HOW THE FEDERAL REGULATION CYCLE AFFECTS THE REAL ESTATE INDUSTRY

by Nicholas Ordway, Jack P. Friedman, CRE and Jack C. Harris

Many real estate professionals believe real estate is becoming dysfunctional due to the degree of federal regulation. Regulations are not a free good. Costs of regulation are transferred to consumers in higher prices, to labor in lost jobs and to business firms in a decline of competitiveness. Today, Congress is reacting with "Contract with America" designed to reduce government costs, along with the U.S. Supreme Court's new property rights doctrine against exactions in cases such as *Dolan v. City of Tigard* (1994). The purpose of this article is to present the regulation cycle of federal government agencies and explain why pressure mounts to begin dismantling the system.

In recent years, the federal government's role in real estate regulation has been all-pervasive and all-expansive. At least since the National Environmental Policy Act of 1969, the federal government has intruded into areas involving the real estate industry that previously were left to states and municipal governments. As the federal government becomes involved in various areas, it writes a wide array of regulations. For example, the Environmental Protection Agency has 9,000 pages of environmental rules; the Occupational Safety and Health Administration has over 4,000 regulations.

How Federal Laws And Regulations Impact The Real Estate Industry

Federal regulation of commerce and consumer protection has been widely accepted for decades. Laws implementing such regulation include: the Sherman Antitrust Act (1890), which protects trade and commerce against unlawful restraints and monopolies and establishes a policy in favor of competition; a Supreme Court ruling which establishes that real estate agents who charge identical commissions in the same area may be found guilty of price fixing; the Magnuson-Moss Warranty Act (Federal Trade Commission Improvement Act) of 1975 which affects housing and housing products by establishing mandatory standards for warranties on consumer products to improve consumer information.

There are, however, numerous other federal government agencies that carry out laws and regulations affecting individuals, specific properties,

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financing terms and societal matters. Many of these agencies go beyond the traditional scope of government regulation on real estate activities contemplated by the original authors of the U.S. Constitution.

A partial list with brief descriptions of some prominent federal government laws that affect real estate is provided in this article. While state and local regulations also exist and are a powerful force, especially with regard to specific proposed developments, they are too varied and numerous to include here. The federal acts listed have been classified into the following categories: environment and energy, finance, foreign ownership, health and safety, and housing. These laws represent only the tip of the iceberg. Government is also involved in tax laws, investment regulations, drug enforcement activities and other areas that impact the real estate industry.

Environment And Energy

Environmental laws include the Clean Air Act (1970, amended 1977); the Clean Water Act (1972 and 1977); the Coastal Zone Management Act (1972; amended 1976); the Federal Water Pollution Control Act (Wetlands) and Amendments (1972); the Resource Conservation and Recovery Act (1976); the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA, also referred to as Superfund); and the Superfund Amendment and Reauthorization Act of 1986 (SARA). Also under environmental laws is the National Historic Preservation Act (1966). The Energy Conservation Standards for New Buildings Act (1976) requires the Department of Housing and Urban Development to implement building energy standards for new residential and commercial construction. Many of these laws have resulted in halting new developments and increasing costs. While the laws themselves usually are understandable and involve broad policy issues, the regulations to implement them often are incomprehensible and deal with minutiae.

Finance

Laws affecting finance can be grouped into several categories including regulations which define the powers of financial institutions, e.g., the Depository Institutions Deregulation and Monetary Control Act (1980); the Farm Credit Act (1971); and the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) (1989). Also pertinent are the Farmers Home Administration (FmHA) Act (1946); the Federal Home Loan Bank Act (1932); the Federal Reserve Act (1933), and the Garn–St. Germain Depository Institutions Act (1982). These laws set the ground rules for operating financial institutions and generally contributing to the safety and security of our banking system.

Another category of finance laws provides for disclosures and protections to consumers. These include the Consumer Credit Protection Act (1960); the Equal Credit Opportunity Act (1974; amended 1976); the Truth-in-Lending Act (1968); the Truth-in-Lending Simplification and Reform Act (1980), which amends the Truth-in-Lending Act of 1968; the Home Mortgage Disclosure Act (1975); the Real Estate Settlement Procedures Act (RESPA) (1974; amended 1975); and Regulation B (Title VII, Consumer Credit Protection Act) and amendments. Regulation Z includes regulations pertaining to consumer credit disclosure issued by the Board of Governors of the Federal Reserve System pursuant to Title I of the Truth-in-Lending Act and Title V, General Provisions, of the Consumer Credit Protection Act. The Interstate Land Sales Full Disclosure Act (1968; amended 1979) is another law in this finance category. Overall, these laws have benefited consumers by providing for better disclosures and reducing credit discrimination against women and some protected minorities.

A third category of finance laws creates special benefits for select groups. These laws include the Section 8 Program, created by the Housing and Community Development Act of 1974; the Senior Citizens Housing Act (1962); the Uniform Relocation Assistance and Real Property Acquisition Policies Act (1970); and the Veterans' Housing Benefits Act (1978) that amends Title 38 of the United States Code to improve the housing benefits programs of the Veterans Administration (now the Department of Veterans Affairs). These laws have had mixed results and have become regarded as entitlements by some beneficiaries.

Foreign Ownership

Laws impacting foreigners include the Agricultural Foreign Investment Disclosure Act (1978) and the Foreign Investment in Real Property Tax Act (1980; amended 1984). These laws eliminate techniques by which a nonresident alien (a foreign national temporarily present in the United States) or a foreign corporation could sell U.S. real estate without being subject to U.S. tax laws.

Health And Safety

Health and safety laws include the Americans with Disabilities Act (1990) and the Occupational Safety and Health Act (1970), which established the Occupational Safety and Health Administration (OSHA) and set up the Occupational Safety and Health Review Commission and the National Institute for Occupational Safety and Health (NIOSH). Some of the regulations have actually increased hazards instead of reducing them. OSHA requirements have also, in many cases, increased costs and paperwork and resulted in delayed construction.

Housing

Laws impacting housing include the Community Reinvestment Act (1977); the Condominium and Cooperative Abuse Relief Act (1980); the Consumer Home Mortgage Assistance Act (1974); the Emergency Home Finance Act (Title III) (1970); the Federal Flood Insurance Program (1968) and National Flood Insurance Act (1968); and the Flood Disaster Protection Act (1973; amended 1975 and 1976). Fair housing laws prohibit discrimination; these are the Civil Rights Act of 1875; the Civil Rights Act of 1964 (Title VI, Nondiscrimination in Federally Assisted Programs); the Civil Rights Act of 1968 (Title VIII, Fair Housing); and the Federal Fair Housing Amendment Act (1988). The government also has laws involving development regulations. These include the National Mobile Home and Construction Safety Standards Act (1974) and the Neighborhood Self-Help Development Act (1978). Overall, these laws have been highly effective in lessening discrimination and in opening up housing markets and contributing to their equity and economic efficiency. Since 1988 however, some critics maintain that the fair housing amendments have been used by litigation entrepreneurs to intimidate innocent defendants into costly settlements.

Why Some Government Regulations Create More Costs Than Benefits

Why are some laws passed by Congress effective and others not? To answer this question, we must look at how some agencies and their regulatory structures tend to evolve through a four-stage process including:

Stage One: Creation and Implementation
Stage Two: Bureaucratization
Stage Three: Exploitation
Stage Four: Dysfunction

Not all agencies fully reach the exploitation and dysfunction phases. How far an agency evolves depends on the preciseness of its mission and the stakeholders involved. For example, the Federal Deposit Insurance Corporation (FDIC) guarantees (within limits) funds on deposit in member banks and thrift institutions. It also makes loans to or buys assets from member institutions to facilitate mergers or prevent failures. In 1989, the FDIC was reorganized to incorporate the functions of the Federal Savings and Loan Insurance Corporation which ceased to exist. The FDIC has been instrumental in inspiring great confidence in the U.S. banking system for more than 60 years. Earning its revenues from small assessments on bank deposits, it is highly effective and functional. On the other hand, agencies such as OSHA have the vague mission of creating a workplace that is in compliance with OSHA's work rules. It has been reported that OSHA itself indicates that 80 percent of workplaces are not in compliance. Few knowledgeable people will argue that OSHA has had a positive net effect in recent years. However, people who have suffered injury in the workplace will remark positively as will their coworkers when a dangerous situation is alleviated.

Stage One: Creation And Implementation

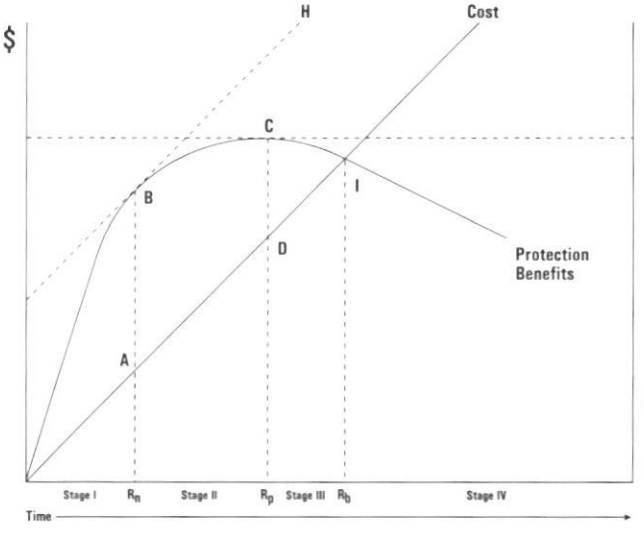
A system of federal government regulations often begins with good intentions. A problem is identified that is harmful to the public and is not being addressed by state governments. For example, the problem of DDT and pesticides was identified in Rachel Carson's classic book *Silent Spring* (1962). This exposure resulted in a public outcry for environmental legislation some of which is listed in this article. Other motivations for new legislation might include economic benefits for the special interest groups which are favored by a political party in power. Often model legislation from specific states or other countries can lead to "me-too" laws on the federal level.

Laws passed by Congress usually set broad policy and require implementation by an administrative agency. If a law does not fall under the purview of an existing agency, a new one may need to be established. Stage I is illustrated in Figure 1.

Agencies dealing with popular issues, such as the environment, attract professional administrators as well as idealists recently out of law schools and graduate programs. Often the benefits of the regulations far outweigh the costs on the regulated. Initial regulations generally attack obvious abuses

FIGURE 1

Costs and Protection Benefits of Regulation Over Time



underway in the free market. Such overt abuses usually can be quickly corrected at relatively low cost. As indicated in Figure 1, this causes a net social benefit reflected by A-B. At point B the net social benefit is the greatest. This point is indicated when the protection function created by the regulations becomes tangent to line H, which is drawn to run parallel to the cost function line. The quantity of regulation reflecting the greatest net benefit is indicated as R_n.

Stage Two: Bureaucratization

Due to the nature of state and/or federal regulation, new administrative roles continue to be added even when the net social benefit begins to shrink. The key is to increase the protection or benefits to the special interest groups involved. Once the net social benefits begin to diminish, the bureaucratization stage begins.

Bureaucratization occurs for several reasons. As described in Philip K. Howard's book *The Death of Common Sense* (1994),[1] "Our regulatory system has become an instruction manual. It tells us and bureaucrats what to do and how to do it. Detailed rule after detailed rule addresses every eventuality, or at least every situation lawmakers and bureaucrats can think of."

The major stakeholders who contribute to bureaucratization are the bureaucrats themselves. The fixation is on paperwork, and make-work becomes the pattern for many of these employees. However, the bureaucratic operational rule is that if a regulation does not permit the firm's action, it is probably illegal and the regulated business firm must prove it has acted correctly. Bureaucrats don't want to make decisions for fear of setting a precedent. Often decisions are delayed or not made. Bureaucrats also make rules to make their jobs easier and more convenient however, this can result in considerable expense for the private sector.

Stage Three: Exploitation

At some point in the process, the number of regulations increases and become so detailed that the level of protection can begin to decrease. This point is designated as C in Figure 1 and occurs because the quantity of regulations has become R_p. Too much regulation can create an incomprehensible system that results in ignoring rules or spending considerable effort to find loopholes or use the system to create exemptions.

Such situations also create the possibility of exploitation by various stakeholders. Lawyers, accountants, former agency employees, lobbyists, retired or active politicians and others can find themselves in a position to exploit an overcomplicated regulatory system by becoming expediters in bypassing red tape. A highly regulated structure can create a barrier to entry by new competitors. Regulations also can change the economies of scale, driving smaller firms out of business. For this reason, entrenched firms, especially if they have grandfathered exemptions, often will defend the regulatory structure.

Stage Four: Dysfunction

Dysfunction occurs once the cost of regulation exceeds any protection or benefits created by regulation. This occurs at point I in Figure I when the protection function and the cost function intersect at a quantity of regulations designated as R_b. Past point I, the net social costs to society begin to increase. However, there may be very little incentive to change the regulations.

To illustrate, suppose that a special interest group receives $25,000 in benefits because of a particular regulation. The cost of this regulation creates an annual cost of $.05 for each of the two million people in a particular city. Therefore, the total cost for the city is $100,000. The $25,000 benefit creates a net social cost of $75,000. Furthermore, because the benefits are concentrated in one firm and the costs are spread over millions, the group will have great incentive to maintain the regulation.

Conclusion

This article outlined the Regulation Cycle of federal government agencies and their regulatory structures. Economic conditions almost always exist to push the regulations into the exploitation stage. However, not all agencies and regulatory structures are dysfunctional. As described, some laws are essential to our economic system, while others have created better information and protection for both consumers and business firms.

Despite good legislative intentions and initial benefits realized by many regulations, an improperly managed and monitored regulatory structure can evolve into the dysfunction stage. Protecting the system will require better identification of costs and benefits and a heavy application of common sense by both Congress and the courts.

NOTE

1. Howard, Philip K., *The Death of Common Sense: How Law is Suffocating America* (New York: Random House, 1994): pp.10-11.

New Technology

Don't Let Arachnophobia Keep You Off The Web

by Patty Dupré, CRE

The World Wide Web, known as the Web for its web-like organization, is a global information system within the Internet which enables users to view almost instantly text, images, video and audio clips from around the world. What makes it so popular is the easy point-and-click access, the visual display and the ability to link to other data anywhere. One moment you can access information from a computer in Seattle, then from a computer in Australia reading population trends for Atlanta, Georgia.

What is required to explore the Web? You need a modem (the faster the better) for your PC, an Internet connection and a Web browser. Your Internet connection can be with a direct access provider, which typically offers Internet access and little else, or with a commercial on-line provider like CompuServe, America On-line, Genie, etc. Many of the commercial providers have Web browsers included in the software, or they can be purchased separately. Some browsers can be transferred, or downloaded, from the Internet directly to your PC. You can take it out for a test drive, and if you decide it's the one for you, pay a license fee within 30 days. For example, Netscape's Navigator, a popular browser, can be downloaded by going to *http://home.netscape.com/*

An important aspect of the Web is hypertext, or data linked to other information on the same computer or on another computer anywhere in the world. Hypertext data is usually a word or picture that is underlined or highlighted in a Web document. Just click on the hypertext, and you are immediately linked to another document.

Web Sites for Real Estate Data

Site	Comments	URL
The Counselors of Real Estate	CRE products/services; member names, addresses; REI (journal) index of articles; Meeting information	http://www.cre.org/
American Real Estate Exchange (Amrex)	Daily news on real estate issues from a number of sources	http://www.amrex.com/
Appraisal Institute (AI)	Data on the AI organization	http://realworks.com/ai/
Census Bureau	1990 and other census data	http://www.census.gov/
Commercial Investment Real Estate Institute (CIREI)	Data on the CIREI organization, listing of CCIMs, Publications	http://www.ccim.com/
Marcus & Millichap Commercial Brokerage Co	Listing of offices and 60% of their active listings	http://www.mmreibc.com/
Internet Real Estate Directory	Directory for real estate sites	http://www.onramp.net/ired/
Realty Links	Listing of real estate sites throughout the US	http://www.xmission.com/~realtor1/
Rent Net	This lists over 119,000 apartments for rent around the country	http://www.rent.net:1000/
WWW Virtual Library	Demographic and population study data	http://coombs.anu.edu.au/ResFacilities/DemographyPage.html/

To view a document on the Web, you first need to know its unique name or URL (Uniform Resource Locator). URLs consist of an address that must be typed exactly as shown; this address will typically begin with "http://" Above are some real-estate related sites on the Web.

There is not a central index or catalog for the millions of sites on the Web. So how can you find the information you need? One way is to use a "search engine," or a computer which will search the Internet for the information you need. Simply call up one of the engines (by typing the URL), and type in the information you want searched in the box provided. Within seconds of my request for population statistics, 481 references were found along with a listing of the first 25 sites. The following are three good search engines to try:

Webcrawler
http://webcrawler.com/

Yahoo
http://www.yahoo.com/

Lycos
http://www.lycos.com/

The Web is a useful tool and growing resource for real estate counselors and all real estate practitioners who require important data quickly. Instead of using snail-mail to receive government statistics for an analysis you are working on, hop on the Web, enter the URL and download the data you need directly into your Excel, Lotus or other spreadsheet program.

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