND DIFFERING GROWTH PATTERNS: ONE SIZE DOESN'T FIT ALL**

### **A. Smart Growth in Differing Contexts**

One set of strategies to implement smart growth does not fit all growth situations. All of the problems and solutions previously discussed have some relevance across all areas and growth patterns. However, we can use geography and the growth context to define a typology that tailors groups of these strategies to local circumstances. Some strategies are more relevant to inner-metropolitan or urban areas, while others are more applicable to outer-metropolitan or rural areas. We can also differentiate strategies by their relevance to a fast-growth or a slow-growth region. The remainder of this report will concentrate on urban or inner areas of metropolitan regions, and contrast the different strategies appropriate for these areas in faster- versus slower-growth contexts.

Revitalization problems and financial solutions essential to achieving the goals of smart growth policies are not present in the same magnitude in all places. In the West, central cities and suburbs are strong and growing (table 8). Many of the cities and suburbs of the Northeast and Midwest are at the other extreme, where population decline or only very limited population growth prevails. Political subdivisions in these areas are characterized by declining tax bases and significant erosion in business and personal income. Growth is often insufficient to meet the costs of maintaining basic infrastructure and local public services.

In the South, like the West, growth is often very significant both relatively and absolutely. While growth is generally very strong in the South, central cities are just starting to feel this growth, and infrastructure is often inadequate to handle this growth. These regional differences affect smart growth implementation in cities. In the summer and fall of 2000, roundtable sessions were held in four representative cities to discuss how smart growth applied in their contexts. Table 8 also presents these four cities and their growth contexts.

**Table 8. Contexts for Applying Smart Growth Financial Techniques**

|                           |   |                             |   |
|---------------------------|---|-----------------------------|---|
|                           | <i>(Slower)</i>   | <b>Growth of Metro Area</b> | <i>(Faster)</i>   |
| <i>(Faster)</i>           | ↑   |                             |   |
| Growth of<br>Central City |   |                             |   |
| ↓                         | <i>(Slower)</i>   |                             |   |
|                           | <i>Slower Metro Growth</i><br><i>Faster Central City Growth</i> |                             | <i>Faster Metro Growth</i><br><i>Faster Central City Growth</i> |
|                           | <i>Slower Metro Growth</i><br><i>Slower Central City Growth</i> |                             | <i>Faster Metro Growth</i><br><i>Slower Central City Growth</i> |

|                           |  |                             |                                       |
|---------------------------|--|-----------------------------|---------------------------------------|
|                           | <i>(Slower)</i>                        | <b>Growth of Metro Area</b> | <i>(Faster)</i>                       |
| <i>(Faster)</i>           | ↑                                      |                             |                                       |
| Growth of<br>Central City |  |                             |                                       |
| ↓                         | <i>(Slower)</i>                        |                             |                                       |
|                           | <i>MIDWEST</i><br><i>(Minneapolis)</i> |                             | <i>SOUTH</i><br><i>(Charlotte)</i>    |
|                           | <i>and</i>                             |                             | <i>and</i>                            |
|                           | <i>NORTHEAST</i><br><i>(Rochester)</i> |                             | <i>WEST</i><br><i>(San Francisco)</i> |

*Slower Growth Metropolitan Area*  
*Stable or Decreasing Central City Growth*

*Faster Growth Metropolitan Area*  
*Significantly or Moderately Increasing Central City Growth*



## B. Smart Growth Development Problems, Strategies, and Responsibilities in Faster-Growth Metropolitan Areas

### ***1. Problems***

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Faster metropolitan growth presents a specific set of challenges to financing smart growth. This section identifies priority problems facing these areas, discusses possible strategies to address these problems, and identifies key responsibilities for lenders and local community leaders to make these solutions happen. Table 9 summarizes and highlights key points discussed below.

***Higher density is required to handle the projected growth in faster-growth metropolitan areas, but the scale and development patterns engender community opposition.*** Developers often propose projects that wring out as much high-density development as can be achieved on a particular site. Community groups, on the other hand, often want nothing other than single-family homes.

Actually, smart growth projects in redeveloping centers need not involve anything more than a “design increase” in density (25 to 33 percent). This means that although existing density is increased by one-quarter to one-third, usually the increase is not visually discernible to the community. Good neighborhood design enables the increase to be easily absorbed. Yet, despite this, there is often opposition by community groups to ***any*** density increase, coupled with an underlying fear of neighborhood displacement by some existing residential and nonresidential tenants. In faster-growth metropolitan-area cities, these groups are often savvy and well financed. This is a very real problem confronting smart growth developers in these locations.

***Another problem facing cities in faster-growth metropolitan areas is the inability to undertake a large-scale, complex development in these locations.***

Land is relatively expensive, often occupied by somewhat viable low-density residential and nonresidential uses, and may require some curative action before it can be used. Development is far more difficult here than on an accessible greenfield site. Furthermore, large development attracts attention simply because of its size. Regardless of how well integrated or intentioned the proposed development, it begets fierce local opposition.

**Table 9**  
**Problems, Strategies, and Responsibilities:**  
**Faster-Growth Metropolitan Areas**

| <i>Problem</i>  | <i>Strategy</i>   | <i>Responsibility</i>   |
|---|---|---|
| Higher density meets community resistance                         | Innovative design and financing through pilot programs                  | Development and financial communities                           |
| Inability to undertake large and complex projects                 | Innovative design and community involvement                             | Development community   |
| Difficulty in financing mixed-use and mixed-income products       | Innovation in lending and appraisal techniques                          | Financial community   |
| High up-front costs   | Streamlining and reform of codes, permitting process, and land assembly | Local government  |
| Preservation and expansion of housing for underserved populations | Partnerships and innovative lending techniques                          | Local government, community groups, and the financial community |

***Developers also are often unable to obtain financing for either mixed-use development or mixed-income housing.*** In faster-growth metropolitan cities, the market is basically healthy. Yet the lending community views both mixed-use development and mixed-income housing as nonconforming development types. The secondary-mortgage market and public and private mortgage

insurers also are not sure about how to treat these two types of “non-standard” uses. Mixed use or mixed income, or both, make sense in the local context—but it is a “deal-slower.” Yet without it, development is not really smart growth.

***Smart growth urban sites in faster-growing metropolitan areas also require large up-front costs.*** Out-parcel assemblage, infrastructure improvements and augmentation, and buffering or integrating actions with adjacent development all typically require significant cash outlays at the start of development. Unique and sustainable markets can generate the large up-front investment. However, frustration over dealing with these problems can drive development to greenfield sites.

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***Solving the issue of large up-front costs requires local government engagement.***

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***A final significant problem for smart growth urban developers in faster-growing metropolitan areas is the preservation and expansion of housing for underserved markets.*** Active parcel assemblage is under way in these areas. Inte-

grating affordable housing in a mixed-income context is critical to achieving the overall vision of smart growth. Furthermore, incorporating affordable housing is often necessary to accommodate the concerns of community groups and to avoid displacement. This is an extra cost of urban redevelopment not likely to be encountered on a vacant greenfield site.

While other challenges previously discussed in section IV can emerge to confront urban developers in faster-growth metropolitan areas, the problems typically are not as severe. Properties in faster-growth locations typically do not have as many legal problems as in slower-growth areas. Those owning urban property in faster-growing metropolitan areas pay real estate taxes and accordingly are both easily identifiable from records and have control of their properties. Properties are not as legally difficult to access as they might be in cities in slower-growing metropolitan locations.

Further, if a developer wants to include a local supermarket or drugstore in a development plan, neighborhoods are not so depressed that subsequent owners of these establishments would feel unsafe or worry that they may

not make it there economically. Finally, crime, public education, and general upkeep of the neighborhood are not likely to be deal-breaking issues in these urban locations. The economic health of the area has kept the city relatively viable.

## ***2. Strategies and Responsibilities***

***To address concerns over higher-density and different development patterns, local government can engage community groups concerned with neighborhood change in residential and nonresidential scale or form.*** This involves identifying the key community leaders and effective ways of reaching out to them. For instance, combined information and design charrettes can be used to demonstrate how the new development will fit into and improve the existing neighborhood. For large and complex projects, conquering high land costs and community opposition also calls for smart strategies by developers. It is unrealistic to expect an enthusiastic reception from the financial community until those problems are resolved. At the same time, the financial community must be open to financing these innovative projects, possibly on a pilot basis.

***For mixed-use and mixed-income projects, the financial community can take the initiative through innovation in lending techniques.*** Smart growth developments incorporating mixed use and income can be financed through enhanced loan and collateral flexibility, introducing new and fine-tuning existing mortgage products, and, above all, introducing **responsible** flexibility up and down the investor chain from mortgagee to insurer.

***Solving the issue of large up-front costs requires local government engagement.*** This often involves parcel assemblage, infrastructure upgrading, and developer concessions to assuage the concerns of community groups. Local government may need to use its powers of condemnation to assemble parcels, institute tax increment financing for infrastructure, and provide the buffers or landscaping that community groups are likely to require. Such actions can bring enough resources onboard to make these developments viable, which in turn makes financing these developments more feasible.

***Addressing preservation and expansion of housing for underserved markets requires mixed-income and affordable housing partnerships to be forged.***

Mixed-income projects might involve lender and state housing finance agency (HFA) partnerships. HFAs have become particularly skilled in providing mixed-income housing; they actively seek partners. Affordable housing projects typically involve partnerships between lenders and nonprofit or faith-based groups, or lenders and local governments. Local governments are increasingly coming under pressure to provide affordable housing as part of renewal efforts; they too are eager for partners. In financing these types of projects, the lending community must be flexible and incorporate these special arrangements into their consideration of credit quality.

The remaining issues of legal complications in acquiring properties, discovering markets in areas that may not appear to have them, and basic quality-of-life improvements require much less action in faster-growing metropolitan areas. However, addressing these issues can further facilitate lending for smart growth. Local governments can find ways to produce cleaner titles on publicly held properties. This might involve removing their own liens on such properties. Local governments can also write down the rent for properties where reduced market demand exists. Finally, local governments and the financial community, to secure local private investment, can provide technical assistance to improve public safety, increase communication in neighborhoods about developments that might affect them, and introduce computers and other technologies to raise the skills of those in primary and secondary schools.

### ***3. Priority Agenda for the Financial Community***

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The key problem affecting the implementation of smart growth in cities in faster-growth metropolitan areas is the difficulty obtaining financing for mixed-use development and mixed-income housing. Therefore, the financial community should be the primary actor in efforts to resolve complications facing smart growth finance.

The key barrier is that many of the players involved (appraisers, lenders, and insurers) are wary of complicated or unconventional projects and the assessment of their risk. Developments in these cities, which may include more commercial uses or rental properties than are typically allowed in residential development financing, are often overlooked in favor of “big box,” “fit the mold” projects in greenfield locations. Thus, the priority agenda item for the financial community is a reexamination of its procedures for

lending on mixed-use projects and middle-income housing. The financial community must enumerate and document barriers to lending, in particular identifying those aspects of a project involving the most risk of unknown outcomes. Using this information, the financial community, in partnership with the public sector, can construct creative risk-sharing arrangements to make the financing feasible. Ultimately, with more experience, market instruments should evolve to handle more and more of this style of development.

#### ***4. Priority Agenda for Local Governments***

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Local governments in cities in faster-growth metropolitan areas bear the responsibility for ensuring that local neighborhoods are aware of smart growth proposals and that the impacts of future developments on existing residents and businesses are appropriately mitigated. Local governments can also work to combat NIMBYism. Local community groups can be informed about significant future development and have forums provided to express support or concern. Typically, local governments have relegated this activity to the developer, who often pays little attention to it due to lack of resources for this purpose or for fear of waking “sleeping dogs.” It is absolutely critical that local government play a significant role in this regard. Additionally, local government can research and secure state and federal funding to minimize residential and nonresidential displacement and to assist in acquiring other outlying properties that could minimize displacement.

### **C. Smart Growth Development Problems, Strategies, and Responsibilities in Slower-Growth Metropolitan Areas**

#### ***1. Problems***

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Cities in slower-growth metropolitan regions exhibit a different cluster of problems in efforts to implement smart growth. This section identifies priority problems facing these areas, discusses possible strategies to address these problems, and identifies key responsibilities for lenders and local community leaders to make these solutions happen. Table 10, presented at the end of this section, summarizes and highlights key points discussed below.

***First and foremost, these cities typically have a lower overall quality of life.***

Population levels and tax bases are stagnant, crime and tax rates are higher, and many neighborhoods lack the unique attributes and viability to attract households to live and conduct business there. This is the most serious issue for cities in slower-growth metropolitan areas, far more problematic than for similar urban locations in faster-growing metropolitan areas. Unless the city can be turned around, creative financing, new forms of appraisal, and other techniques offered by the financial community are irrelevant, as there will be no sustainable market-spurring development.

***Another problem, related to the first, is that commercial tenants who provide convenience goods are reluctant to locate in cities in slower-growing metropolitan areas.***

Food chains and drugstores flock to “big box” greenfield sites, eschewing cities in lower-growth metropolitan areas. Food chains and drugstores will not place employees at risk, nor will they subject their business to significant losses from pilfering due to inadequate public safety protection. Even when public safety is enforced, convenience goods outlets are re-

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***Smart growth redevelopment issues in slower-growth metropolitan areas are more pervasive, requiring more protracted and system-wide solutions than in faster-growth metropolitan areas.***

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luctant to locate in certain neighborhoods, often due to an inadequate understanding of market potential in those areas.

***A major issue facing cities in slower-growth metropolitan areas is legal complications in acquiring properties.*** Properties are in various stages of foreclosure. They may contain mechanics’ liens. They may be illegally occupied. They may be part of lawsuits brought because basic services have not been delivered. In addition, owners protect themselves from being brought to task for these conditions by burying themselves in a convoluted chain of title, which makes identifying and contacting them nearly impossible.

***Provision of adequate housing for existing residents often is a significant stumbling block in slower-growth areas.*** The existing stock of housing units is physically inadequate and requires rehabilitation, complete rebuilding in place, and/or relocating existing residents to acceptable units elsewhere.

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While improved housing stock advances smart growth finance by creating a better quality of life (therefore lessening risk), it also advances the interests of the residents by providing affordable housing.

***Another insidious problem for cities in these locations is large up-front costs linked to inadequate public infrastructure or special site needs related to public safety***—a problem that is not likely to vanish in the short run. Further, sites may need to be cleaned up, community groups brought into the development discussion, and/or the site cordoned off, with access controlled.

These cities also may experience, albeit less intensely, the other problems associated with smart growth finance: insufficient construction and long-term financing for mixed-use and mixed-income development, large and complex projects, and/or higher-density or differently designed projects. However, given the underlying challenges, these other problems are somewhat irrelevant.

The underlying reality is that many of the neighborhoods in these cities often do not warrant significant investment and financing for middle-income housing. Furthermore, the nonresidential businesses that would either serve that market or attract new customers are reluctant to locate there. The uniqueness of the problems of stable or declining cities in lower-growth metropolitan areas is the “catch-22” nature of the phenomenon. New residential and nonresidential development will not take place unless basic quality-of-life issues and public service adequacy are resolved. However, local government cannot attack these challenges without the tax revenues that new development offers.

The smart growth redevelopment issues in slower-growth metropolitan areas simply are more pervasive and fundamental, requiring more protracted and system-wide solutions than in higher-growth metropolitan areas. Still another reality complicating efforts in these locations—one beyond the purview of this report—is concentrated minority poverty in neighborhoods and school systems.

## ***2. Strategies and Responsibilities***

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***In slower-growth metropolitan areas, strategies to achieve smart growth begin with the activities of local government to achieve a better overall quality of life and to improve local public services and infrastructure.*** Obviously,



this cannot be done by local government alone. With no growth and an eroding tax base, no revenue stream exists to support major investment in turning around quality of life, services, and infrastructure. Seeking federal program grants from the U.S. Department of Housing and Urban Development (CDBG, HOME, Empowerment Zones, HOPE VI, Section 8 vouchers, etc.) and the Economic Development Administration (Public Works, Economic Adjustment, Revolving Loan Fund), as well as state allocations for road resurfacing and widening, educational programs, and public safety activities, is paramount. Local government officials also can lobby at state and county levels to ensure that public facilities are built primarily in core urban areas.

Lenders also can participate in improving quality of life in many ways. Many serve on school, nonprofit, and other organizations' boards, working

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***Local governments can enter into partnerships with the financial community to promote lending and investment with creative loss protection.***

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to improve neighborhood conditions. They donate time and resources to Police Athletic League, United Way, and many other such organizations concerned about QOL. They "adopt" schools and provide employment and mentoring to stu-

dents. They fulfill CRA mandates and in other ways provide the capital that can enhance QOL.

***Another strategy for cities pursuing a smart growth agenda in slower-growing metropolitan areas is to go all out to attract convenience and service-oriented businesses that typically would not locate there.*** These are grocery stores, drugstores, dry cleaners, video rental stores, and so on. To attract these businesses, local governments can provide tax subsidies. Local tax revenues can be used to write down rents for a facility—a grocery store, for instance—that would benefit all residents. In addition, local governments and others can enter into partnerships with the financial community to promote lending and investment with creative loss protection. For instance, lenders can look to community groups and faith-based organizations to provide soft-second mortgages on commercial as well as residential (to attract and retain customers) mortgages.

***Cities in slower-growth metropolitan areas must deal with the complicated legal issues of gaining access to properties through fast-take and condemnation procedures.*** The latter might involve nominal sums paid into a trust fund that would be used to pay the owner of the property, if one can be identified. Problem properties involving environmental cleanup often will require local government action. For instance, cities can approach state and federal governments for grants and loans to clean up distressed sites and to seek to lower the levels of mitigation requirements where the intended future use does not require high levels of remediation. The Environmental Protection Agency has brownfield provisions and funding to achieve smart growth in redeveloping and infill neighborhoods. These programs are often underutilized by local governments because of the complicated filing procedures associated with them. The financial community could provide small grants and/or technical assistance for local government proposal writing and filing.

***Cities in slower-growth metropolitan areas should also seek below-market construction and permanent financing and risk-sharing with the primary and secondary-mortgage markets to produce housing.*** Middle-income and mixed-income housing can be provided through a variety of construction programs and mortgage subsidies, including HUD's First Homebuyer<sup>SM</sup> mortgages and a variety of low-interest alternative credit mortgage products being developed by Fannie Mae and Freddie Mac. Public and private mortgage insurers also can join this group to further spread the risk to lend in these markets.

***Yet another strategy for these cities is public financing for large up-front costs.*** In New Jersey, the City of Newark approved, at minimal cost, land improvements on the site of the 1967 urban civil unrest. Currently, several hundred town houses in a gated community are situated there. This achievement involved accessing properties, constructing utilities and site improvements, and one-stop permitting. According to officials from K. Hovnanian Companies of New Jersey, the developer of the site, these steps were critical in making the deal come together.

Other less-important strategies for cities in slower-growing metropolitan areas, but strategies that nevertheless are part of the smart growth toolbox, include the variety of financial innovations in lending and appraisal policies facilitating mixed-use/mixed-income and large/complex projects.

In addition, local governments can employ mediation and mitigation pilot efforts to bring community groups and neighbors objecting to more intense or different uses of individual sites into the process.

### ***3. Local Governments***

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Local governments are the primary actor for fostering smart growth in slower-growth areas, in contrast to faster-growth areas. This is because many of the required actions involve fundamental government responsibilities that, if successfully addressed, can improve, or even create markets requiring lending and investment. The key emphasis must be on growth-spurring actions.

Local governments must set the stage for smart growth by aggressively addressing the issues of local quality of life and insufficiency of public services and public infrastructure. The mayor or senior councilperson must establish as community priorities lowering crime, improving schools, making transit work, and creating appealing residential and business environments, if smart growth is to have a chance for survival. Further, the chief executive could push hard for the location of new public employment facilities inside of the city. When private employment is required to revitalize the neighborhood, local governments should establish incentives to secure that employment. As discussed earlier, local government cannot successfully attack all these problems with their own resources. Significant help is required from state and federal governments and from the private sector.

### ***4. Financial Community***

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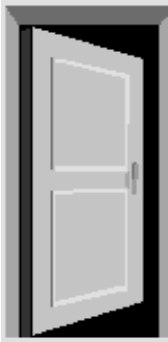
In cities in slower-growth metropolitan areas, the financial community must partner with business and community leaders to initiate redevelopment and infill activity. The financial community can provide technical advice and guidance to the government and local citizenry to get things moving. This can be accomplished by active participation on boards, assistance in proposal writing for grants, hiring consultants on the cities' behalf, and pushing to formulate a vision for future growth.

Once these initial activities are undertaken, the financial community—in concert with local developers and local governments—could be an integral part of any successful smart growth initiative by linking commercially viable

**Table 10****Problems, Strategies, and Responsibilities:  
Slower-Growth Metropolitan Areas**

| <i>Problem</i>  | <i>Strategy</i>   | <i>Responsibility</i>  |
|---|---|--|
| Direct engagement of quality-of-life issues                             | Involving the entire community to change the environment                | Local governments, developers, the financial community, and community groups |
| Reluctance of commercial businesses to locate in cities                 | Public subsidies and creative risk-sharing arrangements                 | Local governments, community groups, and the financial community             |
| Legal complications in accessing properties                             | Providing lenders "clean" collateral positions                          | Local government   |
| Preservation and rehabilitation of housing for under-served populations | Subsidies, partnerships, and innovative lending techniques              | Local government, developers, and the financial community                    |
| High up-front costs   | Streamlining and reform of codes, permitting process, and land assembly | Local government   |

projects with investors who are willing to finance them. This would involve considerable effort and innovation, as it may involve new forms of credit instruments, revamped views of credit risk, and a willingness to take on financial relationships far more complex than their other business. Aggressive redevelopment of cities in lower-growth metropolitan areas will be effective only if the financial community is onboard and is able to recognize the long-term business payoff.



## VII. CONCLUSION

Smart growth involves a comprehensive and coordinated agenda of public and private action designed to fundamentally alter urban form by reallocating economic activity in a more socially and economically desirable manner. The smart growth agenda includes controlling outward development, redeveloping inner-suburban and urban neighborhoods, better designing interfaces between land uses and the basic functions of a neighborhood, preserving land and natural habitats, and providing transportation in a variety of motorized and non-motorized forms.

One component of smart growth, redeveloping inner-suburban and urban neighborhoods, involves numerous activities, most of which require either

public or private financing. These activities include improving urban public infrastructure, rehabilitating or building new housing, attracting various types of commercial uses, providing new forms of transportation, and rebuilding parks and public

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***Lenders must examine existing policies and practice to adapt to the new growth context.***

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buildings. None of these are the standard types of activities that occur in suburban neighborhoods. Infrastructure is old and in disrepair, housing often lacks basic amenities, and the environment is hostile to the usual types of retailers. Parking is insufficient, and transit is slow and/or infrequent. Open space and recreation activities barely exist. This urban environment presents a major challenge to financing smart growth.

In addition, there are regional and metropolitan forces at work. Growth is taking place differently in different regions of the United States. In the South and West it is robust; in the Northeast and Midwest it is barely adequate. To be effective, smart growth must embrace these differences to provide an environment that facilitates the flow of capital investment and lending. To date, this insight has not been part of the smart growth agenda. While they share an overall set of common problems, we find that localities experience these finance problems in differing clusters of intensity,

depending on their local and metropolitan growth contexts. The literature and policy debates have further assumed that the actors who finance smart growth have uniform roles. This is certainly not the case. The focus of this report on linking lenders and local governments to address the difficulties in financing smart growth clearly identifies different roles for each actor, depending on local growth contexts.

Proponents of financing smart growth should conceptualize problems, direct strategies, and assume responsibility in the context of faster and slower metropolitan growth situations. The Northeast and Midwest will receive only one-quarter of the household growth of the United States and one-sixth of the income growth. Smart growth solutions in these areas have different priorities and different lead actors. This unequal distribution of growth between the Northeast–Midwest regions and the Southern and Western United States defines the financing challenges and roles for lenders and city leaders in promoting the flow of capital for smart growth in these region’s cities.

If growth is robust, as projected in the South and West, markets are stronger, land is more costly to access, and existing uses are not subject to change. In these markets, the financial community plays a primary role, where experimentation and accommodation produce new business opportunity offered by smart growth policies. Lenders looking for this business must examine existing policies and practice to adapt to the new growth context, and look for opportunities to partner with other players to develop new lending approaches that accommodate this new style of development. Here, local government primarily plays a coordinating role, emphasizing policies that allocate economic growth in a way that produces more efficient development on a human scale.

If growth is minimal, as projected in the Northeast and Midwest, markets are weak, land is accessible, and existing uses are capable of being changed. In this context, local government must take a primary role, intervening with policies that induce more growth. A focus on improving quality of life and upgrading basic public services can entice commerce and middle-income households back into inner areas. In these markets, local government cannot produce these changes alone. State and national government must be a willing partner to provide resources and direction to break the catch-22 cycle of community decline and resource scarcity preventing the creation of vibrant places in which to live and do business.

In these markets, the financial community's role is more limited because of a lack of market opportunities. However, lenders can and do play an important role of community leadership that can seed future business opportunities. They actively participate in and help organizations that promote economic growth and ensure the future viability of real property assets. In addition, lenders can finance residential and nonresidential projects that bank on major public investments designed to turn neighborhoods and communities around. Some level of private-sector funding, in concert with public investment, for affordable housing and basic commercial uses is critical.

The financial community, to date, has been only a casual observer of the smart growth movement. This report, based on a series of meetings across

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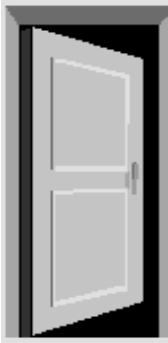
***Smart lenders will recognize the extent to which smart growth policies are being implemented and will adapt their business practices and policies to these new realities.***

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the United States to determine need, can serve as an action agenda for the financial sector. This report does not call for lenders to engage in altruistic and risky ventures. Rather, we posit a new regulatory regime that will govern a significant portion of the markets in which lenders do business. Smart lenders

will recognize the extent to which smart growth policies are being implemented and will adapt their business practices and policies to these new realities. Local governments pursuing these agendas will recognize the legitimate business concerns of lenders, and evaluate their own policies with an eye to setting a better market framework for increasing private investment and lending.

Participation by the lending community is the missing link in the smart growth chain. Smart growth is a market reality. Government and business can either back into this new market paradigm, or they can proactively renew their traditional partnership and create communities wanted by their customers and constituents. When the local community says "Can you do this?" and the developer replies, "No, I can't get the financing," it is time for another voice to be heard. Lenders will say, "Yes, you can—but let's do it together, responsibly."



## **APPENDIX: SMART GROWTH FINANCING TOOLS**

The body of this study referred to numerous actions that can promote a smart growth finance agenda. Again, we do not intend to present an exhaustive list of actions and programs. Rather, we seek to highlight some representative and promising tools that can or are fostering investment in smart growth projects. Some of these actions are quite technical, so we present additional background information in this appendix. For example, the main text discusses federal investment tax credits (ITCs) for rehabilitation; this appendix details the qualifications for, and scope of, the ITC.

The ITC, as well as the other strategies considered in the appendix, are presented as follows. A brief description of the technique is given; this is followed by a synopsis of its applicability to smart growth finance.

The strategies are presented in alphabetical order and include:

- Affordable Housing Financing
- Building Code Reform
- Fast-Take Property Tax Foreclosure
- Finance Risk-Sharing
- Individual Development Account
- Land Banking
- Location Efficient Mortgage (LEM<sup>SM</sup>)
- Low Income Housing Tax Credit
- Property Tax Relief
- Public Employment and Space Utilization to Foster Revitalization
- Rehabilitation Investment Tax Credit
- Tax Increment Financing



## **AFFORDABLE HOUSING FINANCING**

### ***Technique Description***

Over time, housing financing has become dramatically more affordable, especially for single-family homeownership mortgages. Two to three decades ago, single-family loans required a minimum 10 percent down payment (a maximum 90 percent loan-to-value [LTV] ratio) and allowed a maximum 25 to 28 percent housing expense-to-income (“front-end”) ratio and 33 to 36 percent total debt-to-income (“back-end”) ratio.

Today, the more aggressive affordable product financing from the GSEs has reduced down payments to 3 percent or less (LTVs of 97 percent or higher) and permits front-end and back-end ratios of 33 and 40 percent, respectively. Multifamily rental financing has also become aggressive, and the reach of contemporary affordable loans has been extended by coupling the new products with public, foundation, and other assistance (see Low Income Housing Tax Credit and Rehabilitation Investment Tax Credit).

### ***Applicability to Smart Growth Finance***

As an example, multifamily rental finance, tax credit equity, and other affordable financing from Fannie Mae facilitated development of the Belmont Dairy project in Portland, Oregon. Belmont Dairy’s project elements represent a blend of smart growth principles, including mixed uses (housing and retail), mixed incomes (lofts renting at market rates and apartments renting below market), mixed construction (rehabilitation of an historical dairy and construction of a new apartment house), and location on a major public transit route in the core of an established residential and commercial area.

Smart growth’s reclamation of inner-city and older-suburban areas would benefit from still more liberal single-family homeownership financing (e.g., higher LTV and debt ratios). Smart growth would also benefit from more aggressive multifamily rental mortgages, particularly since this type of financing has not experienced the paradigm shift in terms earlier described for single-family homeownership loans. These changes, however, may increase lending risk, so altering terms must be a careful and incremental process. The Atlanta Mortgage Consortium, for example, initially raised the back-end ratio to 50 percent, but after experiencing rising delinquency reduced that ratio to 42 percent.

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## **BUILDING CODE REFORM**

### ***Technique Description***

While regulating both new construction and rehabilitation, building codes are biased toward the former—and that creates problems for rehabilitation and adaptive reuse. In practice, building codes often mandate a new construction standard for renovation and change in use (e.g., second-story commercial space converted to housing). Such required retrofitting of an existing building to a new building standard is technically problematic and expensive. In response, the Department of Housing and Urban Development (HUD) developed the Nationally Applicable Recommended Rehabilitation Provisions (NARRP). In a parallel vein, the state of New Jersey promulgated a separate rehabilitation code. Both establish a sliding scalar of requirements depending on the type of work (e.g., repairs, renovations, alterations, reconstruction, change of occupancy). This approach allows for greater flexibility—for instance, moderate rehabilitation need not conform to new construction standards, and adaptive reuse doesn't automatically trigger a new-building standard. The New Jersey Code reportedly reaped construction cost savings (NAHB Research Center, Inc. 1999) and encouraged an increase in rehabilitation activity.

### ***Applicability to Smart Growth Finance***

Building code reforms, such as the NARRP and the New Jersey code, further smart growth objectives such as rehabilitating older neighborhoods, historic preservation, and adaptive reuse.

Subject to state enabling authority (many states have a uniform statewide code), local governments can adopt/administer more flexible building codes. Training of local officials is critical to maximizing the benefit of the more flexible regulations (e.g., granting variances when the literal adherence to the letter of the code is infeasible).

## **FAST-TAKE PROPERTY TAX FORECLOSURE (FAST-TAKE)**

### ***Technique Description***

Tax foreclosure is the legal action of removing property from parties failing to meet property tax obligations. Foreclosure has two basic parts: **redemption** and **title perfection**. In redemption, the delinquent owner is given a final opportunity to satisfy the tax obligation; in title perfection, the property is taken if no redemption is made. These legal proceedings often involve a significant lapse of time, and can slow and complicate redevelopment efforts.

“Fast-take” is a foreclosure technique that allows for the rapid taking of abandoned or severely deteriorated properties by accelerating the redemption and title perfection procedures. Maryland, Massachusetts, New Jersey, and New York all have adopted such techniques. In Maryland, for example, fast-take is applied to properties needing substantial repairs to comply with the building code. On such parcels, a 60-day redemption is permitted (rather than a usual period of six months), and a fast title perfection procedure (***in rem*** rather than ***in personam***) then follows. The legal basis for fast-take must be carefully reviewed. Fast-take in Illinois, for example, was challenged in a class-action suit.

### ***Applicability to Smart Growth Finance***

Fast-take allows for the acquisition of properties in deteriorated neighborhoods, where tax delinquency is common. These properties can be rehabilitated, adaptively reused, or demolished for redevelopment purposes. Fast-take’s advantages include potential acquisition over time of large numbers of parcels; capitalization of an already existing municipal activity (tax foreclosure); delivery of clean title (taxes are a first lien, and tax foreclosure typically negates prior claims); and relatively low cost compared with other acquisition strategies.

Fast-take has several disadvantages: it is a passive strategy (it “awaits” tax delinquency); it may not deliver contiguous properties, and thus site assembly remains a problem for redevelopment; and, in large scale, it imposes significant management and operating demands. (In the 1970s, New York City devoted all of its CDBG monies to operating ***in rem***-acquired buildings.)

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## **FINANCE RISK-SHARING**

### ***Technique Description***

Lenders can participate in more aggressive lending and/or experimentation for smart growth financing if the financing risk is shared by multiple parties: profit and nonprofit developers; construction and permanent lenders; private mortgage companies and public insurers (e.g., FHA); and direct lenders and secondary-mortgage-market entities.

### ***Applicability to Smart Growth Finance***

Risk-sharing would be especially welcome in higher-risk situations, such as inner-city revitalization or large-scale, mixed-use projects. Risk-sharing would make available currently “nonconforming” financing products, such as higher loan-to-value (LTV) ratio mortgages. (See Affordable Housing Financing.) In addition, risk-sharing could be used to experiment with lending perceived to be higher risk, so that loan performance could be better established with actual experience. This could lead to reducing the uncertainty associated with lending in a smart growth context, perhaps leading to new product development, more accurate loan pricing, and/or identification of new lending opportunities.

Partnerships are essential for risk-sharing. An example is the Self Help Community Advantage™ (SHCA) program. SHCA is a partnership between the Center for Community Self-Help—a North Carolina community-based organization, the Ford Foundation, and Fannie Mae. Self Help purchases nonconforming mortgages from selected lenders and retains full recourse for any credit losses. Self Help’s recourse obligations are supported by capital provided by the Ford Foundation. Because Self Help retains full recourse, Fannie Mae can accept loans that are outside its standard guidelines, and Fannie Mae has agreed to purchase and securitize \$2 billion in such loans over a five-year period (Quercia, Stegman, and Davis 2000).

The SHCA partnership approach writ large can be a bridge mechanism to realize smart growth by encouraging experimentation with currently nonconforming mortgages that support the goals of smart growth.

## **INDIVIDUAL DEVELOPMENT ACCOUNT (IDA)**

### ***Technique Description***

IDAs are dedicated savings accounts that help low-income households purchase a first home, start a small business, or in other ways build assets to enter the financial mainstream. IDAs reward savings by providing matching funds, typically from a variety of public and private sources. IDA programs have been launched both by private initiatives and public programs. For instance, in 1998, the Assets for Independence Act authorized a five-year, \$125 million IDA pilot program. Approximately 30 states have already passed IDA legislation. In Indiana, for example, the state provides a 3:1 match to qualifying households for savings deposited in an IDA.

The Savings for Working Families Act of 2000 (SWFA)—S.2023/H.R. 4105—would bring the IDA to scale by creating approximately 10 million new accounts.

### ***Applicability to Smart Growth Finance***

Foundations and federal, state, and local governments providing matching funds can offer a bonus supplement (e.g., a four-to-one rather than a three-to-one match in Indiana) for households buying a home or starting a small business in locations that further smart growth objectives—cities, older suburbs, and/or neighborhoods served by transit. Conversely, the IDA match could be reduced (to two-to-one in Indiana) if the accumulated assets are withdrawn for purposes that further sprawl—for example, buying a house outside the urban growth boundary (UGB).

A smart growth IDA, especially if the SWFA brings the IDA mechanism to scale, would be one step to linking smart growth to capital.

## **LAND BANKING**

### ***Technique Description***

Land banking involves the acquisition, holding, and disposal of land for public and/or private use. Acquisition is accomplished through tax foreclosure, eminent domain, condemnation, donation, or purchase from private owners. Parcels are then inventoried, demolished, cleaned (ranging from removing debris from a lot to brownfield reclamation), maintained, and improved as necessary (e.g., utilities may be extended or upgraded). Finally, the assembled properties are then sold, leased, and/or donated to public or private parties. Land banking typically is conducted by public or quasi-public entities, such as the St. Louis (Missouri) Land Revitalization Authority (LRA) and the Sacramento (California) Redevelopment Agency.

### ***Applicability to Smart Growth Finance***

Land banking can accomplish the site assemblage necessary to further development in smart growth locations. For instance, a proposed in-town new town in St. Louis, Missouri, was enabled by land banking activities by the LRA over a multiyear period. The Sacramento (California) Redevelopment Agency has acquired land for in-town housing development.

The creation of a land banking entity, as well as its activities, is often governed by state constitutional or home-rule statutes, land banking legislation, and other legal guides. State constitutional or legislative changes may therefore be required to authorize land banking entities (where none exist) or to reform existing organizations and/or practices (if current entities face obstacles to conducting activities supportive of smart growth.)

## **LOCATION EFFICIENT MORTGAGE (LEM<sup>SM</sup>)**

### ***Technique Description***

The LEM<sup>SM</sup> is a home purchase loan that enhances the buying capacity of residents of location-efficient neighborhoods (e.g., those with mixed uses and mass transit). The assumption is that residents in these areas, by reducing their automobile expenses, free up household resources for home buying. Accordingly, the LEM<sup>SM</sup> allows a greater share of household income to be applied for housing expenses. Whereas the “standard” mortgage typically has a guideline housing expense-to-income ratio of 28 percent and a total debt-to-income ratio of 36 percent, the LEM<sup>SM</sup> allows those two ratios to climb to 35 percent and 45 percent, respectively. To illustrate the difference, a Seattle household with a \$50,000 annual income can qualify under a standard mortgage for a \$150,000 home, whereas the LEM<sup>SM</sup> would allow that same household living in a location-efficient neighborhood to qualify for as much as a \$190,000 home.

The LEM<sup>SM</sup> results from a multiyear research program involving three non-profit organizations: the Center for Neighborhood Technology, the Natural Resources Defense Council, and the Surface Transportation Policy Project. Together, they formed the Institute for Location Efficiency (ILE). The ILE developed the LEM<sup>SM</sup> and has formulated a computer program that quantifies the savings that result from living in location-efficient neighborhoods versus less accessible suburban locations.

### ***Applicability to Smart Growth Finance***

The LEM<sup>SM</sup> offers a significant financial advantage to residents of compact, transit-served, mixed-use, and similar areas favored by smart growth.

Lenders underwrite and grant the LEM<sup>SM</sup>, and Fannie Mae purchases these loans. The LEM<sup>SM</sup> is currently a \$127 million pilot program in four areas (Chicago, Los Angeles, San Francisco, and Seattle) and may become available nationwide in 2002.

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## **LOW INCOME HOUSING TAX CREDIT (LIHTC)**

### ***Technique Description***

The LIHTC offers a federal tax credit for providing affordable new or rehabilitated rental housing. The credits available for a project are determined by the development cost, the proportion of low-income units, and the credit rate (which typically varies annually between 4 and 9 percent of the project's qualifying basis for a period of ten years). If all the credits are used, the program has the potential of providing more than \$2 billion in equity per year for low-income housing. LIHTC funds accounted for an average of 1,300 projects and approximately 50,000 to 65,000 affordable housing units placed into service between 1992 and 1994.

### ***Applicability to Smart Growth Finance***

While other smart growth activities typically present significant underwriting challenges, the key element of mixed-income housing, by its very definition, is not a market proposition without subsidy. The LIHTC is currently the cornerstone national program, offering the key subsidy that can produce mixed-income rental housing. The LIHTC also offers important assistance for the rehabilitation of the existing housing stock, an important goal of the smart growth agenda. Rehabilitation comprises about one-third of LIHTC projects. Finally, with half of these projects located in central cities, the LIHTC promotes inner-city revitalization.

The LIHTC is administered jointly by the Internal Revenue Service (IRS) and state agencies. Each state receives an annual tax credit allocation from the IRS equal to an amount per state resident. The process of securing tax credits is very competitive, and awards are made according to project criteria specified in what is termed a Qualified Allocation Plan (QAP), prepared by each state. Once the state allocates tax credits to a project, the developer often offers the credits to investors (usually recruited by syndicators).

The QAP awards points for sought-after criteria: The more points, the more competitive an application. Some QAP criteria may further sprawl. Examples include added points for rural projects or points for the lowest costs per housing unit—criteria that may penalize urban, new urbanism, and brownfield reclamation projects which, by their nature, tend to be more expensive. States might review their QAP criteria to remove or modify such inadvertent smart growth-impeding criteria. States might also take proactive measures to add QAP points to LIHTC applications directly furthering smart growth objectives, such as mixed-use and mixed-income development located in transit-served neighborhoods.



## **PROPERTY TAX RELIEF**

### ***Technique Description***

Typically the most significant source of local revenue, the property tax is a levy on real (and sometimes personal) property. The property tax generally amounts to 1 to 3 percent of value and varies between places. Cities and older suburbs, which have witnessed an outflow of population and industry, often have low property values and high service demands, resulting in a relatively high property tax burden.

Local jurisdictions sometimes offer property tax relief to foster investment. Cities and older suburbs may lower taxes for new construction as an incentive for development. Property tax relief may be accorded to properties of special merit, such as historic landmarks. Alabama, for instance, halves the assessment of certain categories of historic commercial parcels.

Higher taxes resulting from renovation (and therefore increased value) often deter owners from rehabilitating their properties. Many jurisdictions therefore offer property tax relief for rehabilitation. These measures include not reassessing, or only partially increasing the assessment on the property undergoing improvement.

### ***Applicability to Smart Growth Finance***

Property tax relief can encourage smart-growth-fostering activities, such as rehabilitation, historic preservation, brownfield reclamation, and mixed-income housing, in many urban locations. Property tax abatement, for instance, made possible the redevelopment of the Hudson River Waterfront in New Jersey as a higher density, mixed-use, transit-served area.

If authorized by state constitution or statute, local governments can offer property tax reduction programs. This may require such local actions as declaring an area “blighted” and developing a payment in lieu of taxes (PILOT) or other tax relief schedules.

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## PUBLIC EMPLOYMENT AND SPACE UTILIZATION TO FOSTER REVITALIZATION

### *Technique Description*

Government can enact directives to locate facilities in, and support through their other business activities (purchasing, for example), urban, CBD, historic, and other smart-growth-fostering areas. There have been numerous such directives. At the federal level, for example, the **Public Buildings Cooperative Use Act** (PBCUA) mandates that the General Services Administration (GSA) should acquire space in historic properties unless such space is not feasible and prudent. The 1978 **Executive Order 12072** underscores policies set forth in PBCUA and directs federal agencies to give first consideration to central business district (CBD) locations. The 1996 **Executive Order 13006** calls for federal facilities to be located in established urban areas, with first consideration given to historic properties.

There are often parallel directives at the state level (Beaumont 1996, 156–57). In 1977, a Massachusetts executive order called on state government to focus state investment, such as schools and offices, in the downtown centers of older cities and towns. Similarly, a 1986 Vermont executive order gave priority to locating state government activities in historic and other existing buildings when appropriate. In 1994, an Oregon executive order directed all state agencies to give preference to downtown locations when leasing office space. Many other states have comparable directives.

### *Applicability to Smart Growth Finance*

These mandates bolster the economic vitality of cities, downtowns, and historic areas. In addition, they promote the rehabilitation of existing buildings instead of building anew, also supportive of smart growth. By reinvigorating local markets, these actions create new or enhanced market opportunities for additional private lending and investment. The legislation and executive orders also constitute government leading by example which, hopefully, will encourage parallel action in the private sector. Accordingly, such mandates merit adoption and **enforcement** by government. For example, the federal directives listed above occasionally have been undermined by agencies claiming that a CBD, urban, and/or historic location was inappropriate to their mission, citing insufficient parking or other such reason. The General Services Administration, and its equivalent at the state level, should scrutinize carefully such agency claims and should enforce the spirit of the governmental agency locational mandates.

## **REHABILITATION INVESTMENT TAX CREDIT (ITC)**

### ***Technique Description***

A 10 percent federal ITC can be applied to the rehabilitation of nonresidential properties built prior to 1936. A 20 percent ITC can be applied for the renovation of historic residential or nonresidential properties. Various criteria must be satisfied, such as doing “substantial” rehab and satisfying other construction and financial tests (e.g., retaining a specified percentage of outer walls and adhering to limitations on applying tax credits to “passive income,” such as wages).

### ***Applicability to Smart Growth Finance***

The ITC offers a major financial incentive for rehabilitation, especially of historic neighborhoods (for example, a \$100,000 historic rehab would qualify for \$20,000 in federal tax credits). The historic ITC has been used extensively for affordable housing (20 percent of production) and mixed-use development (25 percent of production). For the historic and general nonresidential ITC, the Internal Revenue Service has various restrictions that govern use of the credit (e.g., “nonpassive income” limitations). For the historic ITC, designation of property as a landmark and National Park Service (NPS) review of appropriateness of planned renovation are required to qualify.

Support of these activities alone makes the ITC an important tool for smart growth finance. The ITC could be modified to further improve its utility as a source of finance for smart growth projects. One potential change is to allow the existing ITC to be applied more flexibly. For example, the current “substantial rehabilitation” requirement for the ITC could be replaced with a lesser threshold that would allow for moderate rehabilitation. Smart growth finance would also benefit from expanding the coverage of the existing ITC to owner-occupied housing, for instance (it is currently limited to the rehabilitation of income-producing properties).<sup>10</sup>

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## **TAX INCREMENT FINANCING (TIF)**

### ***Technique Description***

Tax increment financing is a local redevelopment tool that funds, often through bonding, specific public and private improvements and services needed to prepare an area for further investment. TIFs allow a community to recapture increased taxes attributable to redevelopment. The tax revenues yielded, which exceed the taxes generated prior to redevelopment, are termed the “tax increment,” and the TIF captures that gain to reinvest in and sustain the redevelopment.

### ***Applicability to Smart Growth Finance***

TIF generally must serve public purposes, which also promotes a favorable environment for smart growth finance. These include redeveloping blighted areas, constructing affordable housing, and providing employment opportunities. For example, a TIF could be used for site assembly, pollution cleanup, and land write-down in transit-served neighborhoods in cities and older suburbs. It could also be used to assemble and prepare infill sites in suburbs. In Boca Raton, Florida, a TIF was used to increase the downtown’s attractiveness by adding a mixed-use office, housing, retail, and entertainment center (Mizner Park).

Local TIF implementation typically must be authorized by state legislation. Once so empowered, local governments prepare a TIF plan, adopt an ordinance authorizing the issuance of bonds to pay for the TIF improvements, and take other supportive actions (e.g., provide public improvements within the TIF area).

Appendix Table 1

**Consumer Income, Employment, and Commercial Square Footage from  
Household Income of \$82 Billion Sent to Urban Counties**

| <i>Consumption<br/>Component</i> | [A]<br>%<br><i>HHC</i> <sup>1</sup><br>(%) | [B]<br><i>Total</i><br><i>HHC</i><br>(K-S) | [C]<br>\$ Per<br><i>Employee</i> <sup>2</sup><br>(S) | [D]<br><i>EMP</i><br>(K-EMP) |
|----------------------------------|--|--|--|------------------------------|
| I. Food                          | 15.0                                       | 9,820                                      | -  | -                            |
| A. At Home                       | 8.7  | 5,718                                      | 138,871  | 41                           |
| B. Away from Home                | 5.6  | 3,664                                      | 32,489   | 113                          |
| C. Other                         | 0.7  | 438  | 206,206  | 2                            |
| II. Housing/Household Operations | 28.6                                       | 18,718                                     | -  | -                            |
| A. Shelter                       | -  | -  | -  | -                            |
| 1. Financial                     | 9.2  | 6,019                                      | -  | -                            |
| 2. Maintenance                   | 2.8  | 1,852                                      | 203,564  | 9                            |
| B. Utilities                     | 8.2  | 5,365                                      | 589,751  | 9                            |
| C. Household Operations          | 2.7  | 1,734                                      | 131,780  | 13                           |
| D. Furniture/Appliances          | 2.4  | 1,570                                      | 148,476  | 11                           |
| E. Other                         | 3.3  | 2,179                                      | 131,780  | 17                           |
| III. Apparel/Services            | 4.4  | 2,898                                      | -  | -                            |
| A. Clothing                      | 4.4  | 2,898                                      | 106,548  | 27                           |
| IV. Transportation               | 21.3                                       | 13,942                                     | -  | -                            |
| A. Auto Operations               | 10.5                                       | 6,876                                      | 214,916  | 32                           |
| B. Auto Purchase                 | 10.0                                       | 6,556                                      | 486,088  | 13                           |
| C. Other                         | 0.8  | 497  | 38,827   | 13                           |
| V. Health Care                   | 7.1  | 4,626                                      | -  | -                            |
| A. Insurance/Hospitals           | 3.5  | 2,257                                      | 76,865   | 29                           |
| B. Physicians/Other              | 1.9  | 1,243                                      | 114,825  | 11                           |
| C. Drugs                         | 1.4  | 903  | 140,150  | 6                            |
| D. Other                         | 0.3  | 222  | 63,244   | 4                            |
| VI. Entertainment                | 5.3  | 3,454                                      | -  | -                            |
| A. Books/Audio/Movies            | 3.4  | 2,231                                      | 181,933  | 12                           |
| B. Other                         | 1.9  | 1,223                                      | 62,146   | 20                           |
| VII. Other Expenditures          | 18.3                                       | 11,966                                     | -  | -                            |
| A. Personal Insurance/Pensions   | 9.2  | 6,000                                      | 61,086   | 98                           |
| B. Other                         | 9.1  | 5,966                                      | 40,789   | 146                          |
| <b>TOTAL</b>                     | <b>100.0</b>                               | <b>65,425</b>                              | <b>-</b>   | <b>626</b>                   |

Note: Subtotals may not sum to indicated totals due to rounding.

Key: HHC: Household Consumption  
EMP: Employees  
L/M: Low and Moderate  
K: Thousands (000s)

Appendix Table 1 (continued)

**Consumer Income, Employment, and Commercial Square Footage from  
Household Income of \$82 Billion Sent to Urban Counties**

| <i>Consumption<br/>Component<br/>(continued)</i> | [E]<br>%<br><i>L/M</i> <sup>3</sup><br>(%) | [F]<br><i>L/M</i><br><i>EMP</i><br>( <i>K-EMP</i> ) | [G]<br><i>Sales per</i><br><i>Square Foot</i> <sup>4</sup><br>( <i>K-S</i> ) | [H]<br><i>Square Feet</i><br><i>of Space</i><br>( <i>K-Sq. Feet</i> ) |
|--|--|---|--|---|
| I. Food  | -  | -   | -  | -   |
| A. At Home                                       | 33   | 13.6  | 0.3  | 19,061  |
| B. Away from Home                                | 54   | 60.9  | 0.3  | 14,655  |
| C. Other   | 30   | 0.6   | 0.3  | 1,370   |
| II. Housing/Household Operations                 | -  | -   | -  | -   |
| A. Shelter                                       | -  | -   | -  | -   |
| 1. Financial                                     | -  | -   | -  | -   |
| 2. Maintenance                                   | 20   | 1.8   | 0.2  | 9,745   |
| B. Utilities                                     | 20   | 1.8   | -  | -   |
| C. Household Operations                          | 48   | 6.3   | 0.2  | 9,125   |
| D. Furniture/Appliances                          | 20   | 2.1   | 0.2  | 8,264   |
| E. Other   | 20   | 3.3   | 0.2  | 11,467  |
| III. Apparel/Services                            | -  | -   | -  | -   |
| A. Clothing                                      | 34   | 9.2   | 0.2  | 14,492  |
| IV. Transportation                               | -  | -   | -  | -   |
| A. Auto Operations                               | 37   | 11.8  | 0.1  | 57,302  |
| B. Auto Purchase                                 | 22   | 3.0   | 0.3  | 21,852  |
| C. Other   | 59   | 7.6   | 0.2  | 3,315   |
| V. Health Care                                   | -  | -   | -  | -   |
| A. Insurance/Hospitals                           | 21   | 6.2   | -  | -   |
| B. Physicians/Other                              | 5  | 0.5   | -  | -   |
| C. Drugs   | 38   | 2.4   | 0.2  | 4,299   |
| D. Other   | 20   | 0.7   | 0.2  | 1,059   |
| VI. Entertainment                                | -  | -   | -  | -   |
| A. Books/Audio/Movies                            | 28   | 3.4   | 0.2  | 11,155  |
| B. Other   | 28   | 5.5   | 0.2  | 6,439   |
| VII. Other Expenditures                          | -  | -   | -  | -   |
| A. Personal Insurance/Pensions                   | -  | -   | -  | -   |
| B. Other   | 20   | 29.2  | 0.2  | 31,370  |
| <b>TOTAL</b>                                     | -  | <b>170.1</b>  | -  | <b>224,970</b>  |

Sources: 1. 1999 Statistical Abstract. Washington, DC: U.S. Bureau of the Census

2. 1997 Economic Census. Washington, DC: U.S. Bureau of the Census.

3. Public Use Microdata Sample, 1990. Washington, DC: U.S. Bureau of the Census.

4. Dollars and Cents of Shopping Centers. Washington, DC: Urban Land Institute, 1995.

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## **NOTES**

1. Smart growth forums sponsored by the Mortgage Bankers Association of America and the U.S. Conference of Mayors were held in Charlotte, North Carolina; Minneapolis, Minnesota; Rochester, New York; and San Francisco, California, in the summer and fall of 2000.

2. Twenty-three million households occupy the 25 million housing units projected for the period 2000–2025. The difference between these two numbers is ongoing vacancy within the projected increase of 25 million units.

3. The control of sprawl involves reducing the sprawl growth rate threshold by 25 percent in rural and undeveloped counties nationwide (for counties already above the threshold). This is accomplished by sending that growth to nearby more-developed suburban and urban counties in the same Economic Area (EA) (if this growth can be taken by these counties). Nationally, this involves movement of about 10 percent of the projected household growth, or 2.5 million households, during the projection period. Of the approximately 2.5 million households, 1.8 million households are sent to urban counties. For the purposes of this report, these are the households of primary interest.

Urban and suburban counties are defined by different densities in different state groups according to current densities of development. In a very low-density group of states (Montana, North and South Dakota, Wyoming, etc.), a suburban county is one between 20 and 85 persons per square

mile; an urban county is one between 85 and 300 persons per square mile. In a high-density state (Connecticut, Massachusetts, New Jersey, New York, etc.), a suburban county is one between 250 and 700 persons per square mile; an urban county is one between 700 and 3,000 persons per square mile.

In redirecting growth to control sprawl, growth is first redirected to urban counties and then to suburban counties. This is because urban counties are more receptive to growth than suburban counties. The 1.8 million households directed to urban counties and 0.7 million households directed to suburban counties are a function of the number of rural and undeveloped counties in an EA that are sprawling, the number of households to be redirected relative to that sprawl, and the capacity of an urban or suburban county in the same EA to receive this growth. These controls are assumed to be present in every EA that is growing; therefore, there is no spillover between EAs that have these controls and those that do not.

4. The \$82 billion in household income is the income associated with the movement of 1.8 million households from sprawling rural or undeveloped counties to urban counties, multiplied by the average income in the rural or undeveloped county in which the household originally would have established residence. This aggregate figure of \$82 billion, divided by 1.8 million households, produces an average of approximately \$45,000 of income per household. The individual income figures used reflect the original location of residence (rural or undeveloped counties) and are transferred to the subsequent place of residence (urban counties).

5. The \$65 billion in consumption income is derived by applying a percentage distribution of household income for various consumption purposes. Missing from the approximately \$82 billion, and not considered part of the consumption income, are expenditures on federal, state, and local taxes, as well as any income reserved for savings. This amounts to approximately 20 percent of household income, or \$16.4 billion (\$81.8 billion minus \$16.4 billion equals \$65.4 billion) (see appendix table 1).

6. The approximately 625,000 new employees are derived from information from the 1997 *Economic Census*. The *Economic Census* produces, for various categories of consumption (e.g., "food at home"), the amount of annual sales (in the form of a U.S. average) necessary to support a new



employee. For “food at home,” this is \$138,871 annually (see appendix table 1). These sales, divided into annual income available for “food at home” (\$5,718,000,000), yield the number of employees that are annually supported by the consumption expenditures (41,000). This procedure, taken through the various categories of consumption expenditures, yields approximately 625,000 employees supported by annual consumption income expenditures of \$65.4 billion (see appendix table 1). No assumptions are made about where employees filling new urban-county jobs will live. The analysis projects a certain number of new urban-county jobs supported by the retail expenditures of new urban households.

7. The projection of 170,000 new low- and moderate-income employees from the 625,000 new workers is obtained by using the 1990 U.S. Census Public Use Microdata Sample (PUMS) to determine wage profiles by industry sector. The PUMS is used to sum retail employees by type for the nation and to associate an income distribution with each type. “Low and moderate income” is defined as 80 percent of regional median income (four regions nationwide). Households by retail-job type are distributed by region to determine the percentage of households that are low and moderate income for each job category (see appendix table 1). This figure is weighted for the nation as a whole and varies by category from 5 percent (physicians/other medical employees) to nearly 54 percent (“food away from home” [restaurant] workers). This figure, applied to the number of workers in each category, produces the number of low- and moderate-income workers in each category. The low- and moderate-income workers are a subset of all workers.

8. Average annual sales per square foot of retailing space are obtained from *The Dollars and Cents of Shopping Centers* (Washington, DC: Urban Land Institute) category of retail expenditures that are closest to the categories representing the distribution of consumption expenditures. This is a standard component of a market analysis for retail space. Incomes of new households are projected and broken down by consumption category. The projection for annual sales per square foot for businesses likely to provide retailing services in these categories (obtained from ULI or other sources) is divided into income available by retail category to determine future square footage supported by each category (see appendix table 1). No siphoning off by suburban counties is assumed because of the scale

(physical size) of most urban counties, parts of which already include the equivalent of suburban competition at the municipal scale.

9. The Northeast and Midwest receive 16 percent of the income but 25 percent of the households because the households that would have emerged in rural and undeveloped counties in the Northeast and Midwest have less household income than those that would have emerged in similar counties in the West and South. This income is carried with them to the respective urban counties of their Economic ( $\approx$ Metropolitan) Areas. Urban counties of the Northeast and Midwest are hit harder in terms of growth between urban and non-urban counties than their counterparts in the West and South, and even when corrective actions are taken (redirection of households and income), they still do not fare as well. This is true because of the relative income differences of relocatees that exist in their respective regions that are unlikely to change. Thus, any national program that seeks to make urban investment more attractive to the private sector must recognize the very significant regional differences that exist in the current and future income bases of northern versus southern/western counties.

10. Such change was, in fact, proposed but not adopted in the Historic Homeownership Act (H.R. 1172/S.664), which would grant a 20 percent ITC to homeowners for the rehabilitation of homeowners' historic properties. Homeowners with insufficient tax liability to claim the credit could convert the credit to a mortgage credit certificate to obtain a mortgage interest rate reduction from their lender, and the lender would then take the credit against his or her taxes.

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