REAL ESTATE ISSUES®

Published by The Counselors of Real Estate *Volume 30, Number 2* *Winter 2005 - 2006*

The Economic Impact Study for a Big Box Retailer
Joseph S. Rabianski, Ph.D., CRE

The Valuation of Corridors in Eminent Domain: The Chester Valley Branch
Michael Sklaroff, CRE

Kelo v. The City of New London:
What does it really mean?
Richard C. Dearth and J. Russell Hardin

Public Financing for Creating Affordable Housing
Options in the United States
Wintford Thornton

INSIDERS' PERSPECTIVES

FOCUS ON INVESTMENT CONDITIONS
Kenneth P. Riggs, CRE

FOCUS ON THE ECONOMY
Dr. Mark Lee Levine, CRE

CRE

THE COUNSELORS OF REAL ESTATE

www.cre.org

REAL ESTATE ISSUES

Winter 2005-2006 Volume 30, Number 2

CONTENTS

iii
About The Counselors of Real Estate

iv
Editor's Statement

1
The Economic Impact Study for a Big Box Retailer
BY JOSEPH S. RABIANSKI, PH.D., CRE

The economic impact study is one of many specialized studies performed by some CREs. It is therefore a matter of interest to the CRE organization. Economic impact studies have been performed for a wide array of economic activity such as tourist attractions, sporting events and conventions and the results have appeared in newspaper articles. Economic impact studies have been performed for manufacturing plants to show the effect on direct employment in the plant and the increased level of total employment in the community. These economic impact studies also examine the effect on retail sales in the community. In a similar vein, economic impact studies can be performed for other real property activities ranging from regional malls to rock quarry operations and land fills on a desirability scale. Economic studies have also been performed for the employment and retail sales activity associated with the multifamily housing industry within a local jurisdiction such as a county.

This article presents the nature and structure of an economic impact study for a big box retailer. However, the thought pattern and the general procedure applied in this article serve as a model for all economic impact studies. The numerical example contained within the exhibits is taken from a real assignment; however, some modifications have been made to the numbers to cloak the identity of the client.

13
The Valuation of Corridors in Eminent Domain: The Chester Valley Branch
BY MICHAEL SKLAROFF, CRE

This paper will address the conflicts inherent in Eminent Domain, the clash between competing theories of highest and best use and the search for methodologies appropriate to one important variety of special use property, the transportation corridor. The forum for this inquiry was a jury trial. As will be discussed in detail below, the condemnor presented the corridor as an abandoned rail right-

EDITOR IN CHIEF
Hugh Kelly, CRE
Real Estate Economics, *Brooklyn, NY*
CO-EDITOR
Kerry Vandell, CRE
University of Wisconsin, *Madison, WI*
2005 EDITORIAL BOARD
Timothy Barnes, CRE
Cushman & Wakefield, *New York, NY*
Owen M. Beitsch, CRE
Real Estate Research Consultants, *Orlando, FL*
Peter C. Burley, CRE
Simpson Housing Limited Partnership, *Denver, CO*
Mary C. Bujold, CRE
Maxfield Research, Inc., *Minneapolis, MN*
Maura M. Cochran, CRE
Bartram & Cochran, Inc., *Hartford, CT*
John A. Dalkowski, III, CRE
Phoenix Real Estate Counselors, Inc., *Miami, FL*
P. Barton DeLacy, CRE,
PGP Consulting, LLC, *Portland, OR*
Jack P. Friedman, CRE
Jack P. Friedman & Associates, LLC, *Dallas, TX*
Steven M. Friedman, CRE
Ernst & Young LLP, *McLean, VA*
John L. Gadd, CRE
Gadd, Tibble & Associates, Inc., *Wheaton, IL*
Lewis M. Goodkin, CRE
Goodkin Consulting, *Miami, FL*
Donald P. Guarino, Jr., CRE
AEGON USA Realty Advisors, Inc., *Cedar Rapids, IA*
John J. Hentschel, CRE
Hentschel Real Estate Services, *Abingdon, MD*
Paul G. Johnson, CRE
Johnson & Zaddack, Inc., *Phoenix, AZ*
James C. Kafes, CRE
AEGON USA Realty Advisors, Inc., *New York, NY*
Steven Kaye, CRE
CB Richard Ellis/Whittier Partners, *Boston, MA*
Mark Lee Levine, CRE
University of Denver/Levine, Ltd. Consultants, *Denver, CO*
Gerald M. Levy, CRE
Gerald M. Levy & Co. LLC, *New York, NY*
Richard Marchitelli, CRE
Cushman & Wakefield, Inc., *New York, NY*
Michael S. MaRous, CRE
MaRous & Co., *Park Ridge, IL*
William P.J. McCarthy, CRE
W.P.J. McCarthy and Company Ltd., *Burnaby, BC*
Donald M. Moliver, CRE
Monmouth University, *West Long Branch, NJ*
Joe W. Parker, CRE
Appraisal Research Company, Inc., *Jackson, MS*
Stephen F. Peacock, CRE
The Staubach Company, *Houston, TX*
Joe Douglas Prickett, CRE
Archon Group, LP, *Irving, TX*
Roy J. Schneiderman, CRE
Bard Consulting, *San Francisco, CA*
Steven A. Shapiro, CRE
Mack-Cali Realty Corp., *Cranford, NJ*
Michael Sklaroff, Esq., CRE
Ballard Spahr Andrews & Ingersoll, LLP, *Philadelphia, PA*
Robert J. Strachota, CRE
Shenehon Company, *Minneapolis, MN*
Daniel L. Swango, CRE
Swango Appraisal, *Tucson, AZ*
David R. Walden, CRE
Walden-Marling, Inc., *Chicago, IL*
Andrew C. Warren, CRE
Principal Real Estate Investors, *Des Moines, IA*
David J. Wilk, CRE
Greystone Realty Advisors, Inc., *Wilmington, DE*
Jerome W. Witte, Jr., CRE
Qval Property Advisors, LLC, *Houston, TX*
Jim Zemezonak, CRE
Core Realty Partners, *Scottsdale, AZ*

2005 NATIONAL OFFICERS
Richard J. Voelker, CRE - *chairman of the board*
Alvin O. Benton, CRE - *vice chairman of the board*
Kirk Heyle, CRE - *liaison vice chair*
Raymond Jackson, CRE - *liaison vice chair*
Thomas Justin, CRE - *liaison vice chair*

PRESIDENT
Mary Walker Fleischmann

MANAGING EDITOR
Jonathan Laxamana

For more information on becoming a member of the Editor's Council or advertising in *Real Estate Issues*, contact The Counselors' Chicago office at 312.329.8427; info@cre.org

of-way, with little value for adaptive uses. The condemnee considered its property to be a valuable regional transportation resource in a congested, urbanized hub of major development. The gatekeeper of valuation theories at a trial is the judge; the ultimate arbiter of proof is the jury.

CREs represent a treasure trove of experience to parties engaged in major condemnation disputes. In addition to a sophisticated land planner, the condemnee here engaged three CREs: one was the co-author of one of the methodologies for corridor valuation featured in the literature; another was experienced in the adaptive reuse of underutilized urban rail corridors; and the third, a veteran appraiser, was charged with synthesizing theory and practice to arrive at a coherent approach to the appraisal problem.

A jury trial is different from a bench trial in that the proof must persuade twelve jurors, representing a cross-section of the community. Each juror comes to the case with different histories, different viewpoints and different preconceptions. Lawyers and witnesses must be aware that nothing can be taken for granted. We are reminded of the motto of the Stoic philosophy: *admirari nihil* —be surprised at nothing.

21
Kelo v. The City of New London: What does it really mean?
BY RICHARD C. DEARTH AND J. RUSSELL HARDIN

Real estate investors should be aware of the current pronouncements from the United States Supreme Court regarding the powers of eminent domain. The United States Supreme Court in Kelo, et al .v. City Of New London, Connecticut, et al., re-ignited a long-standing legal dispute over private ownership rights. The majority Supreme Court opinion approved the taking of private property by local government for redevelopment purposes and turning it over to another private use. The case, while settling the legal issue of the constitutionality of such a taking, also fueled a public policy controversy.

27
Public Financing for Creating Affordable Housing Options in the United States: Does It Work?
BY WINTFORD THORNTON

The rational-comprehensive paradigm of planning urban areas has used the programs of Section 42 and Section 47 tax credits and HOPE VI, and occasionally TIFs for affordable housing after the Model Cities and other federal programs. Developers have several opportunities using federal and state financing.

INSIDERS' PERSPECTIVES

42
Focus on Investment Conditions
BY KENNETH P. RIGGS, CRE

46
Focus on the Economy
BY DR. MARK LEE LEVINE, CRE

CRE

Editor's Council

Corporate/Organization Members

Appraisal Institute

National Association of REALTORS®

Individual Members

James R. MacCrate, CRE
New York, NY

Joseph H. Martin, CRE
Lawrenceville, NJ

Kenneth P. Riggs, Jr., CRE
Chicago, IL

Daniel Rose, CRE
New York, NY

Anthony F. Souza, CRE
Tracy, CA

Frank X. Troisi, CRE Emeritus
New York, NY

Ray C. Wilson, CRE
San Antonio, TX

The articles/submissions printed herein represent the opinions of the authors/contributors and not necessarily those of The Counselors of Real Estate or its members. The Counselors assumes no responsibility for the opinions expressed/citations and facts used by the contributors to this publication whether or not the articles/submissions are signed.

Currently published quarterly by The Counselors of Real Estate, a not-for-profit organization, of the National Association of REALTORS®, 430 North Michigan Avenue, Chicago, Illinois 60611.

Copyright 2004 by The Counselors of Real Estate of the National Association of REALTORS®. All rights reserved. (Printed in U.S.A.)

Third class postage paid at Chicago. *Real Estate Issues* publishes four times annually (Spring, Summer, Fall, Winter). Subscription rates are: $48 for one year (4 issues); $80 for two years; $96 for three years; $42 per year to students and faculty; $54 foreign rate, submit in U.S. currency; single copy $15. Remittances may be made by credit card or personal check, payable to The Counselors of Real Estate. Remittances, change of address notices, undeliverable copies, orders for subscriptions, and editorial material should be sent to *Real Estate Issues*, The Counselors of Real Estate, 430 North Michigan Avenue, Chicago, Illinois 60611. Phone: 312.329.8427; Fax: 312.329.8881; E-mail: info@cre.org; Website: www.cre.org

Library of Congress card number LC 76-55075

Real Estate Issues is a registered trademark of The Counselors of Real Estate, a not-for-profit organization.

CRE

About THE COUNSELORS OF REAL ESTATE

THE COUNSELORS OF REAL ESTATE, established in 1953, is an international group of high profile professionals including members of prominent real estate, financial, legal and accounting firms as well as leaders of government and academia who provide expert, objective advice on complex real property situations and land-related matters.

Membership is selective, extended by invitation only on either a sponsored or self-initiated basis. The CRE Designation (Counselor of Real Estate) is awarded to all members in recognition of superior problem solving ability in various areas of specialization such as litigation support, asset management, valuation, feasibility studies, acquisitions/dispositions and general analysis.

CREs achieve results, acting in key roles in annual transactions and/or real estate decisions worth billions of dollars annually. Over 300 of the Fortune 500 companies retain CREs for advice on real estate holdings and investments. CRE clients include public and private property owners, investors, attorneys, accountants, financial institutions, pension funds and advisors, government institutions, health care facilities, and developers.

ENRICHMENT THROUGH PEER ASSOCIATION, COLLABORATION, EDUCATION & PUBLICATIONS

Knowledge sharing continues as the hallmark of The Counselor organization. Throughout the year, programs provide cutting-edge educational opportunities for CREs including seminars, workshops, technology sessions, and business issues forums that keep members abreast of leading industry trends. Meetings on both the local and national levels also promote interaction between CREs and members from key user groups including those specializing in financial, legal, corporate, and government issues.

CRE members benefit from a wealth of information published in The Counselors' quarterly award-winning journal *Real Estate Issues* which offers decisive reporting on today's changing real estate industry. Recognized leaders contribute critical analyses not otherwise available on important topics such as institutional investment, sports and the community, real estate ethics, tenant representation, break-even analysis, the environment, cap rates/yields, REITs, and capital formation. Members also benefit from the bi-monthly member newsletter, *The Counselor*, and a wide range of books and monographs published by The Counselor organization. A major player in the technological revolution, the CRE regularly accesses the most advanced methodologies, techniques and computer-generated evaluation procedures available.

WHAT IS A COUNSELOR OF REAL ESTATE (CRE)?

A Counselor of Real Estate is a real estate professional whose primary business is providing expert advisory services to clients. Compensation is often on an hourly or total fixed fee basis, although partial or total contingent fee arrangements are sometimes used. Any possibility of actual or perceived conflict of interest is resolved before acceptance of an assignment. In any event, the Counselor places the interests of the client first and foremost in any advice provided, regardless of the method of compensation. CREs have acquired a broad range of experience in the real estate field and possess technical competency in more than one real estate discipline.

The client relies on the Counselor for skilled and objective advice in assessing the client's real estate needs, implying both trust on the part of the client and trustworthiness on the part of the counselor.

Whether sole practitioners, CEOs of consulting firms, or real estate department heads for major corporations, CREs are seriously committed to applying their extensive knowledge and resources to craft real estate solutions of measurable economic value to clients' businesses. CREs assess the real estate situation by gathering the facts behind the issue, thoroughly analyzing the collected data, and then recommending key courses of action that best fit the client's goals and objectives. These real estate professionals honor the confidentiality and fiduciary responsibility of the client-counselor relationship.

The extensive CRE network stays a step ahead of the ever-changing real estate industry by reflecting the diversity of all providers of counseling services. The membership includes industry experts from the corporate, legal, financial, institutional, appraisal, academic, government, Wall Street, management, and brokerage sectors. Once invited into membership, CREs must adhere to a strict Code of Ethics and Standards of Professional Practice.

USERS OF COUNSELING SERVICES

The demand continues to increase for expert counseling services in real estate matters worldwide. Institutions, estates, individuals, corporations, and federal, state and local governments have recognized the necessity and value of a CRE's objectivity in providing advice.

CREs service both domestic and foreign clients. Assignments have been accepted in Africa, Asia, the United Kingdom, the Caribbean, Central and South America, Europe and the Middle East. CREs have been instrumental in assisting the Eastern European Real Property Foundation create and develop private sector, market-oriented real estate institutions in Central and Eastern Europe and the Newly Independent States. As a member of The Counselor organization, CREs have the opportunity to travel and share their expertise with real estate practitioners from several developing countries including Poland, Hungary, Bulgaria, Ukraine, Czech Republic, Slovak Republic, and Russia as they build their real estate businesses and develop standards of professional practice.

Only 1,100 practitioners throughout the world carry the CRE Designation, denoting the highest recognition in the real estate industry. With CRE members averaging 20 years of experience in the real estate industry, individuals, institutions, corporations, or government entities should consider consulting with a CRE to define and solve their complex real estate problems or matters. ■

Editor's Statement

HUGH F. KELLY, CRE

VALEDICTORIES HAVE EVOLVED AS A FORM OF EXPRESSION THAT, rightfully, has a just a few essential components.

The first of these is the rendering of appropriate thanks. As editor of this journal for the past several years, my job has been made both easier and more joyful by the support of the Counselors' professional staff in the Chicago, most particularly by Jonathan Laxamana, who has served as Managing Editor and who performed most of the heavy lifting in getting the manuscripts, circulating them to the Editorial Board, coordinating reviews, and seeing to the details of getting our issues to press and into the hands of the readership. And Jonathan, I'm sure, would be the first to extend kudos to Gloria Bowman and to our President, Mary Walker Fleischmann, for the their executive leadership in integrating the publication work into the larger mission of the Counselors of Real Estate.

Thanks, too, is due to the Editorial Board. Volunteers all, our editorial board members do a remarkable job of reading manuscript submissions, making thoughtful comments and suggestions that are sent to our authors, and recommending publication (or not) depending on the quality of the work and its relevance to our readership. Mostly the members toil quietly behind the scenes, simply for the love of the work and for the satisfaction of contributing their talents to *Real Estate Issues* and to the Counselors. I'm in their debt, and am happy to have this chance to say, "Thanks."

Also on my gratitude list are the columnists who bring their "Insiders' Perspectives" to the readers each issue. These are all very accomplished professionals, with many, many demands on their time. They show a true spirit of generosity in committing—and delivering—regular submissions that have become a much anticipated feature of our journal.

Next in the order of topics are some observations on the res ipsa, the task itself. I've come to appreciate more fully as editor the great function that *Real Estate Issues* plays, and that it can potentially perform to a much greater degree, in the world of professional publications. Our journal occupies an important central ground, between the academic and inaccessibly technical "peer-reviewed" publications on the one side, and the glossy, self-promoting trade publications on the other. This is a serious venue, where professionals can communicate with each other in clear, understandable language, on topics that are current, worthy of thoughtful commentary, and occasionally controversial. It is a venue that is open to the variety of disciplines that relate to real estate practice: law, planning, design, finance, operations, valuation and investment analysis, and others. As such, it is an excellent reflection of the Counselors' membership and range of interests. There are not many such publications, and there is no group quite like the CREs.

Moreover, the need for such a high-quality, wide-ranging journal has never been greater. Real estate has evolved over the past thirty years and has now taken a permanent place in the institutional investment arena as an asset class alongside stocks and bonds. 'Twas not always thus, but real estate now has to speak the language of mixed-asset portfolios, diversification effects on risk and return, and exploration of efficient frontiers. Hundreds of billions of dollars of pension fund capital, insurance assets, and mutual funds are invested in real estate directly. Trillions of dollars of commercial mortgages are on the books of financial institutions. And hybrid investments in real estate, intermediated though Wall Street, add hundreds of billions more in REIT stock value and in CMBS issuance. The stakes in our industry have grown mightily. And, it is worth mentioning, non-institutional, private investment, has not been crowded out either. The capital value of private investors—families, small trusts, partnerships, owner-users of real estate—is fully equal to the institutional stake, measured in dollars, and even greater, measured by number of properties. This a major component of wealth, and it behooves us to keep a steady eye on it. *Real Estate Issues* is well positioned to do so, to the benefit of its current readership and even more for the expanded readership it should be seeking.

And that brings me to the last component of the valedictory form, the passing of the torch. I'm so pleased the Maura Cochran, CRE, will be serving as Editor-in-Chief in 2006 and hopefully for a number of years thereafter. Those who know Maura will concur that she is a wonderful choice as editor. Our readership will certainly come to recognize the grace and skill, aplomb and professionalism she brings to all her activities. As I take leave of this chair, I know that Maura will have a splendid tenure in a job I thoroughly enjoyed.

I'm truly grateful to have had the chance to serve in this role these past several years.

HUGH F. KELLY, CRE
EDITOR IN CHIEF

The Economic Impact Study for a Big Box Retailer

BY JOSEPH S. RABIANSKI, PH.D., CRE

INTRODUCTION

THE DIRECT ECONOMIC IMPACT OF A BIG BOX RETAIL FACILITY occurs in two parts—the construction phase and the operation phase of the subject property. The construction phase provides a short-term effect while the operation phase generates a long-term effect on the local economy. The direct economic impact consists of the:

- Employment involved in the construction and the operation phases of the facility.
- Wages paid to on-site employees during both the construction and the operation phases of the facility.
- Retail purchases from establishments in the local economy made in association with the construction and the operation of the facility.

THE RESEARCH DESIGN

The research design requires primary data gathered for the construction and operation phases of the facility. Construction data for the analysis comes from both the general contractor and the *Marshall & Swift Cost Manual*. Data for the operation of the facility comes from the operations manager of the corporate chain of the retail establishments under the assumption of normal business operational circumstances. These costs of operation are evaluated for reasonableness by considering the operational and sales data identified in *Dollars and Cents of Shopping Centers* published by the Urban Land Institute and the data from the International Council of Shopping Centers. To the extent possible, all information from the client needs to be independently supported and verified.

The second phase of the analysis is the allocation of the array of expenditures by the Big Box facility within Alpha County. These expenditures are:

- wages and salaries during the construction phase;
- construction material purchases;
- wages and salaries during the operations phase;
- services required during operation of the facility; and
- retail purchases during the operations phase.

The third part of the research design is the estimation and the application of the relevant economic impact multiplier for the Alpha County local economy. This multiplier translates the direct effect of the expenditures into the total effect of the expenditures by estimating the indirect and induced effects of these direct expenditures. The wages generated by the facility that remain in the local economy provide for increased consumer spending that in turn generates a need for additional workers to service the needs of the facility. This is the indirect effect. The induced effect is the increase in employment associated

About the Author

Joseph S. Rabianski, Ph.D., CRE, is the Professor, Department of Real Estate, in the J. Mack Robinson College of Business at Georgia State University in Atlanta, Ga. He has been a real estate academic for 35 years and has been involved in valuation, market analysis, economic and fiscal impact studies, land value impact studies, loss of business studies, expert witness testimony, and consulting activity for 30 of these years. He is the author of five books and in excess of 50 articles in professional journals in the real estate discipline.(jrabianski@gsu.edu)

Exhibit 1—Construction Expenditures by Components

Expense Category	Components in the Category	Cost
Gross Building Size	150,000 square feet	$8,250,000 Total Cost $55 per square foot
On-Site Improvements	Parking Area construction, improvements to the land, etc., for approximately 15 acres	$10,500,000
Total Cost for On-Site Construction by Subcontractor:	Concrete = 20% Masonry = 20% Wallboard/Doors = 8% Special Construction = 4% Mechanical/Fire Systems = 8% Electrical = 20% General Conditions = 10% Miscellaneous = 10%	$18,750,000

Exhibit 2—Allocation Percentages for Construction Components and Local Expenditure

Expenditure Category	Construction Cost Components	Allocation to Local Economic Area	Local Economic Area Expenditure
Total Cost for On-Site Construction by Component	Labor = 30% Materials = 70%	Labor = 80% Materials = 50%	$4,500,000 $6,562,500
TOTAL			**$11,062,500**

with the general spending for consumer goods and services by the workers associated with the direct and indirect effects and the subsequent increase in employment caused by this spending. This is the iterative process that underlies all multipliers used by economists since the outset of Keynesian economics.

DIRECT ECONOMIC IMPACT DURING CONSTRUCTION

The information that describes the construction phase of the analysis consists of the data for direct property-related expenditures. To determine the direct impact on a local economy such as Alpha County, the portion of these direct construction-related expenditures made on the property need to be allocated between the portion made for the property that remain in the county and the portion made that are paid to personnel and establishments outside the local economy.

The direct construction expenditures fall into the categories presented in Exhibit 1. The best estimates of the allocation of those expenditures also appear in Exhibit 1. The gross building size of approximately 150,000 square feet is estimated at a total construction cost of $8.25 million. This translates into a square foot construction cost of $55. These figures were provided by the Big Box Company. An independent verification of the square foot value was performed using data from the Marshall and Swift Cost Service. The cost per square foot estimate for the major structure from this source is $56.92. The on-site improvements are also verified in this manner and estimated to be approximately $10,500,000. The lower square foot construction cost figure is used in the analysis.

Total cost of construction and development are estimated at approximately $18,750,000 for the main structure and the necessary supporting site work in Exhibit 1. The construction process, in simplified terms, will require labor and material; some portion of these construction resources will come from the local economic area. For the construction phase of the project, the local economic area was the array of counties that were adjacent to Alpha County including Alpha County itself. In simplified terms this area is approximated by a radius of 20 to 30 miles and an estimated rush hour drive time of 45 to 60 minutes.

The allocation estimates for labor and materials appear in Exhibit 2. Labor cost was estimated at 30% of total construction costs with construction materials in the most general sense being 70%. Care must be taken at this point

Exhibit 3—Expenditures during Operation

Expenditure Category	Components in the Category
Total Wage Bill for On-Site Personnel: Wages and Salaries	Store Manager, Assistant Store Manager (s), Cashiers, Meat Cutters, Bakery Personnel, Warehouse Personnel, Maintenance Personnel, Security Personnel
Service Expenditures and Service Contracts	HVAC, Plumbing, Electrical, Landscaping/Lawn Care, Solid Waste Disposal, Pest Control, Exterior Painting/Repair, Legal, Advertising, Other
Retail Expenditures	Hardware, Office Supplies, Photocopying/Printing, Other

Exhibit 4—Personnel and Earnings During Operations

Job Category	Number	Wages or Salary	Annual Wage Bill
Store Manager	1	$85,000	$85,000
Assistant Store Managers	2	$60,000	$120,000
Cashiers	80	$28,000	$2,240,000
Warehouse Staff	190	$30,000	$5,700,000
TOTAL	273		$8,145,000

in the analysis to make certain that both "hard" and "soft" costs of construction are included in the analysis.

A reasonable allocation of construction labor between workers from the local economic area and workers who migrate to the area for the job is 80% from the local economic area. This allocation is supported by data from the County about the geographic dispersion of employees in Alpha County. Application of these percentages generates the estimate for a local wage bill of $4,500,000 ($18,750,000 * 30% * 80%) and a local construction materials purchase of $6,562,500 ($18,750,000 * 70% * 50%). As shown in Exhibit 2, the local area contribution to the total construction cost is $11,062,500 of the total construction cost of $18,750,000. This is 59% of total construction resources coming from the local economy.

The construction process will certainly take at least one year and may well take two years until the property can be occupied and placed in service. The analysis in this study assumes that the construction process will take two years so that the $4,500,000 wage bill and the $6,562,500 materials cost will be allocated over the two year period.

DIRECT ECONOMIC EFFECT DURING OPERATION

The information sought in the analysis consists of the data for direct property-related expenditures. These direct expenditures fall into the sets of data displayed in Exhibit 3.

DIRECT IMPACT FROM EMPLOYMENT AND SALARIES

The typical Big Box retail store operates with the personnel and the relevant wage and salary levels presented in Exhibit 4. Total employment for the subject property at full capacity operation will be 273 employees with a total wage bill for such a retail operation of $8,145,000.

DIRECT IMPACT FROM SERVICE EXPENDITURES AND RETAIL EXPENDITURES

The typical Big Box retail store also purchases retail products and services from the local market area. This data typically comes from the records of the corporate offices of the Big Box operator and interviews with store managers of close by same chain facilities as well as interviews with close by competing facilities. These purchases from local firms are displayed in Exhibit 5.

SUMMARY OF THE DIRECT IMPACTS OF THE BIG BOX FACILITY

The summary of the direct monetary impacts of the Big Box Facility appears in Exhibit 6 which carries forward the information provided in Exhibits 4 and 5. The total value of the direct impact for both construction and operation phases for both labor and materials are arrayed for the two year construction period and the operation period which is depicted in the "Year 3 and beyond" column.

THE DIRECT IMPACT OF THE BIG BOX RETAIL FACILITY IN ALPHA COUNTY

Introduction—The State Department of Labor provides employment data for Alpha County. As shown in Exhibit

Exhibit 5—Retail and Service Expenditures by Category

Retail and Service Categories	Expenditure per year
Service Contract for HVAC	$2,500
Plumbing Repairs	$2,000
Lawn and Grounds Maintenance	$6,000
Waste Disposal	$55,000
Building Maintenance and Repairs @ $0.12 per square foot	$18,000
Roof maintenance and repairs @ $0.01 per square foot	$1,500
Parking lot maintenance and repairs @ $0.05 per square foot of lot	$26,000
Other Maintenance and repair @ $0.10 per square foot	$15,000
Office supplies	$3,500
TOTAL Expenditure per year	**$129,500**

Exhibit 6—Summary of the Direct Impacts of the Big Box Facility

Direct Impact of the Big Box Facility	Year 1	Year 2	Year 3 and beyond
Direct Labor	$2,250,000	$2,250,000	$8,145,000
Direct Materials and Services	$3,281,250	3,281,250	$129,500
TOTAL IMPACT	**$5,531,250**	**$5,531,250**	**$8,274,500**

Exhibit 7—Allocation of the Direct Impacts of the Big Box Facility to Alpha County

	Year 1	Year 2	Year 3 and beyond
Direct Labor	$2,250,000	$2,250,000	$8,145,000
Allocation %	48%	48%	48%
Allocated Direct Labor	$1,080,000	$1,080,000	$3,909,600
Direct Materials and Services	$3,281,250	$3,281,250	$129,500
Allocation %	45%	45%	90%
Allocated Direct Materials and Services	$1,476,563	$1,476,563	$116,550
ALLOCATED TOTAL DIRECT IMPACT	$2,556,563	$2,556,563	$4,026,150

6, the economic impact is $5,531,250 in years 1 and 2 during construction and $8,274,500 per year during the operation of the property. Assuming that the economic feasibility of the facility will last into the future, this value will change. It will increase as the population in Alpha County and its environment increases; it will decrease as competition enters the market and if population declines. A market study to determine these potential effects is not part of economic impact analysis, so for the near term the estimate of the economic impact on the Alpha County is $8,274,500.

If a market study is associated with the economic impact study, the third-year impact can be modeled as it moves through a predetermined time period such as 10 years. Inflation will cause the sales volume to increase but will generally not affect the amount of product being sold. An increase in trade area population may cause prices to rise but will affect the amount of product being sold and thereby increase the need for employees in the facility. The change in the direct economic impact over time can be capitalized at the end of the holding period and all of the future impacts can be discounted to the present to get a total figure for the direct economic impact over the remaining economic life of the facility. Most economic impact studies do not take this extra step.

ALLOCATION OF THE DIRECT IMPACT TO EARNINGS IN ALPHA COUNTY

To determine the direct impact on Alpha County, the portion of these direct expenditures made during the operation of the property need to be allocated between the portion made on the property that remain in the county and the portion made that are paid to personnel and establishments outside the local economy. The most direct evidence of the magnitude of this allocation percentage to Alpha County from the local economic area is based on U.S. Census data for 2000 reported for Alpha County by the State Department of Labor. The allocation percentage from this data source is 48% based on the fact that 48% of the residents of Alpha County work in Alpha County. The reasonable assumption is that this relationship holds true for 2000 and that it will remain relatively stable in the years after the decennial census. This allocation percentage is applied to both construction labor in the local economic area (80% of total construction labor) and to employees during operation of the facility.

As stated earlier in Exhibit 2, 50% of construction materials are shipped directly to the site from non-local suppliers and 50% are purchased in the local economic area and most of these in the county in which the facility is located. A reasonable assumption is that 90% of the 50% is purchased in the county. For this reason an allocation percentage of 45% (90% * 50%) is applied to construction materials.

Exhibit 8—Total Impact of the Big Box Facility

Source of Earnings	Year 1	Year 2	Year 3 and beyond
Total Direct Impact	$5,531,250	$5,531,250	$8,274,504
Multiplier for Retail Activity	3.8	3.8	3.8
TOTAL	**$21,018,750**	**$21,018,750**	**$31,443,115**

Exhibit 9—Total Impact of the Big Box Facility to Alpha County

	Year 1	Year 2	Year 3 and beyond
Total Impact of the Big Box (Direct, Indirect and Induced)	$2,556,563	$2,556,563	$4,026,150
Multiplier for Retail Activity	3.8	3.8	3.8
TOTAL Impact of the Big Box to Alpha County (Direct, Indirect and Induced)	**$9,714,939**	**$9,714,939**	**$15,299,370**

Application of these allocation percentages converts the total impact numbers in Exhibit 6 for Alpha County to those in Exhibit 7 for Alpha County.

THE TOTAL IMPACT OF THE BIG BOX RETAIL FACILITY IN ALPHA COUNTY

Introduction—The total economic impact is the sum of the direct impact plus the indirect and the induced impact. The direct impact is the initiating, the primary, economic force. The direct impact is the number of jobs created and the earnings associated with those jobs. These earnings are spent creating the indirect and induced impact on additional jobs and earnings. The indirect and induced impacts are the secondary forces set in motion by the direct impact that work their way through the economy. The indirect and induced effect is the subsequent series of jobs and earnings created as the initial direct earnings filter through the local economy. The economic impact multiplier represents the iterative process in a single number.

The process for calculating the multiplier is fully developed in the Appendix to this article. Consider the following comments as a brief conceptual introduction to the topic. The key to the estimation of the economic impact multiplier is the identification of the industries and firms that are selling goods and services to the non-local economy. These are the basic industries. The basic industries are identified by the application of the location quotient technique, which compares the industrial structure of the local economy, Alpha County, to a regional or national economy (the State, U.S. region or the Nation). The significance of basic industries and basic employment versus non-basic industries and employment are explained, as is their role in the estimation of the location quotient. The economic impact multiplier for the basic industry is estimated by dividing total employment by basic employment in a static as well as a comparative static (dynamic) perspective. The nature and significance of the static versus the dynamic multiplier is discussed and the appropriate one is selected. The calculations set the basic economic impact multiplier at 3.8 for the 1996 to 2004 time period.

Retail is typically not a basic industry. However, in the case of Alpha County, retail trade does present itself as a basic industry during this time period. The retail trade location quotient is greater than one in each of the three years being used as data points. Therefore, the retail trade multiplier can be the basic multiplier of 3.8. However, in more typical situations were retail is a non-basic industry the multiplier would be reduced to 2.8.

ESTIMATION OF THE TOTAL IMPACT OF A RETAIL ACTIVITY TO THE ALPHA COUNTY AREA AND TO ALPHA COUNTY

The total impact of a retail activity is expressed as the multiplier times the direct change in employment and earnings as expressed in Exhibits 6 and 7. The results presented in these two Exhibits are reproduced in Exhibits 8 and 9 respectively. The basic economic impact multiplier is estimated to be 3.8 as shown in the Appendix. Exhibit 8 shows the total impact of the big box retailer in the metropolitan area during the two years of construction and then the years of operation.

Exhibit 9 shows the portion of the total impact that will affect Alpha County during the two years of construction and then the years of operation.

ESTIMATE OF THE SALES TAX REVENUE TO ALPHA COUNTY FROM THE BIG BOX FACILITY

Big Box records indicate that the typical Big Box facility sells approximately $80 million in goods ranging from food items to electronics to jewelry items. In Alpha County, food and beverage items are items subject to a sales tax of 1% while all of the other items sold in the

Exhibit 10—Total Sales by Product Category and Sales Tax Rates

Sales Tax Rate	Product Category		
@ 1%	Fresh Food	14%	
	Packaged Food (60% of 51%)	30.6%	
	Total Percentage @ 1% sales tax rate	44.6%	(45%)
@6%	Hard line items	23%	
	Soft line items	12%	
	Sundries (40% of 51%)	20.4%	
	Total Percentage @ 6% sales tax rate	55.4%	(55%)

Exhibit 11—Conclusion and Summary of Total Impact Items for Alpha County

Impact Item	Year 1 and 2 (Construction)	Year 3 and beyond
Total Wages and Earning	$9.7 Million/year	$15.3 Million/year
Total Employment	$3,281,250	498/year
Sales Tax Revenue	**$5,531,250**	**$3,000,000/year**

store are subject to a 6% sales tax. The sales in this typical Big Box facility consist of 23% "hard line" items, 12% "soft line" items, 51% food and sundry items, and 14% in fresh food items. This data comes from the corporate offices of the subject property and interviews with close by stores in the same chain. The hard line items and the softline items are taxed at 6%; the fresh food items are taxed at 1%. The "food and sundry items" category must be allocated between food items at a tax rate of 1% and sundry items at a tax rate of 6%. The allocation will be 60/40% to food versus sundries. Based on these figures, the chart shown in Exhibit 11 was developed from the Big Box data on product categories.

The information presented in Exhibit 10 was coupled with an estimate for total annual sales to obtain the following calculations for Alpha County. The figure of $80 million in annual sales volume was generated from information provided by the client and then verified through interviews with the managers of other big box retailers in the local area and national data from secondary data providers like Dollars and Cents of Shopping Centers.

55 % of these sales subject to a 6% sales tax rate = $2,640,000

45% of these sales subject to a 1% sales tax rate = $360,000

Total Sales Tax Revenue = $3,000,000

CONCLUSIONS AND SUMMARY FROM THE ECONOMIC IMPACT STUDY

The conclusion of the analysis yields the information that is summarized in Exhibit 11.

The values for total wages and salaries carry over from Exhibit 7. The total employment number is estimated to be 498 (273 from Exhibit 4 * 48% * 3.8)

EPILOGUE

The application of an economic impact study provides information about the impact of an event, in this case a big box retailer, on the employment level and household income level in a local economy. This information is important to a client for presentation to the local authorities when seeking approval from the local jurisdiction to initiate a development project. In this context, the economic impact study plays an important part in rezoning applications and eminent domain decisions.

The accuracy of the resulting information is highly dependent on the accuracy of the information placed into the analysis. The following points become important to recognize:

- Much of the data for the analysis comes from the client. For this reason it is incumbent on the analyst to verify the accuracy of this information. The analyst should not assume that this client-generated data is accurate and unbiased.

- The geographic delineation of the "local economy" is a critical issue in the analysis. Some development projects can affect an entire metropolitan area (i.e. several counties). This is especially true if the development project is very large and/or if the metropolitan area is small. The typical retail project affects the geographic areas set out in the guidelines (not hard and fast rules) used by the International Council of Shopping Centers and the Urban Land Institute. Neighborhood shopping centers are affected by their retail market areas and their retail trade areas. The retail trade area is typically 1 to 2 miles and 5 to 6 minutes drive time; the retail market area is generally a factor of 3 times the retail trade area distances and times. In turn, the neighborhood shopping center's effect on employment and household income are more localized; the majority of the employees come from relatively short distances. On the other hand, the super regional shopping center has a retail trade area that is typically 10 to 20 miles and 30 to 45 minutes drive time. The labor market for the supper regional shopping center is safely assumed to by co-terminus with its market area.

- Typically, the economic impact study focuses on a local jurisdiction. It focuses on a specific county in a metropolitan area. It focuses on a City within the boundaries of a County. This situation sets up a mismatch between the conceptual area of the "local economy" and the "area of interest" which is a portion of geography that could be affected by the development project. Here the analyst needs to decide on an "allocation" percentage to determine what portion of the economic impact is felt in the "area of interest."

- The magnitude of the multiplier is also a matter of close scrutiny for the analyst. It has to be based on historic facts that provide a relationship between basic employment and total employment at both points in time (static and comparative static analysis), and over time (dynamic analysis). The analysis must also be assured that the evidence from the past is applicable to the future. A multiplier of 3 based on historic data concerning the industrial structure of the local economy is not directly relevant to the future if the local economy is undergoing a fundamental change in that industrial structure. An increase in the proportion of basic industries in the industrial structure will increase the size of the multiplier and vice versa.

APPENDIX

THE ECONOMIC IMPACT MULTIPLIER FOR ALPHA COUNTY

Introduction—An economic impact study provides information about the effect of a business on the local economy in which it exists. For this study the business being analyzed is the Big Box Retail Facility and the local economy is Alpha County. The economic impact includes the affect on earnings and employment in both the retail business as well as the affect on additional employment in the local economy brought about by the employment change in the Big Box Retail Facility. In addition, the economic impact extends to the increase in retail products and services purchased by the Big Box Retail Facility from retailers and service providers in Alpha County.

ANALYSIS OF ALPHA COUNTY EMPLOYMENT-BY-SITE DATA

The magnitude of the economic impact multiplier is determined from data on employment-by-job-site in Alpha County. The source of this data is the Department of Labor from which information about employment-by-site was gathered for Alpha County. This information is displayed in Appendix Tables 1, 2, and 3 respectively. Table 1 presents the following information about Alpha County in 1996.

1. The entries at the left hand margin in Column A identify the one digit Standard Industrial Classification [SIC] Codes by which the U.S. Department of Commerce and the State organize their employment data and statistics. Column B shows the two-digit industrial classification categories.

2. Column C provides the 1996 employment-by-site data for these SIC codes for Alpha County.

3. Column D provides the distribution of the 1996 employment data across the SIC codes for Alpha County. For example, 16.79% of the 1996 employment in Alpha County was in the Manufacturing sector while 23.9% was in the service sector.

4. Column E provides the 1996 employment-by-site data for these SIC codes for Alpha County.

5. Column F provides the distribution of the 1996 employment data across the SIC codes. For example, 9.06% of the 1996 employment in Alpha County was in the Manufacturing sector while 31.53% was in the service sector.

Exhibit A— Economic Impact Multiplier Summary

LQ > 1.0			
Basic Static Industry Multiplier			
1996	2000	2004	Average
7.20	6.15	6.66	6.67
Non Basic Static Industry Multiplier			5.67

6. Column G presents the location quotient for Alpha County based on a comparison with the data. The numbers in Column G are generated by dividing the value in Column F the values in Column D. Location Quotients greater than 1.0 are considered export industries and the source of economic growth.
7. Column H shows the amount of basic employment by export industry. The numbers in this column are Column E times the LQ minus 1. For example, basic employment in the two-digit printing industry is 5409 times (1.45 - 1) = 2408.

Tables 2 and 3 are duplications of Table 1 but presented employment data for 2000 and 2003. The columns in these two Tables are the same as they are in Table 1.

THE LOCATION QUOTIENTS

The next important piece of information is the identification of those industrial classification categories (SIC codes in 1996, NAISC codes in 2000 and 2003) in Alpha County that produce products and services that meet the needs of the population in the local economy and also can be sold to people who live outside of Alpha County. The location quotient [LQ] is an analytical method that identifies the industrial classification codes that export goods and services.

The LQ is calculated by means of the following formula:

$$[e_{SIC}/e_{TOTAL}]/[E_{SIC}/E_{TOTAL}]$$

Where:

e_{SIC} = Alpha County employment in the jth SIC code

e_{TOTAL} = Total employment in Alpha County

E_{SIC} = Employment in the jth SIC code

E_{TOTAL} = Total employment in the State

When the LQ equals one, the relationship between the employment in the local economy, Alpha County, and the regional economy, is in balance. The employment in the local economy produces enough of the product to meet the needs of its population. When the LQ exceeds one, the local economy is producing more of the product than its own population needs and thus sells it to people or businesses external to the local economy. These are the export industries which are viewed as the industries that generate the growth of employment in the local economy.

THE STATIC MULTIPLIERS

The static multiplier estimation for 1996 is presented in Exhibit A. Column G presents the location quotient for each industrial category. The values in Column G are the distribution percentage for Alpha County in Column F divided by the distribution percentage for Column D. In Column G, each value greater than 1.0 identifies an export industry. These industries are viewed as industries that meet the needs of the local economy and also produce products or services for export.

The next issue is the distribution in these export industries between the portion of their output that is sold locally (the non-basic component) and the portion that is exported (the basic component). As an example consider the two-digit printing industry in Table 1. The total employment of 5,409 in the printing industry in Alpha County has to be separated between basic and non-basic employment. This is done by taking the percentage of printing in total employment in Georgia, 1.23% (1.2337% more exactly), and multiplying it by total employment in Alpha County, 303,374. This yields the non basic employment of 3,743 in printing. The basic employment is 5,409 - 3,871 = 1,538 in the printing industry. This same procedure is performed for each export industry. The static economic impact multiplier for the basic industry in Alpha in 1996 is 7.20. It is calculated by dividing the total employment of 318,529 by the basic employment estimate of 44,243.

Two decisions are depicted in Exhibit A. First, the average static economic impact multiplier of 6.67 is selected for this study. Second, the Retail Industry is not an export industry. It meets the needs of the local population. The appropriate multiplier to use is the static economic multiplier for non-basic employment of 5.67; it is one less than the basic employment multiplier. The economic meaning of the multiplier is that an initial increase in non-basic employment in the local economy will have a secondary

Exhibit B— Basic Dynamic Industry Multiplier

	Total Employment	Basic Employment	Static/ Multiplier	
1996	318,529	44,243	7.20	
2000	358,895	58,380	6.15	6.67
2004	285,479	42,848	6.66	
	Change Total Employment	**Change Basic Employment**	**Dynamic**	
2000 - 1996	40,366	14,137	2.86	
2004 - 2000	(73,416)	(15,532)	4.73	3.79
Non Basic Dynamic Industrial Multiplier				**2.79**

effect of increasing employment to meet the needs of the new employees in the non basic industrial sectors. The multiplier represents the conclusion of an iterative process. In order to generate a multiplier of 6.67, the marginal propensity to consume must be 85.03%. To generate a 5.67 multiplier, the marginal propensity to consume is still 85.03% but the multiplier formula changes from [1/ (1-b)] to [b/ (1-b)].

THE DYNAMIC MULTIPLIERS

In addition to the static multipliers that are estimated for each year, a dynamic multiplier can be estimated for the movement from year to year. The dynamic multiplier is the change in total employment in the local economy divided by the change in basic employment in the local economy. Consider the 1996 to 2000 employment situations. Total employment changed by +40,366 and basic employment changed by +14,137 during these two time period. The dynamic multiplier is 2.86 (40,366/14,137). In the 2000 to 2004 time period, total employment changed by -73,416 and basic employment changed by -15,532. The dynamic multiplier for 2000 to 2004 is +4.73 (-73,419/-15,532).

MULTIPLIER RECONCILIATION

What is the best estimate for the multiplier in the economic impact analysis? If you will allow me an analogy, the static multipliers give us three independent snapshots of the child as he changes over time—a picture at one year of age, at four years of age and a picture at eight years of age. The dynamic multiplier is more of a video covering a period of time such as 1996 to 2000 and 2000 to 2004 in this situation. (The dynamic multiplier for 1996 to 2004 yields a nonsense figure because the economy peaked in 2000. A period of growth was followed by a period of decline. The nonsense dynamic multiplier for this eight year period is 23.7. It would require a marginal propensity to consume of approximately 96.8% which is quite high.) (Table 2)

Conceptually, the dynamic multiplier gives a more realistic picture of the economic situation as long as it is used in a sensible manner. It should follow a trend line in a single direction as shown in this example. Here we had a trend line for the 1996 to 2000 period and a separate trend line for the 2000 - 2004 period. Given this statement, the appropriate economic impact multiplier is the dynamic multiplier that provides information about the two periods. This would be the average value of 3.79 for basic industrial sectors and 2.79 for the non basic industrial sectors. Analysis of Tables 1, 2 and 3 in this appendix reveals that retail is a basic industry in Alpha County.

ECONOMIC IMPACT MULTIPLIER FOR BIG BOX RETAIL FACILITY IS 3.8

Table 1—Employment in Alpha County and State in 1996

A	B	C 1996 State Employment	D %	E 1996 Alpha Employment	F %	G Alpha/State Location Quotient	H Basic Employment LQ>1.0
INDUSTRIAL CATEGORY							
Agriculture		39,800	1.13%	1,890	0.59%	0.53	
Mining		7,787	0.22%	405	0.13%	0.58	
Construction		165,773	4.70%	15,679	4.92%	1.05	722
Manufacturing		598,775	16.96%	28,238	8.87%	0.52	
Food and kindred products		69,348	1.96%	3,866	1.21%	0.62	
	Tobacco	-		-			
	Textile	120,567	3.42%	-			
	Apparel	41,370	1.17%	990	0.31%	0.27	
	Lumber and Wood	39,949	1.13%	987	0.31%	0.27	
	Furniture	10,984	0.31%	870	0.27%	0.88	
	Paper	34,169	0.97%	2,104	0.66%	0.68	
	Printing	42,906	1.22%	5,409	1.70%	1.40	1,538
	Chemicals	20,942	0.59%	1,444	0.45%	0.76	
	Petroleum	1,134	0.03%	-			
	Rubber and Plastics	24,658	0.70%	2,063	0.65%	0.93	
	Leather	1,876	0.05%	-			
	Stone, Clay, glass, concrete	19,460	0.55%	881	0.28%	0.50	
	Primary metal	14,303	0.41%	300	0.09%	0.23	
	Fabricated metal	23,938	0.68%	1,057	0.33%	0.49	
Industrial machinery & computers		35,180	1.00%	1,922	0.60%	0.61	
	Electrical equipment	33,193	0.94%	1,902	0.60%	0.64	
	Transportation equipment	45,895	1.30%	-			
	Instruments	10,697	0.30%	368	0.12%	0.38	
	Misc.	6,686	0.19%	705	0.22%	1.17	102
	Not Elsewhere counted	3,456	0.10%	3,370	1.06%		
Transport and Warehousing and Utilities		236,789	6.71%	27,864	8.75%	1.30	6,500
Wholesale trade		240,990	6.83%	27,426	8.61%	1.26	5,683
Retail trade		658,513	18.65%	60,876	19.11%	1.02	1,461
Finance, Insurance and Real Estate		177,904	5.04%	19,602	6.15%	1.22	3,551
Services - Total		831,276	23.55%	95,640	30.03%	1.28	
	Hotel	42,909	1.22%	4,123	1.29%	1.06	252
	Business	250,858	7.11%	27,450	8.62%	1.21	4,816
	Auto	31,422	0.89%	3,242	1.02%	1.14	407
	Amusement and recreation	37,895	1.07%	2,148	0.67%	0.63	
	Health	223,037	6.32%	26,373	8.28%	1.31	6,249
	Legal	21,984	0.62%	2,134	0.67%	1.08	150
	Education	34,311	0.97%	11,450	3.59%	3.70	8,354
	Social	43,184	1.22%	4,059	1.27%	1.04	163
	Engineering	69,696	1.97%	8,111	2.55%	1.29	1,823
	Other	81,876	2.32%	8,398	2.64%	1.14	1,011
Federal government		97,223	2.75%	10,234	3.21%	1.17	1,462
Local government		326,921	9.26%	19,043	5.98%	0.65	
State government		136,749	3.87%	9,784	3.07%	0.79	
Not elsewhere classified		4,039	0.11%	-			
TOTAL		**3,530,371**	**100.00%**	**318,529**	**100.00%**		**44,243**
Basic Employment multiplier in Alpha county (1996)							**7.20**

Table 2—Employment in Alpha County and State in 2000

INDUSTRIAL CATEGORY		2000 State Employment	%	2000 Alpha Employment	%	Alpha/State Location Quotient	Basic Employment (LQ > 1.00)
A	B	C	D	E	F	G	H
Agriculture		44,977	1.17%	1,871	0.52%	0.45	
Mining		7,798	0.20%	303	0.08%	0.42	
Construction		202,827	5.27%	24,780	6.90%	1.31	5,853
Manufacturing		596,200	15.50%	24,072	6.71%	0.43	
Food and kindred products		71,614	1.86%	3,071	0.86%	0.46	
Tobacco		-		-			
Textile		101,545	2.64%	-			
Apparel		23,595	0.61%	325	0.09%	0.15	
Lumber and Wood		42,697	1.11%	234	0.07%	0.06	
Furniture		12,007	0.31%	347	0.10%	0.31	
Paper		31,232	0.81%	1,278	0.36%	0.44	
Printing		43,817	1.14%	4,412	1.23%	1.08	323
Chemicals		22,171	0.58%	789	0.22%	0.38	
Petroleum		1,429	0.04%	-			
Rubber and Plastics		29,983	0.78%	1,871	0.52%	0.67	
Leather		533	0.01%	-			
Stone, Clay, glass, concrete		21,157	0.55%	804	0.22%	0.41	
Primary metal		13,961	0.36%	412	0.11%	0.32	
Fabricated metal		25,310	0.66%	912	0.25%	0.39	
Industrial machinery & computers		43,578	1.13%	2,043	0.57%	0.50	
Electrical equipment		36,678	0.95%	1,904	0.53%	0.56	
Transportation equipment		51,495	1.34%	-			
Instruments		12,456	0.32%	378	0.11%	0.33	
Misc.		7,926	0.21%	1,198	0.33%	1.62	458
Not Elsewhere counted		3,016	0.08%	4,094	1.14%		
Transport and Warehousing and Utilities	242,326	6.30%	39,865	11.11%	1.76	17,252	
Wholesale trade		258,152	6.71%	33,498	9.33%	1.39	9,408
Retail trade		714,248	18.57%	68,932	19.21%	1.03	2,281
Finance, Insurance and Real Estate		189,425	4.93%	19,856	5.53%	1.12	2,180
Services	Total	995,771	25.89%	112,766	31.42%		
Hotel		47,294	1.23%	5,438	1.52%	1.23	1,025
Business		329,501	8.57%	36,875	10.27%	1.20	6,127
Auto		37,638	0.98%	3,692	1.03%	1.05	180
Amusement and recreation		34,289	0.89%	2,112	0.59%	0.66	
Health		247,917	6.45%	24,868	6.93%	1.07	1,733
Legal		25,883	0.67%	2,594	0.72%	1.07	179
Education		42,335	1.10%	12,587	3.51%	3.19	8,636
Social		55,181	1.43%	6,024	1.68%	1.17	875
Engineering		89,885	2.34%	8,853	2.47%	1.06	465
Other		85,848	2.23%	8,752	2.44%	1.09	741
Federal government		97,708	2.54%	9,782	2.73%	1.07	664
Local government		328,762	8.55%	16,586	4.62%	0.54	
State government		167,800	4.36%	7,451	2.08%	0.48	
Not elsewhere classified		-		104	0.03%		
TOTAL		**3,845,994**	**100.00%**	**358,895**	**100.00%**		**58,380**
Basic Employment multiplier in Alpha county (2000)							**6.15**

Table 3—Employment in Alpha County and State in 2004

INDUSTRIAL CATEGORY		2004 State Employment	%	2004 Alpha Employment	%	Alpha/State Location Quotient	Basic Employment (LQ > 1.00)
A	B	C	D	E	F	G	H
GOODS PRODUCING							
Agriculture		26,545	0.70%	44	0.02%	0.02	
Mining		7,146	0.19%	225	0.08%	0.42	
Construction		195,774	5.18%	10,552	3.70%	0.71	
Manufacturing		449,041	11.88%	20,556	7.20%	0.61	
	Food	65,574	1.74%	2,975	1.04%	0.60	
	Beverage	6,025	0.16%	-			
	Textile mills	37,956	1.00%	78	0.03%		
	Textile products	38,607	1.02%	137	0.05%		
	Apparel	9,088	0.24%	94	0.03%	0.14	
	Lumber and Wood	23,210	0.61%	401	0.14%	0.23	
	Paper	24,619	0.65%	1,674	0.59%	0.90	
	Printing	21,077	0.56%	2,504	0.88%	1.57	912
	Petroleum	1,168	0.03%	-			
	Chemicals	21,493	0.57%	676	0.24%	0.42	
	Plastics	24,025	0.64%	2,062	0.72%	1.14	247
	Nonmetallic	18,665	0.49%	1,171	0.41%	0.83	
	Primary metal	7,856	0.21%	145	0.05%	0.24	
	Fabricated metal	25,687	0.68%	1,199	0.42%	0.62	
	Machinery	23,286	0.62%	1,224	0.43%	0.70	
	Computers	14,024	0.37%	286	0.10%	0.27	
	Electrical equipment	16,582	0.44%	1,221	0.43%	0.97	
	Transportation equipment	41,616	1.10%	-			
	Furniture	14,070	0.37%	406	0.14%	0.38	
	Misc.	14,413	0.38%	942	0.33%	0.87	
SERVICE PRODUCING							
Wholesale trade		205,230	5.43%	18,765	6.57%	1.21	3,262
Retail trade		444,882	11.77%	36,543	12.80%	1.09	2,938
Transport and Warehousing		147,391	3.90%	9,245	3.24%	0.83	
Utilities		20,387	0.54%	2,050	0.72%	1.33	510
Information		122,538	3.24%	13,460	4.71%	1.45	4,204
Finance and Insurance		153,723	4.07%	13,336	4.67%	1.15	1,724
Real estate, rental and leasing		58,151	1.54%	5,647	1.98%	1.29	1,254
Professional, scientific		193,589	5.12%	15,993	5.60%	1.09	1,370
Management		51,699	1.37%	5,982	2.10%	1.53	2,077
Administrative and Waste		245,039	6.48%	21,911	7.68%	1.18	3,401
Education services		50,916	1.35%	13,695	4.80%	3.56	9,849
Health		326,387	8.64%	31,786	11.13%	1.29	7,132
Arts, entertainment and recreation		36,738	0.97%	2,901	1.02%	1.05	126
Accomodation and Food Services		311,817	8.25%	15,678	5.49%	0.67	
Other		99,380	2.63%	8,687	3.04%	1.16	1,180
Unclassified		6,473	0.17%	218	0.08%	0.45	
Federal government		94,249	2.49%	9,781	3.43%	1.37	2,662
Local government		148,449	3.93%	12,378	4.34%	1.10	
State government		383,771	10.15%	19,407	6.80%	0.67	
	TOTAL	**3,779,315**	**100.00%**	**285,479**	**100.00%**		**42,848**
Basic Employment multiplier in Alpha county (2004)							**6.66**

The Valuation of Corridors in Eminent Domain: The Chester Valley Branch

BY MICHAEL SKLAROFF, CRE

THIS PAPER WILL ADDRESS THE CONFLICTS INHERENT IN EMINENT DOMAIN, the clash between competing theories of highest and best use and the search for methodologies appropriate to one important variety of special use property, the transportation corridor. The forum for this inquiry was a jury trial. As will be discussed in detail below, the condemnor presented the corridor as an abandoned rail right-of-way, with little value for adaptive uses. The condemnee considered its property to be a valuable regional transportation resource in a congested, urbanized hub of major development. The gatekeeper of valuation theories at a trial is the judge; the ultimate arbiter of proof is the jury.

CREs represent a treasure trove of experience to parties engaged in major condemnation disputes. In addition to a sophisticated land planner, the condemnee here engaged three CREs: one was the co-author of one of the methodologies for corridor valuation featured in the literature; another was experienced in the adaptive reuse of underutilized urban rail corridors; and the third, a veteran appraiser, was charged with synthesizing theory and practice to arrive at a coherent approach to the appraisal problem.

A jury trial is different from a bench trial in that the proof must persuade twelve jurors, representing a cross-section of the community. Each juror comes to the case with different histories, different viewpoints and different preconceptions. Lawyers and witnesses must be aware that nothing can be taken for granted. We are reminded of the motto of the Stoic philosophy: *admirari nihil* -- be surprised at nothing.

BACKGROUND

As urban land becomes more and more developed and traffic more and more congested, public agencies have taken a second look at acquiring underutilized rail corridors to solve critical transportation problems. Adaptive reuse of these corridors presents opportunities for solutions to congestion in urban areas throughout the nation.

Fundamentally, however, the value of corridors is intrinsic to their attributes, and what is said of land in general, quoting Will Rogers, "they're not making any more of it," can be said of corridors. But the truth is that they (i.e., condemnors) are making more corridors, but the costs of assemblage and other obstacles are formidable. So that when a ready-made corridor is available, a transportation agency may jump at the chance to make the acquisition, using the power of Eminent Domain if necessary. Reported cases demonstrate, however, that condemnors continue to try to acquire corridors on the cheap. Fortunately, courts in the few reported cases have been willing to require just compensation and permit valuation methods designed to address intrinsic value. In the few cases reported, juries have returned impressive verdicts.

About the Author

Michael Sklaroff, CRE, chairs the Real Estate Department and manages the real estate practice of the firm of Ballard, Spahr, Andrews and Ingersoll in Philadelphia, Pa. His practice areas include real estate development, eminent domain and valuation, and zoning and land use. (sklaroff@ballardspahr.com)

The Valuation of Corridors in Eminent Domain

The valuation of corridors in Eminent Domain raises challenging questions of appraisal methodology. Two approaches seem to have taken hold in the literature: the across-the-fence plus enhancement factor method ("ATF Method") and the replacement cost method. The direct sales comparison approach has limited utility, primarily because corridors, properly viewed, are special purpose properties, meaning that comparable sales are difficult, if not impossible, to find.

A recent Pennsylvania case illustrates the challenge of valuing a corridor in an Eminent Domain trial in a state largely without caselaw guidance in valuation methodologies. The trial represented an opportunity to test the competing approaches in the real world in real time.[1]

THE CHESTER VALLEY BRANCH

The Chester Valley Branch (the "Corridor"), a railroad right-of-way assembled in the 1850s, served Pennsylvania's Lancaster, Chester and Montgomery Counties in moving farm products to Philadelphia. After World War II its use declined as the construction of major highways and suburban development stimulated motor freight and automobile traffic. The Corridor lying parallel to heavily traveled Route 202, remained an important but underutilized physical link between the edge city hub of King of Prussia and major office, commercial and residential development to the west in the area known as Great Valley.

In the 1980s, as part of a corporate restructuring, Conrail was getting rid of rail lines as fast as it could under federal legislation that expedited the abandonment process, the Northeast Railroad Services Act of 1981. Abandonment of the Corridor would come with a price: title would revert to underlying owners and Conrail would have to dismantle four bridges and bridge structures, and remove nine street and other grade crossings and restore the underlying properties. In PECO Energy, however, Conrail found a captive buyer. PECO, a public utility providing electricity to the region, needed to assure the continuity of occasional freight service to move huge transformers to its Upper Merion substation. Management had in mind not only this service, but also the possibility of owning a resource for fiber optic cable, power lines and other uses.

PECO and Conrail negotiated a deal. PECO would pay $600,000 for a quit-claim deed and accept the risk that title would dissolve upon conveyance from Conrail, a railroad company, to PECO a non-rail company. The consideration included not only the cash payment, but also a non-cash price, which included an indemnity against damages, costs and liabilities that might arise from the ultimate abandonment of the right-of-way, including the removal costs of the bridges and overpasses and restoration of streets and other lands. Had Conrail had not decided to get out of the freight business in the area as part of its business plan, it would never have sold the line to PECO. In any event, PECO's acquisition preserved the Corridor as a transportation resource for the region.

Following the 1986 quit-claim, an owner of an underlying fee interest challenged PECO's title, claiming (not surprisingly) that the transfer of the railroad right-of-way to a non-railroad company worked an abandonment of rail use and consequently revested title in underlying fee owners. The trial court sustained the challenge. On appeal, the Superior Court reversed the trial court and upheld PECO's position that there was no abandonment as a matter of law. The case was remanded to determine whether there was abandonment as a factual matter, but since the rail line had been in continued use there was no question of abandonment and the challengers did not pursue their claim.[2]

By March 9, 1993, the date of condemnation, increased development in the region had driven traffic volumes way beyond the capacity of the road system. Congestion in the King of Prussia hub, especially at Route 202, became intolerable and resulted in unacceptable traffic hazards and chronic gridlock. Regional planners and PennDOT identified the Corridor as a possible solution to the regional traffic crisis. In a study funded by PennDOT and other agencies, the Delaware Valley Regional Planning Commission ("DVRPC") commissioned a joint-use study (the "Joint Use Study") to consider alternative uses that could be made of the Corridor, including a roadway for high-occupancy vehicles ("HOV"), transit, commuter rail, a bus way and freight railroad, the latter to free up a parallel railroad for reuse for cross-county suburban transit.

Potential users of the Corridor included the Southeastern Pennsylvania Transportation Authority ("SEPTA"), which was charged by the Legislature to operate an affordable regional transit system, and PennDOT itself. At the time of the condemnation, PennDOT was considering building a by-pass to Route 202 at Route 422 as part of a plan to widen Route 202 to increase capacity and reduce congestion. In the early to middle stages of planning the Route 202 widening project, and even before obtaining 80% federal funding, PennDOT decided to acquire the Corridor. The decision on the re-use of the Corridor would be

PennDOT's alone. Although some consideration may have been given to an HOV lane as a way to address the traffic crisis, sometime after 1993 PennDot rejected HOV as a feasible solution.

THE CONDEMNATION

On March 9, 1993, PennDOT acquired 6.23 miles of the 7.6-mile Corridor as a transportation corridor and offered PECO $400,000 as just compensation. In order to avoid claims by owners of the underlying fee interests, the taking encompassed only the easement estate. PennDOT and PECO had negotiated a Cooperation Agreement under which PECO would give up its right to challenge the taking, PennDOT would provide alternative rail transportation of transformers at PennDOT's expense and PECO would be entitled to obtain just compensation for the Corridor.[3]

ATTRIBUTES OF THE CORRIDOR

The physical attributes of the Corridor may be summarized as follows:

- Area: 65 acres.
- Area of the take: 51 acres.
- Length: 7.66 miles.
- Width: 66' average.
- Corridor improvements: 9 bridges and 4 grade crossings.
- Rail improvements: single track.
- Topography: level roadbed.
- End points: connects with (a) Conrail rail line to the west and (b) to the electrical utility's regional substation and then over an expressway to the east.
- Midpoints occur along limited access highway and a roughly parallel freight line, as well as corporate centers, office buildings, retail commercial developments and residential communities.

The Corridor presented a clear shot through some of the most highly developed land in the region. A major attribute was its connectivity: to highways, transit and a major regional commercial hub. This connectivity was recognized in the Joint Use Study, in which DVRPC recommended that the Corridor be shared between the utility's occasional use and the Highway Department's use of the right-of-way for high-occupancy vehicle road along heavily congested Route 202 (as well as possible use by SEPTA for light rail, heavy rail, or bus way). The study recognized that the right-of-way provided "a rare opportunity to create additional capacity to move people in an area which is experiencing significant congestion." For damages to the Corridor, including the loss of 51 acres located in the midst of some of the most valuable real estate in the region, PennDOT, as stated above, initially offered the grand sum of $400,000.

THE TRIAL

At trial, PECO moved to exclude the use of the direct sales comparison approach, because each of the appraiser's sales failed to pass muster as "judicially" comparable, especially the sale of the subject in 1986. That sale was problematic for PECO if treated as a comparable. Consideration paid was $600,000 in cash and the indemnity. In any event, Conrail, the seller, was in liquidation mode. Accordingly, Conrail was not a "typically motivated seller."[4] It was clear that the non-cash consideration in the 1986 sale, especially by reason of the title cloud addressed in the indemnity, could not be reduced to cash equivalency.[5]

The case presents a test of three appraisal methodologies for corridors: direct sales comparison; ATF Method; and replacement cost. The ATF Method and the cost approach may be said to be industry standards for valuing corridors. Each recognizes that corridors are valuable—or not—depending upon their utility. But the fact that few reported decisions were available—and none in Pennsylvania—requires going back to first principles to determine what appraisal methodologies work.

We start with definitions as set forth in *The Dictionary of Real Estate Appraisal* (Fourth Edition), Appraisal Institute, 2002:

> ***corridor***—A long, narrow strip of land or real property rights for which the highest and best use is to provide an economic benefit by connecting the end points, and sometimes serving intermediate points along the way. Most corridors provide these connections for energy (oil and gas pipelines, electrical power transmission lines), transportation (road, rail, aqueducts, canals, navigation, aircraft overflight), or communications (fiber-optic lines) purposes. Abandoned corridors may or may not have a highest and best use of continued corridor use.

corridor factor [6]—In the valuation of existing corridors, a factor that expresses the ratio of the price paid for a transportation or communications corridor (i.e., the sale price of an existing corridor) and the across the fence (ATF) value. Typically used in the valuation of existing corridors and not the assembly of new corridor. Also called *railroad factor, synergism factor, enhancement factor* and *continuity factor*. See also **across the fence method; corridor valuation**.

corridor valuation—The process of estimating market value of the right to use corridor real estate. According to the Bureau of Land Management and U.S. Forest Service, relevant valuation approaches include land-based methods such as the across the fence method, going rate (sales comparison) approach, alternate route (cost avoidance) approach, and before and after method, and non-land-based methods such as liquidation value, replacement, income value, and competitive bid methods.

across the fence method [7]—A land valuation method typically used to estimate the value of a real estate corridor, including railroad or pipeline rights of way, highways, or other corridor real estate. The price of value of land adjacent to the corridor (i.e., "across the fence") is considered for the valuation. Other considerations include corridor factor and usage factor adjustments. See also corridor valuation.

across the fence (ATF) value [8]—In the valuation of real estate corridors, the value concluded based on a comparison with adjacent lands before the consideration of any other adjustment factors. The ATF value accounts for location and market conditions. Accordingly, this is an intermediate value without (or prior to) the consideration of the corridor factor.

A condemnee is entitled to just compensation for the taking of its property by Eminent Domain as a matter of constitutional law.[9] Under normal circumstances, just compensation means fair market value of the property taken before and after the condemnation. The fair market value of the property need not be based on the property's present use, but may be based on all potential uses, including the property's highest and best use. 26 P.S. § 1-603; *Pennsylvania Gas & Water Co. v. Pennsylvania Turnpike Comm'n*, 428 Pa. 74, 77, 236 A.2d 112, 114 (1967).

Under Pennsylvania law there are two requirements for proving highest and best use: the land must be physically adaptable to the use, and there must be a need for the use as reflected in the market for the use in the area at the time of condemnation.[10] As confirmed in the Joint-Use Study, the Corridor was physically adaptable to transportation use, indeed, many valuable uses. Conrail used it as a transportation corridor until PECO acquired it. PECO continued to use it as a transportation corridor until condemnation. PennDOT's use of the Corridor, indeed, its very ownership, depended on its continuing PECO's use for transportation purposes. While PennDOT avoided condemning the underlying fee ownership, nevertheless the abandonment of transportation use along the Corridor might work a reversion of title to underlying fee owners.[11]

STRATEGIC POSITION

The value of a corridor is a function of the areas through which it passes and the points it connects. A condemnee can show that demand for a corridor exists where the property occupies a strategic position, which is of probable value to others for use as a corridor.[12] The demand for a transportation corridor was reflected in the market in Montgomery and Chester Counties at the time of condemnation.

In the old case of the North Shore Railroad, one railroad condemned a 5,100-foot-long, 30-foot-wide section of the another railroad's five-mile-long corridor. The condemnee railroad had graded and ballasted the right of way but had never used it. Furthermore, the condemnee had lost its railroad franchise and could not itself use the property as a railroad at the time of condemnation. The condemnor argued that the highest and best use was therefore limited to farmland. The Pennsylvania Supreme Court, however, affirmed the trial court's holding that the land could be valued for railroad purposes. The Court determined that there was a market for railroad use of the property mainly because the property was in a "strategic position":

> [T]here was ample evidence tending to show that its property as a whole occupied a strategic position, which was not merely of possible, but of probable value to others as well as to [condemnor], by reason of its availability for the location and construction thereon of a line of electric or steam railway. *Id.*[13]

At the time of condemnation, as the date of trial, the Corridor was strategically located in an area of rapidly increasing residential and commercial density and traffic congestion. As DVRPC found, and as PECO's planning expert testified, the Corridor occupied a strategic position that was of value to others by reason of its availability as a

site for an HOV lane, busway, railway, highway or freight line to alleviate congestion on U.S. Route 202 in the King of Prussia area. The Corridor would have provided a needed transportation link for people and goods between other existing and planned corridors—including U.S. Route 202, U.S. Route 422, Interstate 76, Interstate 276, the proposed Schuylkill Valley and Cross County Metros, and Conrail's Trenton Cutoff—and the many residential areas and commercial and industrial facilities along the right-of-way. Therefore, there was demand for the Corridor as a transportation corridor.

DEMAND FOR CORRIDORS: NO NEED TO SHOW ACTUAL BUYER

Because it had shown that demand existed, PECO need not have identified an actual specific buyer. The law *assumes* that an actual buyer existed as the normal rule for condemnation valuation. Even where the property is regularly traded in the marketplace, there is no need to show an actual buyer:

> Market value, essentially, is based on assumption, not fact. To establish market value, it is not necessary to point out any designated person able and willing to buy the property at the price alleged (or at any price), or to show that the owner is in fact willing, or even has the legal capacity, to sell it.

Julius L. Sackman, 4 *Nichols on Eminent Domain* § 12.02[2], at 12-80 (Rev'd 3d ed. 1998). With seldom-traded properties especially, this result is essential to achieve just compensation. Corridors are "special use" properties. J.D. Eaton, *Real Estate Value in Litigation*, at 238 (2d Ed. 1995). By definition, special use properties are seldom traded, and few special use properties would have any value if value depended on proving the existence of an actual buyer. But since special use properties do have value in condemnation proceedings, there is no need to show that an actual buyer exists.[14]

DEMAND NOT LIMITED TO PRIVATE BUYERS

It is also important to note that demand is not limited to private buyers. The crux of corridor value is utility. As one of PennDOT's appraisal witnesses admitted, a market exists "where there is an economic, social or market demand." At condemnation, the Corridor was still useful as a transportation corridor. Therefore, it does not matter whether the most probable buyers for the Corridor were governmental or quasi-governmental authorities or utilities or other private sector purchasers.[15] PennDOT's valuation expert at trial used as one of his Conrail liquidation sale "comparables" a sale to a governmental authority, thus conceding that public bodies can be part of the market.

THE ATF PLUS ENHANCEMENT-FACTOR AND COST METHODS ARE APPROPRIATE METHODS TO VALUE THE CORRIDOR.

Because of insufficient data for sales of comparable corridors, the ATF Method and replacement cost methods are appropriate for valuing the Corridor.[16] The traditional sales comparison approach does not work because there are so few comparable sales.

An owner generally is entitled to receive what a willing buyer would pay in cash to a willing seller at the time of the taking.[17] In the usual case, market data is competent evidence of the value of the condemned property.[18] But the normal market data approach does not suffice here because sales data are not sufficient. Appraisal Inst., *supra* at 418. ("[T]he reliability of the sales comparison approach is diminished if substitute properties are not available in the market"). The direct sales comparison approach is seldom used in corridor valuation due to the lack of comparables that are meaningful with respect to location and geography. *See* Gary S. Valentine, "Appraising a Transportation Corridor," *Right-of-Way* (November/December 1998) at 6-10.

An ideal comparable would have been the sale of a 60-foot-wide transportation corridor with good title in a nearby densely developed, congested area. A good comparable would have had some of these attributes, enough to make adjustments that would satisfy the requirements of the sales comparison approach. At the very least, a comparable corridor would have utility for road or transit use in an urbanized area. There were not enough sales of suitable properties, however, to perform a traditional comparable sales analysis. This dearth of comparable sales does not, however, impair the value of the Corridor.

PLOTTAGE

A key to understanding corridor valuation is "plottage." An assemblage of land gives the land an enhanced value over and above the sum of the values of the individual component lots.[19] This enhancement is called the "plottage." Functional corridors are intrinsically valuable because they are assemblages, and assemblage enhances the value of the component lots. *See* John P. Dolman & Charles F. Seymour, "Valuation of

Transportation/Communication Corridors," *The Appraisal Journal* ("Dolman & Seymour") 509, 515 (October 1978). Two recognized appraisal methods are founded on the concept of plottage: the ATF Method and the replacement cost method.

THE ATF METHOD

Recognizing the special nature of corridors, the appraisal industry and the courts have approved the ATF method for valuing corridors.[20] The method is based on the recognition that a useful corridor's value exceeds the value of the land over which the corridor passes. To apply this method, the appraiser divides the corridor into segments based on the zoning of non-corridor adjacent land.[21] The appraiser then values each segment by reference to sales of comparable non-corridor parcels, and adds the values of the segments to yield the "ATF value."

To account for plottage, the appraiser multiplies the ATF value by an "enhancement factor" or "corridor factor," which is a multiple derived from the factors by which sales prices of other corridors exceeded the ATF values of the bare land. By examining sales of other corridors, the appraiser may derive an enhancement factor for the Corridor. Factors may vary from 1.25 to 2 or higher. In effect, the ATF Method is a derivative approach.

THE REPLACEMENT COST METHOD

Another valuation method is replacement cost. Where property by its nature is infrequently traded, such that there are insufficient comparable market sales, the condemnee may introduce cost[22] as evidence of fair market value.[23] Such property is called special use or special purpose property.[24] A transportation corridor is such a property and, as with other special use properties, one measure of a corridor's value is its replacement cost.[25]

An appraiser valuing a transportation corridor must calculate the cost of assembling an equally desirable corridor, i.e., a corridor of comparable dimensions, utility, topography, location and environs. The appraisal industry and at least one court have adopted the cost approach for valuing corridors.[26]

To calculate the replacement cost of the Corridor, PECO's appraiser started with the same land value—the ATF value—that he calculated under the ATF Method. To account for plottage, he multiplied the ATF value by an "assemblage factor," derived from the factor by which the assembly costs of similar corridors exceeded their bare land costs. Assemblage factors typically run from 3.74 to 14.09.[27]

Since there were few sales comparable to the Corridor, the traditional direct comparison method was a doubtful method for valuing the Corridor, consideration of the few available comparables was used to confirm the condemnee's appraiser's final valuation conclusion.[28]

These three methodologies were tested by court review on the eve of trial and in the course of the jury trial. The court excluded the replacement cost method as too speculative; approved of the ATF Method; and over PECO's objection allowed PennDOT's appraiser to testify to the direct sales comparison approach based almost entirely on Conrail liquidation sales.

The challenge for PECO was to bring the corridor to life. By the time of trial, the rail and ties had been removed, portions were an active highway and sound barriers occupied substantial length of the right-of-way. Other areas were overgrown. In order to illustrate the value of the Corridor, PECO, over PennDOT's objection, presented to the Jury an animation of the Corridor, showing its context in the region, its connectivity to the road system and various modes of transportation uses considered in the Joint Use Study. Central to the value of a corridor is utility. To be sure, the Corridor had been underutilized at the date of the taking, but its "strategic" position could not be denied. Fortunately for PECO, the Joint Use Study determined that the Corridor represented "a rare opportunity to create additional capacity to move people in an area which is experiencing significant congestion."

THE VIEW

The view itself was extraordinary. The Judge, Jury and the lawyers and appraisers traveled by bus for 2 1/2 hours on, over, under, around, and beside the Corridor. The view, 11 years after the take, demonstrated the value of the Corridor for transportation purposes. One and a half miles of the Corridor had become a major bypass from the limited access highway to the expressway, PennDOT's solution to a portion of the congestion problem. Other portions of the Corridor contained two miles of segments of sound barriers. Some remnants were put to service for rails to trails.

PECO'S CASE

The highest and best use was urban transportation corridor, and potentially a solution to regional traffic congestion. Examples abound of the adaptive reuse of underutilized rail corridors to transit and other uses. The ATF Method is a recognized and appropriate method for corridor valuation. The market for rail corridors was too limited to permit the direct sales comparison approach. The 1986 sale of the subject property -- the Corridor itself -- was not a comparable because it included non-monetary consideration that could not be reduced to cash value. The Conrail sales were not relevant because Conrail, seeking to get rid of excess assets for purposes of corporate restructuring, was not a typically motivated seller. PennDOT's appraiser demonstrated the inapplicability of the market data approach because all he could find were five sales by Conrail out of liquidation mode and one sale of a 10-foot wide subterranean pipeline easement 250 miles away from the subject.[29] Using the ATF Method (even without factoring in the cost approach), damages were in excess of $10 million.

PENNDOT'S CASE

The railroad right-of-way was not much of a corridor. It didn't have sufficient end points to be valued under the ATF Method. The Corridor itself sold to PECO in 1986 for only $600,000. The Corridor has no economic use as a transportation corridor because additional takings would have been necessary to connect end points to other land to make the corridor valuable. In any event, there were enough comparable sales to support a theory of market without using more sophisticated methods. In sum, PennDOT's appraiser concluded that the highest and best use was a recreational pedestrian and bicycle trail. Finally, there was no value-in-use because the utility's rail service had been relocated to a parallel rail line at no cost to the utility.

VERDICT

The Jury's verdict was approximately $5 million, over 12 times the original offer, and almost $9.5 million with delay damages. After the verdict, lawyers for both PECO and PennDOT spoke informally to the members of the Jury. The Court's rulings and the Jury's comments shed light on the practical use of the appraisal methodologies.

Over objection, the Judge had permitted PennDOT's appraiser to testify on the direct sales comparison approach (using the five Conrail sales and an underground pipeline easement). The Jury preferred this approach; it's simpler. Nevertheless, the Jury disbelieved PennDOT's "comps" and used its own values.

The Court approved the use of the ATF Method and found it logical. The Jury, however, discounted this approach. They found it hard to understand. Interestingly, the Jury's conclusion of value approximated the ATF value, but without the enhancement factor.

As stated above, the Court rejected the cost method as too speculative, using its gatekeeper function.[30] The Jury didn't hear testimony on this methodology, but after the fact several expressed interest in hearing evidence of the cost of assembling a hypothetical, parallel corridor, which they believed relevant.[31]

SUMMARY

Our system of justice brings to bear the collective common sense of twelve citizens, drawn from a cross-section of the community. Ultimately, legal theory and appraisal methodology are tested in the crucible of fairness and common sense. Nothing compares to a jury trial as a test of appraisal theories in the real world, real time.■

REFERENCES

1. Any lawyer worth his salt would not proceed in such a difficult case without sound advice from qualified experts. We were lucky to have three CREs on board: our appraiser, Reaves Lukens, Jr.; John Pinto, an expert on valuation of rail corridors; and Charlie Seymour, senior consultant, the co-author of the *ATF Method*. So armed, we can only say that any mistakes or shortcomings are those of the undersigned.

2. Quarry Office Park Associates v. Philadelphia Electric Co., 394 Pa. Super. 426, 576 A.2d 358 (1990)

3. The taking triggered preliminary objections from an adjacent landowner, this time to challenge PennDOT's title, claiming that the taking worked a condemnation of the underlying fee interests. PennDOT was able to defeat the objections by establishing through pleadings that it held good title to a public transportation corridor by its acquisition to PECO's railroad title.

4. Frequently in discussions with appraisers the question is posed as whether a sale is arms-length. This is a misnomer. Even arms-length sales can be excluded if one of the parties is not "typically motivated."

5. This concern was a prophecy fulfilled when one of the underlying fee owners challenged the transfer in court and got the trial court to grant summary judgment that the transfer from a railroad company to a non-railroad company worked an automatic abandonment and reversion of title. After extended litigation, the Superior Court reversed and remanded for a determination as to whether there was abandonment in fact.

6. Note in original states that the term may be defined differently in different jurisdictions and is subject to pending federal legislation and judicial interpretation. Id.

7. Notes in original state that these terms may be defined differently in different jurisdictions and are subject to pending federal legislation and judicial interpretation. Id.

8. Notes in original state that these terms may be defined differently in different jurisdictions and are subject to pending federal legislation and judicial interpretation. Id.

9. U.S. Const. amend. 5; Pa. Const. art. I § 10 and art. XVI § 8; Pennsylvania Eminent Domain Code, 26 P.S. § 1-601.

10. Pennsylvania Gas & Water Co., 428 Pa. at 81, 236 A.2d at 116 (emphasis supplied). Appraisal technique identifies four similar criteria: physically possible, legally permissible, financially feasible and maximally productive. Appraisal Inst., *The Appraisal of Real Estate*, at 307 (12th Ed. 2001).

11. See Quarry Office Park Assocs., supra.

12. North Shore R.R. Co. v. Pennsylvania Co., 251 Pa. 445, 449, 96 A. 990, 992 (1916).

13. In cases not involving corridors, courts have held that strategic location is evidence of a market for condemned property. See, e.g., Chandler-Dunbar Water Power Co., 229 U.S. 53, 77 (1913) (holding that the location of a property such that it would probably be desired for canals and locks was evidence that the highest and best use was as a site for canals and locks); In re Condemnation by the Pa. Turnpike Comm'n of 79.42 Acres of Land in Jefferson Twp., 1 Pa. Commw. 66, 71, 272 A.2d 279, 281 (1970) (considering proximity to areas of population density as evidence of need for recreation facilities); Appeal of Andorra Assocs., 128 Pa. Commw. 6, 12, 562 A.2d 953, 955 (1989) (considering proximity to areas of population density as evidence of need for retail shopping).

14. See, e.g., Redevelopment Auth. of Washington County v. Faith United Presbyterian Church, 7 Pa. Commw. 490, 496, 298 A.2d 614, 617 (1972).

15. At least four of the 12 sales that PennDOT's expert considered, and two of the five sales that he analyzed as comparables, were to entities with condemnation authority (PECO, the Canadian Pacific Railroad and the Lackawanna County Railroad Authority). Recognizing this reality, courts treat sales to condemnors as market sales where the sales are (1) sufficiently voluntary, or (2) the only recent sales of comparable property in the area were to condemnors. See, e.g., State v. Pioneer Co. Mill, Ltd., 637 P.2d 1131, 1137 (Haw. 1981).

16. 26 P.S. § 1-603, cmt. to clause (1) and §1-705, cmt. to subdiv. (2)(iv); Pennsylvania Gas & Water Co., 428 Pa. at 83-84, 236 A.2d at 117; State v. Southern Pacif. Transp. Co., 749 P.2d 1233, 1236 (Or.Ct.App. 1988); People ex rel. Dept. of Transp. v. Southern Pacif. Transp. Co., 148 Cal.Rptr. 535, 540-41 (Ct.App. 1978).

17. United States v. Miller, 317 U.S. 369, 374 (1943).

18. See 26 P.S. § 1-705(2); Appraisal Inst., supra, at 419-21.

19. Appeal of Elgart, 395 Pa. 343, 346-467, 149 A.2d 641, 643 (1959). In Appeal of Elgart, the court wrote that: "[A]n increment of value (plottage value) arises as a consequence of combining two or more sites, thereby developing a single site having a greater value than the aggregate of each when separately considered. There is a recognized economic advantage in larger real estate holdings. Substantial sums are paid by developers for the acquisition of larger plots of land because the advantage of contiguous lots is always reflected by a larger square foot value." Id. at 346-47, 149 A.2d at 643. See also Appeal of John Wanamaker, 360 Pa. 638, 641-42, 63 A.2d 349, 350-51 (1949); Moore v. Montgomery County, 22 Pa.Commw. 262, 265, 348 A.2d 762, 764 (1975).

20. Dolman & Seymour at 509; State v. Southern Pacif. Transp. Co., 749 P.2d 1233, 1236 (Or.Ct.App. 1988); Southern Pacif. Transp. Co. v. Santa Fe Pipelines, Inc., 88 Cal. Rptr. 2d 777, 783-88 (Ct. App. 1999).

21. i.e., the land "across the fence" from each segment.

22. "Cost" may mean reproduction cost, which is the cost of obtaining an exact replica of the property. Appraisal Inst., supra, at 350. Or "cost" may mean replacement cost, which is the cost of substitute property with the same utility. Id. Courts usually make no distinction between the two terms. Nichols, supra, § 12C.01[3][b], at 12C-30 (3d ed. June 1998); Eaton, supra, at 161, 232.

23. 26 P.S. § 1-603, cmt. to clause (1) and §1-705, cmt. to subdiv. (2)(iv) (cost approach applies to property that has a special value but for which normally there is no market price); Redevelopment Auth. of Washington County v. Faith United Presbyterian Church, 7 Pa.Commw. 490, 496, 298 A.2d 614, 617 (1972); Appraisal Inst., supra, at 353-356; Eaton, supra, at 232.

24. 26 P.S. § 1-603, cmt. to clause (1) and §1-705, cmt. to subdiv. (2)(iv); Nichols, supra § 12C.01[1], at 12C-2, 12C-8; Appraisal Inst., supra, at 25-26.

25. 26 P.S. § 1-603, cmt. to clause (1) and §1-705, cmt. to subdiv. (2)(iv); Eaton, supra, at 238. The value of a special use property like a church, a factory or a museum, derives primarily from the improvements. The appraiser values the special improvement at its replacement cost less depreciation. 26 P.S. § 1-705(2)(iv); Appraisal Inst., supra, at 356. Since comparable market sales are generally available for the land in such cases, the appraiser values the land using the comparable sales method. 26 P.S. § 1-705(2)(iv); *Appraisal of Real Estate* at 356-57. With properties like corridors, parks and reservoirs, however, the land itself, not the improvements, is the special use. Pennsylvania Gas & Water Co., 428 Pa. at 83, 236 A.2d at 117 (holding that owner was entitled to replacement value of land suitable for a reservoir because no market exists for reservoir land); Nichols § 12C.01[1], at 12C-2, 12C-8 ("[P]arks, highways, . . . railroads and turnpikes have been held to be special purpose properties."); Eaton, supra, at 238 (railroads and streets are special use properties).

26. Eaton, supra, at 238 (2d ed. 1995); Gary S. Valentine, Appraising a Transportation Corridor, Right of Way, at 6, 8 (Nov./Dec. 1998); People ex rel. Dept. of Transp. v. Southern Pacif. Transp. Co., 148 Cal.Rptr. 535, 540-41 (Ct.App. 1978). See also Pennsylvania Gas & Water Co., 428 Pa. at 83, 236 A.2d at 117 (holding that owner was entitled to replacement value of land of a type for which no normal market exists). In People v. Southern Pacif. Transportation, the Department of Transportation condemned a one-and-a-half-mile-long portion of Southern Pacific's R Street Line, an urban railroad corridor. Because there was "no relevant market" for the condemned property, the court held that the jury could consider the cost of replacing the Corridor as evidence of the property's value. 148 Cal. Rptr. at 540-41. This case is in accord with Pennsylvania law. Because corridors are special purpose properties, replacement cost is a proper measure of value of a condemned corridor. Also see, Arthur G. Rahn's "The Cost Approach in Corridor Valuation," International Right-of-Way Association, January 2004.

27. As discussed later, the trial court granted PennDOT's motion to exclude testimony on the cost method.

28. Were an appraiser to attempt a comparable sales valuation of the Corridor, however, the obvious starting point would be what are perhaps the only true comparable sales: (1) Conrail's 1995 sale of an existing corridor, the 1.85 mile long City Branch in Philadelphia, to SEPTA; and (2) PennDOT's assembly of a new corridor, the 5.32 mile long Exton Bypass in Chester County.

29. Interestingly, within several years before the 1993 taking, PennDOT assembled a 5-mile corridor 10 miles to the west in land substantially less valuable than that in the area of the take of the utility's assembled corridor. The cost of assembling that corridor—land only—was $44 million dollars.

30. See Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993).

31. Using the cost method, the Corridor was valued by PECO's appraiser (before averaging with the ATF Method) at $30 million. A five mile corridor assembled from scratch by PennDOT to the west of the Chester Valley Branch several years before the taking had cost $44 million by the time of trial.

Kelo v. The City of New London: What Does It Really Mean?

BY RICHARD C. DEARTH AND J. RUSSELL HARDIN

INTRODUCTION

MUCH INK AND AIR TIME WAS SPENT ON THE PRONOUNCEMENT OF THE UNITED STATES SUPREME COURT that local governments have the right to acquire private property for redevelopment purposes with the ultimate intent to convey it to another private enterprise for a private use. While the ruling seems to have taken many by surprise, a number of state supreme courts have long held that the proposition of local governments taking private property for the purposes of private redevelopment was not only legal but should be encouraged. What are the ramifications of this decision and what should be the public policy when it comes to redevelopment?

THE CASE

On June 23, 2005, the United States Supreme Court in a 5-4 decision re-ignited a long-standing legal dispute over private ownership rights. In *Kelo, et al.v. City Of New London, Connecticut, et al.*,[1] the majority opinion approved the taking of private property by local government for redevelopment purposes and turning it over to another private use. The case, while settling the legal issue of the constitutionality of such a taking, also fueled a public policy controversy.

The facts in *Kelo* are not uncommon across the country. In the *Kelo* case, the City of New London, Connecticut, gave final approval to a development plan that "was projected to create in excess of 1,000 jobs, to increase tax and other revenues, and to revitalize an economically distressed city, including its downtown and waterfront area." The city was attempting to redevelop a 90 acre tract of land known as the "Fort Trumbull" area. The area was located on a peninsula in the Thames River. The area contained approximately 115 privately owned residences. Plans for the redevelopment of the area included approximately 80 new residences in a planned community. The redeveloped area would also include a small "urban village" containing

About the Author

Richard C. Dearth is an assistant professor of management and Chair of the Department of Management and Marketing in the College of Business at Pittsburgh State University in Pittsburgh, Kansas. He holds a B.A. degree from the University of Kansas and a J.D. degree from Washburn University of Topeka School of Law. He practiced law for over 35 years with a concentration in real estate and governmental law. He teaches law-related subjects.

J. Russell Hardin is an associate professor of accounting and Dean of the College of Business at Pittsburgh State University in Pittsburgh, Kansas. He holds a B.S. and M.A. degrees in Business from Appalachian State University and a Ph. D degree in accounting from the University of Mississippi, He is also a CPA and teaches tax and MBA courses. He has published several articles and books in the accounting, tax and international business field.

hotels, shops, museums, a river walk, and a new facility for the Pfizer company.

As is usually the case in large redevelopment projects, the City acquired many parcels of property from willing buyers, while a few other owners refused to sell for various reasons. In order to complete the project, the city decided to force the sale of the balance of the properties needed by the use of eminent domain. *Kelo* owned a private home in the area and did not desire to sell the property because of the expansive water view. Another landowner, Dery, had lived in her house since 1918 and did not want to leave the property. In all, nine landowners challenged the legal right of the city to acquire the property. The city admitted that the area involving the nine residences was not "blighted" but maintained its right to acquire the property purely for redevelopment purposes.

Eminent domain proceedings were instituted under the authority of a Connecticut state statute that gave authority to local government for eminent domain taking as "part of an economic development project" and determined that an economic development project is a "public use" and "in the public interest." In the action, the landowners claimed that the statute violated the Fifth Amendment to the U.S. Constitution that requires, "Nor shall private property be taken for public use, without just compensation." At the heart of the issue before the Supreme Court was whether the city's proposal to redevelop the property under that state statute would qualify as a public use sufficient to pass Constitutional muster.

In its majority opinion, the Supreme Court said that the taking of the property for "redevelopment" purposes satisfies the public use requirement even though the ultimate owner of the property will be a private owner. The Court did indicate that under some circumstances a government agency may not take property for a purely private use but declined to clearly enunciate the standards defining a purely private use. The Court stated:

> Two polar propositions are perfectly clear. On the one hand, it has long been accepted that the sovereign may not take the property of A for the sole purpose of transferring it to another private party B, even though A is paid just compensation. On the other hand, it is equally clear that a State may transfer property from one private party to another if future use by the public is the purpose of the taking; the condemnation of land for a railroad with common-carrier duties is a familiar example. Neither of these propositions, however, determines the disposition of this case. As for the first proposition, the City would no doubt be forbidden from taking petitioner's land for the purpose of conferring a private benefit on a particular private party. Nor would the City be allowed to take property under the mere pretext of a public purpose, when its actual purpose was to bestow a private benefit. The takings before us, however, would be executed pursuant to a carefully considered development plan.

The Supreme Court points out that historically a requirement that property taken must be used by the general public has been rejected by the courts, and accordingly the Supreme Court argues that Courts have been encouraged to afford, "legislatures broad latitude in determining what public needs justify the use of the takings power."

The Court rejects the establishment of a "bright line" rule that "economic development does not qualify as a public use," arguing that "promoting economic development is a traditional and long accepted function of government."

Moreover, the Court refused to require judicial approval of condemnations before construction begins. The majority held that:

> . . . orderly implementation of a comprehensive redevelopment plan obviously requires that the legal rights of all interested parties be established before new construction can be commenced. A constitutional rule that required postponement of the judicial approval of every condemnation until the likelihood of success of the plan had been assured would unquestionably impose a significant impediment to the successful consummation of many such plans. Just as we decline to second-guess the City's considered judgments about the efficacy of its development plan, we also decline to second-guess the City's determinations as to what lands it needs to acquire in order to effectuate the project.

The majority opinion was quick to emphasize that the opinion does not prevent any state from placing further restrictions on the public use requirements under a state statute regarding taking for public use. Clearly under the majority opinion, the use of eminent domain proceedings to acquire private property for the purposes of commercial redevelopment will be allowed so long as it is consistent with state law.

STATE LAW BACKGROUND

In many states, the decision in *Kelo* should not come as a surprise. Over the last 50 years,[2] the courts have been sup-

portive of economic redevelopment. In Kansas for example, the issue has been well-settled law for a few years. In *General Building Contractors, L.L.C. et al. v. Shawnee County, Kansas,*[3] the Kansas Supreme Court was faced with a very similar factual question but reached a more far-reaching conclusion than *Kelo*. Kansas recognized a Kansas county's power of "home rule" in 1974. Home rule in essence is the power of a local government to assume power and authority where no state law prohibits the action or where the state law does not apply uniformly to all Kansas counties or cities. Prior law known as "Dillon's Rule" held that local governments may exercise "only those powers specifically granted by the state legislature." The Shawnee County Commissioners passed a "home rule" resolution granting them the power to exercise eminent domain "when necessary in the public interest for lawful purposes including economic development." An area of approximately 400 acres of land in Shawnee County was targeted for "redevelopment" as an industrial park with the title to the redeveloped area to be ultimately in the hands of private business. All of the area slated for redevelopment had been acquired by voluntary sale except for the plaintiff's property. It was estimated by the county that the new project would include "thousands of jobs, increased payroll, an increased standard of living, more opportunities for many people in the community, plus a greatly enhanced tax base." The plaintiff resisted attempts to condemn the property by challenging the validity of the home rule ordinance. The Kansas Supreme Court held that not only can Kansas counties assume the power to acquire property for economic development purposes by "home rule," but also that the acquisition of such property for economic development meets the "public purpose" test by restating an earlier Kansas Supreme Court decision of *State ex rel. Tomasic v. Unified Gov't of Wyandotte County/Kansas City, 265 Kan.* 779, 962 P.2d 543 (1998). The *Tomasic* decision may well have acted as a model for the majority opinion in Kelo, although not directly cited.

The decision of the Kansas Supreme Court is certainly prophetic. In *Tomasic*, the local government for Wyandotte County/Kansas City, Kansas, established a plan for the development of a large area of land into an auto racetrack facility with a financing scheme known as tax increment financing or TIFF. After plans were announced, the Kansas Legislature amended portions of the urban redevelopment statutes to allow for the use of TIFF financing for such a purpose. The local government ultimately commenced eminent domain procedures to acquire parcels of privately held property that could not be purchased by private sale. A challenge was made of the authority of the local government on private use grounds. The Kansas Supreme Court held in *Tomasic* that, "This court has held that there is no precise definition of what constitutes a valid public use, and what may be considered a valid public use or purpose changes over time. Further, this court has noted that as long as a governmental action is designed to fulfill a public purpose, the wisdom of the governmental action generally is not subject to review by the courts." The Court endorsed the view that "the development of recreational facilities and the facilitation of economic development in partnership with private enterprise have been considered legitimate public purposes for the exercise of eminent domain and the expenditure of public money." The Court in *Tomasic* went on to hold that:

> It is elementary that the legislature possesses no power to authorize the appropriation of one's property for a private use or purpose, but it is equally well-settled that the right to take private property for a public use is inherent in the state, and that the legislature may authorize the acquisition and appropriation of private property for a public use provided the owner is compensated therefore. The difficulty often encountered lies in the inability of courts comprehensively to define the concept of a public use or purpose, due, no doubt, to the exigencies shown by the facts and the diversity of local conditions and circumstances in an everchanging world… The mere fact that through the ultimate operation of the law the possibility exists that some individual or private corporation might make a profit does not, in and of itself, divest the act of its public use and purpose.

As a result of *Tomasic*, the Unified Government of Kansas City Kansas/Wyandotte County went on to build the Kansas Speedway that has attracted some NASCAR races and the Village West Entertainment and Shopping District. The Unified Government claims that this development attracts over 10 million visitors a year to an area that was once farms and pasture land. The 400-acre Village West development is located at the intersections of Interstates 70 and 435. The Unified Government claims that with recent expansions and future planned expansions it will become one of the "largest tourism districts in the country, and most certainly the largest in the Midwest."[4]

The effect of *Tomasic* may be more than coincidental. The National League of Cities filed a brief amicus curia

(friend-of-the-court brief) in support of the action taken by the City of New London in the *Kelo* case. In the brief, The National League of Cities called, "eminent domain often indispensable for revitalizing local economies." The Kansas Speedway project was used as an example of economic development that can generate "tens of millions of dollars in economic activity" on land that had been held by private landowners.

Other states have traveled in a totally different direction from Kansas. In *Wayne County v. Hathcock*, 684 N.W.2d 765 (Mich. 2004), the Michigan Supreme Court in 2004 overruled a previous decision and held that the use of eminent domain by Wayne County to secure land to create a 1,500-acre business and technology park that would ultimately be privately held violated the public use doctrine. In the decision the Michigan court framed the issue. The Court said, "We are presented again with a clash of two bedrock principles of our legal tradition: the sacrosanct right of individuals to dominion over their private property, on the one hand and, on the other, the state's authority to condemn private property for the commonwealth." It was acknowledged by the Michigan Court that the project would help the "struggling economy of southeastern Michigan by attracting businesses, particularly those involved in developing new technologies, to the area." The Michigan court simply held that the use of eminent domain under these circumstances violated the "public use" doctrine under the Michigan constitution. The Court held that Article 10 Section 2 of the Michigan Constitution provided for the use of the power of eminent domain for a "public use" only, and that the proposed business and technology park did not qualify because the ultimate title to the property would be held privately. It should be noted that the state of Kansas has no language similar to Michigan in its state Constitution. However, the Michigan Constitution is similar in scope to the Fifth Amendment of the United States Constitution interpreted by *Kelo*. *Kelo* may also not be dispositive of Hathcock. The U.S. Supreme Court clearly announced that the effect of state law was to be different in each state. Some states have no decisions to act as a guide in interpreting the *Kelo* doctrine and have relied on the Attorney General's opinions. According to the Washington Attorney General, Washington has a fairly clear constitutional prohibition against the use of eminent domain for private purposes. Washington's Attorney General A.G. McKenna issued an opinion soon after the decision in *Kelo* was reached. In the opinion, McKenna pointed out that "The Washington State Constitution prohibits the use of the power of eminent domain to condemn private property for private use and reserves to the judiciary the role in determining what constitutes a public use." McKenna pointed out that the Washington Supreme Court "has defined the 'public benefit' limitation in a narrow way." McKenna questioned the effect of *Kelo* on property owners in Washington.[5] Certainly, *Kelo* will not have universal effect in each of the 50 states. The effect of *Kelo* will be state-law dependent.

IMPLICATIONS

Propelled largely by an emotional and sharp dissent by Justice O'Connor, the aftermath of *Kelo* has been a glut of anti-*Kelo* legislation initiated around the country as well as passionate campaigns by public interest groups. The rallying cry of many of these groups is Justice O'Connor's often-quoted passage, "Nothing is to prevent the State from replacing any Motel 6 with a Ritz Carlton, any home with a shopping mall or any farm with a factory." According to Tresa Baldas, writing in the *National Law Journal*, 28 states have seen a total of 70 bills introduced to reverse the effects of *Kelo*.[6] Several bills and resolutions have been introduced in Congress. The Castle Coalition, a group of citizens against eminent domain abuse, has instituted a "Hands Off My Home" program backed by a $3 million financial commitment. The premise of "Hands Off My Home" is to initiate legislation reversing the effects of *Kelo* by legislation or constitutional amendment in every one of the 50 states.[7] The issue will remain a topic of national discussion for some time to come. Some estimate there are approximately 10,000 reported eminent domain cases pending.[8]

Almost before the ink was dry on the Supreme Court Decision, the House of Representatives of the United State Congress leaped into the breach with a resolution that expressed "the grave disapproval of the House of Representatives" of the *Kelo* opinion. The resolution, which lacks the force of law, was passed on a roll-call vote of 365 in favor and 33 against. The resolution claims that the *Kelo* determination "renders the public use provision in the Takings Clause of the Fifth Amendment without meaning." The House resolution cites with approval the dissenting opinion in *Kelo* and concludes that the majority opinion, "justifies the forfeiture of a person's private property through eminent domain for the sole benefit of another private person." The resolution recited the prerogative of Congress to "address through legislation any abuses of eminent domain by State and Local government."[9]

In light of such Congressional disdain for the *Kelo* policy, one would expect enforceable legislative action to be swift and sure. Such has not been the case to date. While this article does not attempt a detailed review of proposed federal legislation, some of the bills currently in Congress may be of interest. One approach is to prohibit the states from using eminent domain for economic development projects if federal funds are involved.[10] A variation of that approach would be to prohibit eminent domain from being used where federal funds are involved unless it was to acquire real estate for a utility, roadway, pipeline, prison, hospital, or property taken during a national emergency or disaster.[11] Another is to redefine "public use." Under a Senate bill now under consideration, "public use" would not include economic development.[12] A bill introduced in July 13, 2005, would exclude from gross income gain from the forced sale of property by eminent domain.[13]

An analysis of the current status of the interpretation of the "public use" doctrine in each of the 50 states should be undertaken as the subject of another research project once an opportunity to evaluate these legislative efforts has been reached. Currently, anyone practicing in the field should be attuned to developments in the state where their real estate is sited. While each state debates the public policy of eminent domain, perhaps of interest may be a rather novel approach to moderating the effects of eminent domain that has been proposed in the Kansas legislature. The bill specifically authorizes the use of eminent domain for economic development purposes; however, it requires the government to pay 125% of the fair market value for owner-occupied residential property and operating farms located outside of a city. The bill also requires that the government prepare an economic development project plan that provides the public with information about how the proposed project will generally benefit the community as a whole and that the size and scope of the project is reasonably necessary. The plan would have to be approved by a 2/3 majority vote of the governing body desiring to take the action and only after a finding that the property could not have been acquired through good faith negotiations.[14]

Finally, it should be pointed out that nothing in *Kelo* changes the basic process for eminent domain procedures. Land owners are to be awarded "just compensation" for the land taken.

CONCLUSION

Before governments are too quick to "fix" the so-called abuses of eminent domain, they should evaluate what happened in Wyandotte County. The Amicus brief of the National League of Cities provides the opportunity for that insight. The National League of Cities related, "In 1997, Kansas City, Kansas, and Wyandotte County had been struggling economically for almost fifty years." The National League of Cities argued that the speedway, made possible through eminent domain, created "wealth that has been spread throughout the region." In the League's brief, a study was cited that found "$89.3 million flowed into the local economy on race days at the track during the first season, and the larger metropolitan area reaped $150 million in economic activity, including $70 million in local workers' wages and $10 million in increased business tax collections." The League went on to say that:

> The most important economic impact of the speedway has come from the retail development that the speedway sparked, a 400-acre retail project called Village West that is headed toward 10 million visitors a year. Village West probably would not have been possible without the speedway. The Village West tourism district will create approximately 4,000 new jobs. Within the next several years, the state and local governments will receive $53 million in annual tax revenue from the development. The once moribund housing market has revived, with single-family housing starts increasing by 146% between 2000 and 2003. In the last seven years, tax rolls have swelled with $700 million worth of new real estate development. None of these benefits would have occurred without the use of eminent domain. Before the speedway existed, there were no market forces swirling around the 400-acre Village West site, which had previously been 'in the middle of a demographically barren nowhere. [15]

The Wyandotte County story may never have been written without the use of eminent domain. Will other communities be able to create similar "success" stories if the anti-*Kelo* backlash becomes a reality across the country? Some may argue that the *Kelo* case really only impacts the real estate professional engaged in large scale, mixed-use developments. As Jay Gitles and Scott Buser point out in a recent article:

> The *Kelo* model presents governments with a pragmatic approach to address the problems facing decaying urban communities. Some such communities have been left behind in favor of suburban or

> ex-urban development, which lately has been the path of least resistance for investment. There are valid concerns, however, that this powerful tool will come at the expense of small-scale developments or residential owners that stand in the way of economic development.[16]

Some may argue that the *Kelo* decision enables the so-called "big box" retailing to the detriment of small family retailing. The Wyandotte county example does feature two very large retailers, but they, in turn, attracted some smaller retailers and services establishments in recent additions to the area. So called "reforms" of the power of eminent domain may be a "slippery slope" because as with all regulations, unexpected consequences often result. In this case, the Supreme Court left the power to make the ultimate policy decision on the use of eminent domain with the states and local government. This appears to be the most responsible and reasonable place to make this public policy decision rather than some federal statute that sets policy for the entire nation.■

REFERENCES

1. Kelo, etal v. City of NewLondon, Connecticut, et. al. 545 U. S. _____ (2005) 1

2. http://www.nlc.org/content/Files/Natl%20Muncipal%20Brief.pdf

3. General Building Contractors, L.L.C. et. al v. Shawnee County, Kansas ___Kan. 525; 66 P.3d 873; 2003 Kan. LEXIS 191

4. http://www.wycokck.org/gen/wyco_generated_bin/documents/basic_module/Legends_Tenants.pdf

5. http://www.atg.wa.gov/releases/rel_EminentDomain_062405.html

6. States Ride Post-'Kelo' Wave of Legislation Eminent domain curbs introduced in 28 states, by Tresa Baldas, *The National Law Journal*, 08-02-2005

7. http://www.castlecoalition.org/HandsOffMyHome/

8. Berliner, Public Power, *Private Gain: A five-year, State-by-State Report Examining the Abuse of Eminent Domain* (2003)

9. House Resolution 340, passed 6/30/2005

10. H.R. 4128 (Private Property Rights Protection Act of 2005)

11. H.R. 3405 (Strengthening the Ownership of Private Property Act of 2005 "STOPP Act of 2005")

12. S. 1313 (Protection of Homes, Small Business, and Private Property Act of 2005)

13. H.R. 3268 (Eminent Domain Tax Relief Act of 2005)

14. Kansas Senate Bill 446

15. http://www.nlc.org/content/Files/Natl%20Muncipal%20Brief.pdf

16. Gittles, Jay and Buser, Scott, *Heartland Real Estate Business*, August 2005 France Publications, Inc.

Public Financing for Creating Affordable Housing Options in the United States

BY WINTFORD THORNTON

INTRODUCTION

This article will explore how to build affordable housing through using Low-Income Housing Tax Credits (LIHTC), Tax Incremental Financing (TIF), Homeownership Mortgage (HOME) Investment Partnership Act Program, Homeownership for People Everywhere (HOPE VI), and the National Park Services' (NPS) Federal Historical Preservation Tax Credits (HPTC). The Wisconsin Housing Economic Development Authority (WHEDA) is used as an example of how other state tax credit programs work throughout the United States. This article explores the use of tax credits as they are an essential part of the government's programs to encourage affordable housing. Subdivisions, condos, and apartment units can be built with these various sources of alternative financing. According to Malpazzi and Green (2002) there is no evidence that Section 42 developments in particular have a negative influence on surrounding property values, they may in fact enhance values even though they are perceived as a negative housing externality (26-28).

According to (HUD, 2006a, 26), in the third quarter of 2005, national homeownership rates for all households were at 68.8% and minority households were at 51.2%, revealing a nearly 18% gap. Rental vacancy rates at 9.9% versus homeowner's vacancy at nearly 2%, showing a significant shortfall of nearly 8% (HUD, 2006a, 26). Median rent was $922, which is a 10% decline from the previous year (HUD, 2006a, 19). In comparison, the 2006 Department of Housing and Urban Development's maximum fair market rent limits at the 60% level of the county median income, which in Dane County, Wisc., is $988 for a two-bedroom (Wheda, 2005b). Nationally, the apartment absorption rate was at 65%, which is a 27% decline from the previous year (HUD, 2006a, 19). Conventional fixed-rate 30-year mortgage are at 5.76%, a 2% decline from last year (HUD, 2006a, 21). According to (HUD, 2002c), there is an average of about 1,300 LIHTC projects and 90,000 units were placed in service in each year of the 1995 to 2002 period. Whereas the national housing inventory tallied in at 108,431 occupied units, which were placed in service in the 3rd quarter 2005, 74,588 were

About the Author

Wintford Harlen Thornton received a BS in Educational Policy and Community Studies and a BA in English Literature from the University of Wisconsin-Milwaukee in 1996. He served as a Congressional Intern to U.S. Representative Sam Coppersmith in 1992. He later earned a MS in Urban and Regional Planning in 2004 and anticipates completing a MS in Land Resources from the University of Wisconsin-Madison in 2006. He currently works at the University of Wisconsin Extension in Program Development and Evaluation as a Graduate Assistant/Evaluation Specialist. He can be reached at wintfordt@yahoo.com or wthornton@wisc.edu

owner-occupied and 33,843 were renter occupied, leaving 15,688 vacant units (HUD, 2006a, 25). Affordable housing start-ups are lagging demand.

This article will examine the process, practice, and politics of increasing the supply of affordable housing through these programs. Realistically, most affordable housing would not be built, if government financing were not available at the local, state, and federal level.

WHY USE INNOVATIVE FINANCING?

Besides finding another way to use other people's money to fund real estate deals, there are other benefits some of which (Vandell, 2006) mentions as investor's objectives and constraints such as:

- Making projects more dynamic and lucrative in terms of partnerships
- Putting less of your own equity in the deal
- Maximizing profit
- Making the project feasible
- Satisfying investment constraints (i.e., legal, cultural, ethical, availability of alternatives, wealth, and risk acceptance)
- Managing risk appropriately
- Obtaining non-pecuniary returns (social capital, prestige, respect, self-actualization)
- Maximizing tax shelters and capital gains
- Acquiring financing with less points
- Using the public financing process to secure political support and ownership
- Building community
- Acquiring assets and cash flow
- Receiving administrative expediency from the planning and development department
- Owning the building at reversion
- Providing supply and service utility
- Leveraging existing equity and debt

Using innovative financing that serves the same market demographic as your existing client bases and target audiences is a great benefit.

These are some of the solid and intangible, direct and indirect awards of using an innovative financing venture. With the advent of 60, 80 or 100% of the area median income stipulations for residents and homeowners in LIHTC- and TIF-funded projects, the client base is excellent for servicing new single and married teachers, police, social workers, and government workers, which make up the persistent middle class. With rising mortgage interest rates, labor mobility, and redevelopment succession these class and occupational groups will continue to drive the demand side of affordable housing.

THE NEED FOR AFFORDABLE HOUSING

On the other side of the demand-side picture, the persisting poor also need adequate housing outside of the existing and depreciating housing stock. The lack of affordable housing and the loss of employment precipitated and caused homelessness (Wood, Valdez, Hayashi, & Shen, 1990, 1050; Mills & Ota, 1989, 487; Johnson, 1989, 30-32 cited in Tusan, 1997). To prevent homelessness, affordable housing is necessary. Because welfare grants, women's wages, and child support payments are often insufficient to pay for rent (Zorza, 1991, 421 cited in Tusan, 1997), affordable housing is a crucial safety net to prevent homelessness. Fifty percent of women and children in the United States become homelessness when they flee domestic violence and many are turned away by overcrowded shelters and thereby forced to return to their abusers (Tusan, 1997, 29). Affordable housing could provide these women with shelter. Often Section 8 voucher holders cannot find affordable housing because of discrimination; voucher price ranges are lower than the market rate rent cost, and landlords' fear that Section 8 tenants will cause crime and property damage. Tusan (1997) states that nationwide 56% of poor renters spend at least 50% of their income on housing (26). Tusan (1997) asserts that "it would be unrealistic to assume that the job market can absorb all homeless and extremely poor individuals at a wage sufficient to meet current housing costs" (59). Tan (2000) says 64% of families receiving four or more types of assistance are single female high school dropouts with children under 18 (34). These single mothers spent 70% of their assistance on housing, food, and clothes (Tan, 2000, 33). Hence, increasing affordable housing stock is paramount.

CONTEXT

The National Park Service (NPS) is promoting affordable housing through its subsidy, the Federal Historical Preservation Tax Credit Incentives Program (HPTC). The HPTC is a partnership among the NPS, State Historical

Preservation Officers, and the Internal Revenue Service (IRS). This housing subsidy for low- and moderate-income people is a pittance compared to other housing subsidies like mortgage interest deduction. In 1995, the IRS distributed 82.5% of $58.3 billion of housing subsidies (mortgage interest deduction) to people with incomes over $200,000 (Dreier, 1997, 7). These tax subsidies are three times the 1996 budget for HUD, 23 times the private investments leveraged for HPTC in 2000, and 97 times the combined average annual $60 million budget (Gay, 1996, 39) for programs involving historic tax credits. This results in a budget inequity that reflects a political bias against low- and moderate-income people. This bias is codified in the tax code and in national housing priorities.

An example of creating a more equitable housing policy was attempted in the mid 1990s. Sen. Robert Packwood, Rep. Richard Armey, and former Presidential Candidate Steve Forbes wanted to limit the regressive and inequitable mortgage interest deduction (Dreier, 1997, 21). They were unsuccessful, but other tax policies in the past have encouraged affordable housing while preserving historic housing stock.

President Ford signed the first legislative act for tax credit incentives and gave the NPS through the Department of the Interior, the responsibility to review and approve of rehabilitation projects that maintained the historic character of a building. This tax reform was called the 1976 Tax Reform Act. It was passed by the Congress to preserve historic buildings through a five-year tax write-off of building rehabilitation cost.

Because these tax incentives were minimal, Congress made additional changes in the law in 1978, 1981, and 1986. In 1981, the Economic Recovery Tax Act boosted the usage of historic preservation tax credits from about $600 million in 1981 to approximately $2.5 billion in 1984. However, the 1986 Tax Reform Act reduced the amount of tax credits preservationists could receive, therefore the volume of HPTC projects dropped.

Today, an average of 30,000 buildings is added to the National Register of Historic Places annually. In 2000, affordable housing creation with the usage of historic preservation tax credits (HPTC) peaked at its highest point since 1976. Affordable housing accounts for 44% of the total HPTC units created since 1997. Between fiscal years 1992 and 2000, the number of HPTC applications doubled and historic tax credit investments increased by a multiple of 5. In the 18-year period between 1978 and 1996, Wisconsin had $300 million in HPTC investment work and 400 projects (Sewell & McCormick, 25). Comparatively, between 1995 and 2000, HPTC investments in New York, Pennsylvania, and Louisiana accounted for an average of $440 million in spending in each state. Since 1976, $30 million in HPTC was used in the City of Madison (Landgraf, 2002) for 134 buildings (NPS, 2006b). "Since 1976, the Historic Preservation Tax Incentives have rehabilitated more than 32,000 historic properties, stimulated over $33 billion in private investment, rehabilitated more than 185,000 housing units and created over 140,000 housing units, of which over 75,000 are low- and moderate-income units" (NPS, 2006a).

TAX CREDITS

Tax credits reduce federal tax liability on a dollar-for-dollar basis. For example, if an entity has a net tax liability of $1 million and possesses $1 million in tax credits, it can apply the $1 million in tax credits to create a zero net tax liability for itself. In comparison, a mere tax deduction only offsets gross income by the tax bracket (e.g., 31%, 39%) of the entity (corporation, partnership, or individual). Hence, a dollar of tax deduction is only worth the amount of the tax which the deduction saves on a dollar of income (e.g., 31% tax bracket equals .31 tax deduction per dollar of taxable income). This ability of a direct dollar-for-dollar offset by using tax credits has sophisticated investors, banks, insurance companies, investment companies, and other large businesses buying tax credits from affordable housing developers. These tax credits will improve the earnings statements of such investors, banks, and other large businesses.

First, the developer is awarded tax credits from the NPS and/or WHEDA to finance the housing construction. Second, the developer uses the tax credits as equity and sells the tax credits to a financial institution. Currently, HPTC sell at 95 cents to 99 cents on the dollar and LIHTC sell at about 78 cents on the dollar. The marketplace of supply and demand determines the price of tax credits. Financial institutions use tax credits to reduce their tax liability.

The following will show how tax credits raise money/equity from the National Park Service's HPTC and WHEDA's LIHTC. An example of a financing structure for making affordable apartments out of a historic building in the City of Madison is shown in Appendix 1.

For example, the rehabbing of a building suitable to house 100 people could cost at a minimum of $1.2 million in total or $12,000 per unit. The developer using LIHTC from WHEDA that qualified for a 9% credit would receive $1.2 million * .09 to create $108,000 in equity per year for ten years for a grand total of $1.08 million in additional funds. For example, that same developer can also use a 20% HPTC package from NPS and apply it to the qualified rehabilitation expenses, for example, $1 million * .20 to generate $200,000 for a total $1.28 million. According (Primoli, 2006) the IRS Qualified rehabilitation expenses are:

> Any expenditure for a structural component of a building will qualify for the rehabilitation tax credit. Treasury Regulation 1.48-1(e)(2) defines structural components to include walls, partitions, floors, ceilings, permanent coverings such as paneling or tiling, windows and doors, components of central air conditioning or heating systems, plumbing and plumbing fixtures, electrical wiring and lighting fixtures, chimneys, stairs, escalators, elevators, sprinkling systems, fire escapes, and other components related to the operation or maintenance of the building. In addition to the above named "hard costs," there are "soft costs" which also qualify. These include construction period interest and taxes, architect fees, engineering fees, construction management costs, reasonable developer fees, and any other fees paid that would normally be charged to a capital account.

Eighty percent of affordable housing creation has come from tax credit deals, which are considered to be more conservative, stable, and predictable than the unsubsidized rate of the multifamily (apartment) housing market (Bergsman, 2002, 41). When big businesses buys tax credits, they do not want to capture the rental income from low to moderate properties, nor do they want to own it. The developer possesses the cash flow from the property's rental income. Tax credit investors agree to revert the property to the developer for pennies on the dollar at the end of the WHEDA's mandatory holding period of 15 years (Landgraf, 2002). Big business is only interested in keeping the apartments running to avoid having to give back the tax credits to WHEDA that they bought from the developer.

HISTORICAL PRESERVATION TAX CREDITS

The use of the HPTC program has made it possible to rehab buildings that give towns and cities a sense of place and pride, and special character. Factories, schools, hotels, apartments, churches, warehouses, and office structures have to be restored in a manner respecting their historic nature. The HPTC program creates jobs for specialized craft people and journeymen because rehab work is 75% labor and 25% materials (Landgraf, 2002). Indirectly, the use of HPTC can increase property values and property tax revenues (NPS, 2006a; Gay, 1996, 40). Gay (1996) states rehabbing "builds strong neighborhoods," reverses "population decline," attracts "role models" and creates "thriving cities" by "attracting the middle-class back to the city" (40). The awarding of HPTC encourages developers to rehab when additional funding is needed to complete a development. Gay contends that rehabbing does not “gentrify the neighborhood” (Hutch, 2002, 12) but reverses segregation because it is not just an “interest only to white people” (Gay, 1996, 40), however several others believe that the displacement of old standing residents creates a segregated community by race, income and class (Adelman, Smith, and Cheng, 2003; Turetsky, 2003; Gotham, 2005; Knoff, 1990; Hamnett, 2000; Abu-Lughod, 1994; Anderson, 1990; Atkinson, 2000).

In order to access HPTC, a rehabbed building must be approved or "certified" as a historic structure or located in a historic district. The rehabbing must be consistent with the historic character of the building. The NPS mentions the rehabbing "must not damage, destroy or cover materials or features, whether interior or exterior, that help define the building's historic" nature (NPS, 2006a). The rehabbing projects must met the 10 Standards (36 CFR Part 67) to be eligible for HPTC and certification. The NPS mentions that "the Standards apply to historic buildings of all periods, styles, types, materials, and sizes" (NPS, 2006a). They apply to both the exterior and the interior of historic buildings. The 10 NPS Standards also encompass related landscape features and the building's site and environment as well as attached, adjacent, or related new construction (Appendix 2). Developers should apply for historic certification before beginning work. Work undertaken before approval can compromise certification.

Developers can quickly identify potential historic buildings through their State Historic Preservation Officer (SHPO) which has a list of potential and historic buildings in the state. The SHPO will go out with a developer to look at property if it is not on their historic property possibilities list. For example, in the City of Madison, the SHPO office is in the State Historical Society Library at the University of Wisconsin-Madison. The process of get-

ting a building listed for affordable housing purposes involves getting the SHPO to nominate the property. The SHPO is usually enthusiastic when developers want to rehab and will fill out the nomination forms and route them for review at the state board. The state board will make a recommendation and if it is approved, and the current owner does not object to the nomination, then it is forwarded to the NPS for further consideration.

HPTC are allocated at 20% for the certified rehabilitation of certified historic structures and 10% for the rehabilitation of non-historic, non-residential buildings built before 1936. A HPTC of 20% means that 20% of the total eligible rehab cost will be given back to the developer in the form of a tax credit, which can be sold to a financial institution for equity financing. A 10% HPTC works the same way. The 20% HPTC can be used to rehab commercial, industrial, agricultural, or rental properties, but is not available for exclusively owner-occupied dwellings. In order to qualify for the 20% HPTC a building must be depreciable (income producing) and rehabbing must be substantial as shown in exceeding $5,000 in cost or the adjusted basis of the building during a 24-month period. However, rehabbing can occur on a 60-month schedule if the work is completed in stages with plans and specs. The property must be placed in service (used) for at least five years and it must have at least a Part 1 (evaluation of historic significance) preliminary certification determination. This means that the building does not have to be listed on the National Register of Historic Places to claim the HPTC; the building just has to be eligible (Landgraf, 2002). For Part 1, Part 2 and Part 3 of the Historic Preservation Certification, a developer would hire an experienced architectural firm to seek the certification. Most importantly, the rehab expenses that are not eligible for HPTC funding are the costs of acquiring or furnishing a property, new additions that expand the existing property, new building construction, parking lots, sideways, and landscaping. Only the work undertaken to rehab the building, professional fees, site survey fees, and reasonable and related construction costs that add to the basis of the property are eligible for HPTC. HPTC can be claimed on IRS Form 3468 before (when the substantial rehab test is met) or after the year the building is utilized. If the developer does not receive certification in 30 months after claiming the credit, then the historic assessment can be extended or the credit recaptured. HPTC can be delayed being used for one year or carried forward for 20 years. One way to use the 10% HPTC for affordable housing is to rehab the target property to use as commercial space, then wait until the placement in service period expires in five years, and then convert the commercial space for affordable housing use. The benefit of using the 10% HPTC is that there is no formal review process for rehabbing non-historic buildings. However, in the initial rehabbing three requirements must be adhered to: one, at least 50% of the building's existing walls are retained in place as external walls; two, at least 75% of the building's current exterior walls are kept as internal or external walls; and three, 75% or more of the properties existing internal structural framework remain in place (IRC Section 47(c) (iii)).

WHEDA AFFORDABLE HOUSING TAX CREDIT PROGRAM

"Created by the Tax Reform Act of 1986, the LIHTC program gives States the equivalent of nearly $5 billion in annual budget authority to issue tax credits for the acquisition, rehabilitation, or new construction of rental housing targeted to lower-income households" (HUD, 2006b). "There are nearly 22,000 LIHTC projects and more than 1,141,000 housing units placed in service between 1987 and 2002" (HUD, 2006b).

WHEDA's affordable housing program operates under Section 42 of the Internal Revenue Code of 1986 to allocate, award tax credits to developers. These developers must also independently qualify under Section 42. This program allows developers and Community Housing Development Organizations (CHODO) (PLGP, 2000, 247) to have equity access to finance affordable housing projects. Nationally, the government increased the availability of tax credits to 40% (Hutch, 2002, 12). In 2005, WHEDA will have approximately $10.2 million of tax credit authority. It is based on the $1.85 (2005) per capita figure which is adjusted for inflation with the consumer price index. WHEDA divides this pool of tax credits into five set-asides: general fund at 35%; non-profit fund at 10%; preservation at 40%; and rural set-aside is 10%, with a reserve set-aside is 5% of the total tax credits allocated. The maximum tax credit allocation per development is $725,000. Currently, scoring a minimum threshold of 175 or higher points is needed. In 2005, the score ranges were 196-308 points in the general category, 225-314 points in the non-profit category, 200-305 points in the preservation category, 244-292 in the rural category and 219-314 in the additional credit category (Ash and Boerigter, 2005, 7). The cutoff scores by set-aside in points for general was 278, non-profit was 275, preservation was 257 and rural

was 244 (Ash and Boerigter, 2005, 8). Applications need to demonstrate market strength via a market study by a WHEDA-approved market study consultant and passing an initial application review and meeting with WHEDA. In order to win the tax credits, a developer's plans will change according to what WHEDA expects and values. These expectations that promote quality housing are given more points in the application screening process. This competitive process is similar to other state administered tax credit programs across the U.S. The average credit amount for projects moving forward is $384,291 and the average amount per unit is $8,264 (Ash and Boerigter, 2005, 4). A successful developer will submit a self-scoring exhibit to WHEDA (Appendix 3).

According to IRS revenue ruling (2004-82):

> Section 42(h)(6)(A) provides that no credit will be allowed with respect to any building for the taxable year unless an extended low-income housing commitment (as defined in § 42(h)(6)(B)) is in effect as of the end of the taxable year. Section 42(h)(6)(B)(i) provides that the term "extended low-income housing commitment" means any agreement between the taxpayer and the housing credit agency which requires that the applicable fraction (as defined in § 42(c)(1)) for the building for each taxable year in the extended use period will not be less than the applicable fraction specified in the agreement and which prohibits the actions described in subclauses (I) and (II) of 42(h)(6)(E)(ii).

The extended period is 30 years. The IRS is mandating the review and renegotiation of thousands of non-compliant extended use agreements with state allocating agencies better know as land-use restricted covenants on low-income housing tax credit projects. State tax credit authorities are following suit; "[o]wners of developments funded with competitive [LIHTCs]" cannot have an opt-out provision from the mandatory 30-year holding period (Wheda, 2005a, 5). This law helps preserve the supply of affordable housing stock.

HOPE VI

In 1993, the HOPE VI Program was created by the Department of Housing and Urban Development (HUD). HOPE VI permits public housing authorities (PHA) to use a combination of private financing, LIHTC, private mortgages, other local/state funding and public housing development funds to develop public housing units owned by an entity other than the PHA. The goal of mixed-finance development is to maximize the leveraging of other funds (e.g., TIF, LIHTC, & HPTC) both public and private to create mixed-income communities (HUD, 2001d, 1). Since 1993-2005, HOPE VI has made 231 revitalization grants totaling approximately $5.7 billion to 132 housing authorities in more than 37 states plus the District of Columbia and Puerto Rico (HUD, 2004f; 18, HUD, 2004h; HUD 2005g). Unfortunately, some developers avoid using HOPE VI, because of the time investment to complete the administrative paperwork, the scarcity of funds, and the fact that awarding HOPE VI is political (Landgraf, 2002). HOPE VI rules state "at a minimum, the Public Housing funds provided for construction may only be used to construct and/or rehabilitate units that will function as public housing and a pro rata share of their common area costs" (HOPE VI, 2001, 4). Prospective Section 8 tenants do not have a federal preference; the local PHA can adopt a different admission process for renting in the rehabbed housing. The PHA can provide capital and/or operating assistance to privately-owned development units. The privately-owned units must be available for use as public housing by low-income families for a minimum of 40 years. Turestsky (2003) lists several needed improvements to HOPE VI such as, replacing the high density public housing units with low-density units on a one-to-one basis when HUD works with developers to revitalize house stock; desegregating housing; involve residents in their community redevelopment; and penalize PHAs that allow their properties to deteriorate to receive a preference in the HOPE VI selection process (8). Building mixed-income communities will provide the opportunity to desegregate housing.

THE PROCESS OF SUCCESS BETWEEN DEVELOPERS AND THE CITY

Developers should seek local government assistance beyond possible zoning problems, because they have "much to offer in [development] arrangements, including site control, development approvals, equity, and financing" (PLGP, 2000, 247). Developers should observe a community's neighborhood plan and cooperate and compromise with the wishes of the city's planning department and neighborhood groups. Briggs (1997) says the working for the collective good necessitates “trust and understanding” and “requires ties among disparate groups and individuals, built up over time”(113). Local government planners have to decide on where and how to best investment public

monies because "only about one dollar of housing subsidy is currently available for every three to four dollars of housing need" (PLGP, 2000, 257). This housing subsidy used for affordable housing can come from Tax Incremental District (TID) or loans from the Community Development Authority (CDA). Therefore, it is important that public input from members of general public and power brokers is sought out. The developer and planners can do some consensus building to create options and alternative solutions with the community so that the affordable housing is viewed as an acceptable use of a rehabbed historical building. One process to involve the public in deciding how an affordable housing apartment is going to fit in the neighborhood is to involve interests as early as possible to prevent a backlash that will kill the housing project (PLGP, 2000, 430-431). This participation process should do the following: be tailored to citizens' needs, include the affected parties, identify and nurture shared interests, share credible information, provide impartial and collaborative leadership, maintain momentum (time is money for the developer), and involve the media (PLGP, 2000, 432-436) to mold public opinion. The Practice of Local Government Planning (2000) book outlines that "when participants trust each other and recognize the legitimacy of their respective goals in the context of ongoing dialogues, promises, [and] trade-offs . . .taken to build agreement, the formal definition of agreement often proves less important than the process" (427).

Briggs (1997) mentions that:

> Cities with affordable-housing systems rich in social capital will be the 'winning horses' in an era of increasing competition ushered in by devolution. These better-functioning cities are the cities where housing developers and managers, government agencies, foundations, and intermediary groups are connected by a variety of dense ties, including overlapping board memberships, career paths. . . that span the system-ties that facilitates trust, high-skill cooperation and even appropriate risk taking that depends on close coordination and trust to make scarce dollars go a long way .

Since "there is rarely consensus regarding how scarce housing subsidies should be allocated . . . decisions [made] the cost of operating the program . . .amount of leverage . . .likelihood of success, cost of the program, and the availability of long-term local political support" cooperation among developers, planners and the communities where affordable is built is paramount to managing risk and getting the project built (PLGP, 2000, 256; Grasskamp, 1981).

Table 1—Municipal Financial Assistance for Residential Development

Specialty street lighting	Terrace landscaping
Improved intersections	Traffic calming
Waste receptacles	Burial of utilities and pedestrian lighting
Acquisition of property such as entire parcels, rights-of-way, & air space	Razing of building
Construction site preparation	Environmental remediation
Intensive landscaping of sites	Parking lot screening
Seating areas	Canopy trees with or without tree-grates
Architectural and engineering work to the preparation of development plans for properties	

Source: City of Madison (June 3, 2002). "Project Plan for Tax Incremental Finance District #30: East Washington Avenue at Hawthorne." Department of Planning and Development. Community and Economic Development Unit, 1-4.

TAX INCREMENTAL FINANCING

Developers who want cooperation in building affordable housing need to be involved in the community. In Wisconsin, the TIF duration period is 28 years (as of 2004); previously it was 21 years. The municipality using a TIF will float a public bond issue to initially finance the TIF. This debt financing is provided to a developer for a period of 12 years (as of 2004); previously it was 7 years. This public debt investment is offered by the municipality to stimulate economic growth and development for a specific geographic area, such as a neighborhood, a zip code, or corridor. Specifically, the development project offered TIF will throw off sales and/or property tax revenue to pay off the original bond issue so that other projects (department stores, regional shopping centers, even housing developments) can borrow funds generated by the TIF Developers. TIF negotiations can yield outstanding benefits and significant cost reductions. For example, finding a historic building in a Tax Incremental District (TID) in

the City of Madison to rehab for affordable housing could result in the developer acquiring grants, loans or direct assistance (City of Madison, 2002, 1-4) in the areas listed in (Table 1).

Eligible developments must demonstrate that without TIF assistance, the project could not occur or be financially feasible. The former benefits could be provided by the city because affordable housing development satisfies the TIF objectives, stimulates rehabilitation of dilapidated building, and creates mixed-use in-fill redevelopment, and follows the recommendations of adopted neighborhood plans. The City of Madison's TIF policies also concur with affordable housing, which are to assist in the revitalization of historic or architecturally significant or deteriorated buildings. In the City of Madison, TIF assistance is granted to housing developments if residents' households are 80% or lower than Dane County's median income, adjusted by family size and have a component of rent not exceeding 30% of monthly gross income. The affordable housing will generate property taxes to pay off the debt to finance the development project. It is important for the developer to get into a new tax incremental district whenever possible to get the maximum increment benefit.

COMMONALITIES IN PROGRAM REQUIREMENTS OF LIHTC, NPS, HOME, HOPE VI, AND TIF THAT MAKE AFFORDABLE HOUSING WORK

1) HOME Loans and LIHTC tax credits can be used together and can qualify for the 9% tax credits if the HOME funds come from Community Development Block Grant (CDBG) funds (Landgraf, 2002, 320).

2) LIHTC and Historic Preservation Tax Credits can be used together (WHEDA, 2005, xvii; NPS, 2006a).

3) HOME Loans require 40% of units be at least 50% of County Median Income (CMI) and LIHTC require that 40% of units be at least 60% of CMI or 20% of units be 50% of CMI. Choosing a tenant mix that makes 40% of units at 60% of CMI would satisfy the requirements for both programs. For HOME funds to be used in the eligible basis of the 9% or 4% tax credit, 40% of the units would be at least 50% of CMI.

4) Also if HOME loan is used to acquire/rehab a building, the development can receive both the 9% tax credit and extra 30% of basis for being in a Qualified Census Tract (QCT).

5) After five years, a building rehabbed using HPTC can be put to any use, the building can even be demolished, which is unlikely to occur. This could occur if the developer wanted the land underneath the building to be developed or sold. The developer would need petition for the city to change any historic preservation easement restrictions. Only after a mandatory five-year in-service period (NPSa 2006), a developer that received a 10% basis for the HPTC can rehab a building to use it as a rental property. Otherwise during the first years, a developer that receives the 10% basis for HPTC cannot use the building as a rental property (NPSa 2006). In this particular situation, after the mandatory five-year period has expired, the developer can apply and use LIHTC and HOME Loan funds to renovate and adapt the historic building to be used for rental property.

6) Under the 20% HPTC rule, LIHTC and HPTC can be used together to acquire/rehab a historic building for rental property use.

7) All affordable housing using subsidy programs can accept Section 8 vouchers, which could quickly be used to lower vacancy rates. Section 8 tenants can satisfy the 20% of low-income residents at 50% or less of County Median Income (CMI) or 40% low-income residents at 60% or less of CMI.

PROBLEMS DEVELOPERS ENCOUNTER

- The proforma statement for the development must take in several considerations with government financing.

- Projects receiving post-1989 tax credit allocations, the low-income rent cannot exceed one-half of the average gross rent for non-low-income units (Landgraf, 2002, 328).

- The 30% increase in tax credits for developments in a QCT does not apply where the developer elects to use a 9% basis for tax credits in tandem with below-market loans under the HOME program (Section 2.02 (B)(2)(a)) (Landgraf, 2002, 347).

- The IRS will exclude state and local grants from eligible basis (Section 8.04), therefore these grants can be structured as loans from a non-profit or housing authority whenever possible (Landgraf, 2002, 347). If the developer is working with a non-profit, the non-profit can apply for

a grant for the project and then loan the grant to the developer (Landgraf, 2002, 306).

CONCLUSION

Public-private partnerships with the developer being the general partner and the government finance bureaucracy being the limited/silent partner can yield new housing stock for the community and cash flows with attractive Internal Rate of Returns for developers. Even with the time invested to prepare long government documents and the opportunity cost of pursuing tax credits in a state-wide competition, the process is worthy of being considered because of the present value of the financial awards gained through innovative financing. These alternative and innovative mixed-financing public-private partnership programs do work, but housing units financed with these funds are not keeping up with demand and are not crowding out supply (depending on local price elasticity of supply and demand, income elasticity of demand).

On December 30, 2005, President George W. Bush authorized $11.5 billion of out of $55 Billion Gulf Coast aid package through HUD's Community Development Block Grant Program to specifically assist efforts for the long-term recovery and rebuilding of several Gulf Coast states: Alabama, Florida, Louisiana, Mississippi, and Texas. Fifty-five percent of the funding was allocated toward unmet housing needs in areas of concentrated distress (HUD, 2006e).

This is an opportunity for public financing of private residential real estate ventures for the reconstruction of damaged and destroyed housing stock after Hurricanes Katrina, Rita, and Wilma for the coastal areas of Mississippi and Louisiana, and through out the plethora of areas where evictees relocated and resettled. Rather than building in areas that are economically and racially exclusive.

Government and housing does not have to mean minority and poor, but often it has. The government fosters racial housing integration through mixed income housing guidelines to house tenants with household incomes between 60 to 100% of the Area Median Income, but it also offers an extra 30 percent financial incentive for development in low income areas using LIHTC, which in effect fosters *de jure* racial segregation. This is because some development is in areas where middle and higher income populations have resisted living, with the exception of gentrification. The racial housing patterns today, as in past, reflect high racial dissimilarity (Quinn and Pawasarat, 2003). In the 1930s, there was a pervasive fear that if one or two Black families moved in a predominately white neighborhood, property values would decline (FHA, 1938; Adelman, Smith, and Cheng, 2003). See the play *A Raisin in the Sun* for a better understanding of housing discrimination. After lobbying and testimony by from representatives from the American Institute of Architects (AIA), the National Association of Real Estate Boards (NAREB), and lending industry on the Federal Reserve Board of Governor Member Marriner S. Eccels' subcommittee (Pope, 2002), the 1934 Federal Housing Administration (FHA) Underwriting Act passed and it codified racial segregation perceptions and language into law and it became widely accepted and adopted by the realty and development community. This was done to deter blacks from living in white communities, which excluded low-income areas and neighborhoods that have reached the tipping-point. To illustrate this point, Vandell (1995: 302) quotes directly from the 1938 FHA Mortgage Underwriting Manual, secs, 911, 929, 937:

> Areas surrounding a location are investigated to determine whether incompatible racial and social groups are present, for the purpose of making a prediction regarding the probability of the location being invaded by such groups. If a neighborhood is to retain stability, it is necessary that properties shall continue to be occupied by the same social and racial classes. A change in social or racial occupancy generally contributes to instability and a decline in values.

The 1934 FHA Underwriting Act created and preserved predominately white neighborhoods through provided funding and underwriting in order to get residential mortgages in urban and suburban areas. "Local and national real estate boards followed the lead of the FHA in adopting a code of ethics stating 'a Realtor should never be instrumental in introducing into a neighborhood … members of any race or nationality . . .whose presence will clearly be detrimental to property values in that neighborhood'" (Gotham, 2000, 19 cited in Helper, 1969, 201). The space development community (e.g., banks, appraisers, developers, realtors, agency officials) institutionalize the FHA racial preferences through assigning an evaluative hierarchy that ranked all-white neighborhoods as having the highest appraisal values, with racially integrated communities having second highest appraisal values and all-black and latino neighborhoods having the lowest appraisal values (Gotham, 2000, 19). Between

1934-1962, $120 billion in residential home loans were made, of which Black households accounted for 2% (Adelman, Smith, and Cheng, 2003).

The property appraisal method used by the real estate community asked several evasive questions on the race, occupation, and income of residents and applicants (Adelman, Smith, and Cheng, 2003; Pope, 2002). The application of this criteria in property valuations created a disparate impact and treatment on blacks, Jewish and Latino populations, which consequently resulted in the redlining of neighborhoods with the making of Residential Security Maps that were placed in City Survey Files and Realtors and appraisers offices and were used by the lending industry to establish real estate values (Adelman, Smith, and Cheng, 2003; Pope, 2002). Restrictive covenants were placed on express easements, deeds, titles or incorporated by reference to subdivision plans by dedication to bar selling to blacks, Jewish and Latino persons. Neighborhoods were graded A with the color green, B was assigned blue; C was reserved for yellow, and red was dedicated for D (Adelman, Smith, and Cheng, 2003; Pope, 2002). Black neighborhoods were rated as a moral risk with the letter D as the lowest rating, hazardous.

Despite the new housing opportunities provided through HOPE VI, NPS, LIHTCs, and TIFs; racial and spatial residential segregation persists (Dawkins, 2004; Rosenbaum and Argeros, 2005; McClure, 2005). Malpazzi asserts that ethnic and cultural segregation has several causes such as "whites prefer to live with other whites," overt discrimination in real estate brokerage and finance, and black home-sellers receive lower home purchase prices versus white home owners (2003: 163-170). Turetsky (2003, 9) pointed out that "many multifamily properties designated for the LIHTC are in segregated neighborhoods. The LIHTC should not amount to a government subsidy of segregation. As the program expands, HUD should work with residents and localities to ensure that the tax credit works in a way that both provides housing opportunities and desegregates communities." The danger of a "government subsidy of segregation" is also demonstrated by the fact that 54 percent of the tax credit units are focused in high urban minority and high poverty census tract areas, 26 percent in poverty stricken suburban areas and 20 percent in rural hinterlands (Turetsky, 2003, 6-7). History does not have to repeat itself. Although the government offers an incentive of 30% extra basis for LIHTC projects, these financing programs can be used anywhere, including high income areas to build subdivisions, condos, and apartment buildings. Developers should build public-partnership residential housings in proximity to water, scenic areas and universities, in locations with high demand; where development is already well established; near to high-quality competition and in walking distance from commercial activities which will increase property values rather than in isolation with concentrated clusters minority and low-income residents.■

REFERENCES

Abu-Lughod, J. L. (Ed.). (1994). *From Urban Village to East Village: The Battle for New York's Lower East Side*, Oxford, UK; Cambridge, USA : Blackwell.

Adelman, L, (Executive Producer), Smith, L.M. (Episode Producer), and Cheng, J. (Series Co-Producer). (2003). *Race: The power of an illusion*. Episode Three: The House We Live In. [Videotape]. San Francisco: CA: California Newsreel.

Anderson, E. (1990). *Streetwise: Race, Class and Change in an Urban Community* University of Chicago Press, Chicago.

Ash, M. and Boerigter, B. (2005, March 18). WHEDA: 2005 Wisconsin Tax Credit Scoring and Application Summary. Multifamily Development. Last assessed by Internet on March 6, 2006. http://www.wheda.com/cat_tca/devfocusgroup

Atkinson, R. (2000). "The hidden costs of gentrification: displacement in Central London", *Journal of Housing and the Built Environment* 15 (4):307-326.

Bergsman, S. (2002, October 21). "The ground floor: Affordable housing's tax credits lure investors." Barron's. 82, 42, 41.

Bratt, R. (1994). Confronting the management challenge: affordable housing in the nonprofit sector. Community Development Research Center. Graduate School of Management and Urban Policy. New School for Social Research. In Husock, H. *Repairing the ladder: Toward a new housing policy paradigm* (Policy Study No. 207), pp. 9-20.

Briggs, S. X. (1997, Summer). "Social capital and the cities: Advise to change agents." *National Civic Review*, 86, 2: 111-118.

Brooks, M. (2002). Planning theory for practitioners. Planners Press: Chicago, IL.

Brown G.W. & Davidson S. (1978). "Social class, psychiatric disorder of mother, and accidents to children." *Lancet*; 378-81. In Ian Roberts & Barry Pless. (1995, Oct. 7). "Social policy as a cause of childhood accidents: The children of lone mothers." *British Medical Journal*; 311: 7011-925, Intl. Ed., London.

City of Madison (June 3, 2002). "Project Plan for Tax Incremental Finance District #30: East Washington Avenue at Hawthorne." Department of Planning and Development. Community and Economic Development Unit, 1-4.

Cobb S. (1976). "Social support as a moderator of life stresses." Psychosom Med; 38:18-29. In Ian Roberts & Barry Pless. (1995, Oct. 7). "Social policy as a cause of childhood accidents: the children of lone mothers." *British Medical Journal*; 311: 7011-925, Intl. Ed., London.

Dawkins, C. (2004). Recent evidence on the continuing causes of black-white residential segregation. *Journal of Urban Affairs*, Vol. 26: 3. 379-400.

DuBois, W.E.B. (1899). "*The negro problems of Philadelphia*" from The Philadelphia Negro. In Richard LeGates and Frederic Stout, eds. *The City Reader*. 2nd Ed. London and New York: Routledge: 2000: 58.

Ehrenreichs, Barbara and John (1978). "The Professional-managerial class." In *Between Labor and Capital*: Political Controversies Series, No. 1. (Ed). Pat Walker. Boston: South End Press.

Federal Housing Administration. *FHA Underwriting Manual*. 1938. Washington, DC. In Vandell, K.D. "FHA Restructuring Proposals: Alternatives and Implications." Housing Policy Debate. 6, 2: 299-393.

Gay, P. (1996). "Urban treasures or urban nightmares?" CRM, 20:6:39-41.

Gotham, K.F. (2005, June 7). “Tourism gentrification: The case of new Orleans' vieux carre (French Quarter).” Urban Studies, 42, 7: 1099-1127.

Graaskamp, J.A. 1981. *Fundamentals of Real Estate Development*. Development Component Series. Washington, D.C.: Urban Land Institute.

Green, R.K., Malpezzi, S., and Seah, Y. K. (2002). "Low Income Housing Tax Credit Housing Developments and Property Values." The Center for Urban Land Economics Research. University of Wisconsin. Last assessed by Internet on February 28, 2006. http://www.bus.wisc.edu/realestate/pdf/pdf/LITC%20Popular25.pdf.

H.R. Conf. Rep. No. 842, 99th Cong., 2d Sess. (Conference Report (TRA '86) at II-92)). In *A developer's guide to the low income housing tax credit: how much credit can you obtain for your property-the federal rule*. p. 25. In Landgraf, Tom. (Fall 2002). University of WI-Madison. RE 611, p. 329.

Hall L.A., Williams C.A., & Greenberg RS. (1985). "Supports, stressors and depressive symptoms in low income mothers of young children." *American Journal of Public Health*; 75:518-22. In Ian Roberts & Barry Pless. (1995, Oct. 7). "Social policy as a cause of childhood accidents: The children of lone mothers." *British Medical Journal*; 311: 7011-925, Intl. Ed., London.

Hamnett, C. (2000). "Gentrification, postindustrialism, and industrial and occupational restructuring in global cities." In *A Companion to the City*. (Eds.). G. Bridge and S. Watson. Oxford: Basil Blackwell, pp. 331-341.

Hansberry, Lorraine. (1959). *A Raisin in the Sun*. New York: New American Library.

Helper, R. (1969). Racial Policies and Practices of Real Estate Brokers. Minneapolis: University of Minnesota Press. In Gotham, K. F. (2000). Separate and Unequal: The Housing Act of 1968 and the Section 235 Program. Sociological Forum, 15, 1: 13-37.

Department of Housing and Urban Development. (2006a). U.S. Housing Market Conditions. 3rd Quarter, 2005. Office of Policy Development and Research. Pages 1-86. Last assessed by Internet on February 28, 2006. http://www.huduser.org/periodicals/ushmc/fall05/USHMC_05Q3.pdf

Department of Housing and Urban Development. HUD USER. (2006b). Last assessed by Internet on February 28, 2006. http://www.huduser.org/datasets/lihtc.html#data

Department of Housing and Urban Development. (2002c). *Updating the Low-Income Housing Tax Credit Database: Projects Placed in Service through 2002*. Office of Economic Affairs. Last assessed by Internet on February 28, 2006. http://www.huduser.org/Datasets/lihtc/report9502.pdf

Department of Housing and Urban Development. (2001d, March). "HOPE VI Guidance: Mixed-finance public housing development." Pages.1-6. Last Assessed by Internet on March 2, 2006. http://www.hud.gov/offices/pih/programs/ph/hope6/mfph/mfdev.pdf

Husock, H. (1996). *The history of housing reform: Ignoring the rules of the housing ladder*. In Husock H. *Repairing the ladder: Toward a new housing policy paradigm* (Policy Study No. 207), pp. 9-20.

Department of Housing and Urban Development. (2006e, January 26). Press Release 06-011. Jackson announces distribution of $11. 5 billion in disaster assistance to five gulf coast states impacted by hurricanes. Last Assessed by Internet on March 6, 2006. http://www.hud.gov/news/release.cfm?CONTENT=pr06-011.cfm

Department of Housing and Urban Development. (2004f, November). HOPE VI Revitalization Grants Fiscal Years 1993-2003. Pages 1-18. Last assessed by Internet on March 6, 2006. http://www.hud.gov/offices/pih/programs/ph/hope6/grants/revitalization/rev_grants_all.pdf

Department of Housing and Urban Development. (2005g, November,4). HOPE VI Fiscal Year 2005 Revitalization Grants. Last assessed by Internet on March 6, 2006. http://www.hud.gov/offices/pih/programs/ph/hope6/grants/revitalization/05/grantawardees.cfm

Department of Housing and Urban Development. (2004h, June 15. HOPE VI Fiscal Year 2004 Revitalization Grants. Last assessed by Internet on March 6, 2006. http://www.hud.gov/offices/pih/programs/ph/hope6/grants/revitalization/04/2004rev_grantawards.cfm

Hutch, D. (2002). Symposium: "The rational for including disadvantaged communities in the smart growth metropolitan development framework." *Yale Law & Policy Review*. 20, 353:1-5.

Huxley, M. & Yiftachel, O. (2000). "New paradigm or old myopic? Unsettling the communicative turn in planning theory." *JPER*, 19: 333-342.

Internal Revenue Service. Internal Revenue Code. Treasurer Regulations 1.48-1(e)(2).

Internal Revenue Service. Internal Revenue Code. IRS revenue ruling (2004-82): Last assessed by Internet on February 28, 2006. http://www.irs.gov/pub/irs-drop/rr-04-82.pdf

Johnson, A. (1989). "Female-headed homeless families." Affilia. 4, 23:30-32. In Tusan, Christina. (May 1997). "Homeless families from 1980-1996: Casualties of declining support for the war on poverty." *Southern California Law Review*. 70 S. Cal. L. Rev. 1141, pp.27, 28.

Joint Committee on Taxation of the U.S. Congress. (1994, November 9). "Estimates of federal tax expenditures for fiscal years 1995-1999." Washington. DC: Government Printing Office. November 9. In Dreier, Peter. (Winter 1997). "The new politics of housing." *Journal of the American Planning Association*. 63,1:1-21.

Knopp, L. (1990). "Exploiting the rent gap: The theoretical significance of using illegal appraisal schemes to encourage gentrification in New Orleans", *Urban Geography*,11, pp. 48-64.

Kravitz, A. S. (1970). "Mandarinism: Planning as a handmaiden to conservative politics." In Planning for politics: Uneasy partnership, eds., T.L. Beyle and G. T. Lathrop. New York: Odyssey Press.

Landgraf, T. (Fall 2002). UW-Madison. School of Business. Department of Real Estate and Urban Economics. Residential Property Development Reader.

Malpazzi, S. and Green, R. (2003). *A Primer on U.S. Housing Markets and Housing Policy*. Washington, DC: The Urban Institute Press.

McClure, K. (2005). "Deconcentrating poverty through homebuyer finance programs." *Journal of Urban Affairs*, Vol. 27:3. 221-233.

Mills, C. and Ota, H. (1989). "Homeless women with minor children in the Detroit metropolitan area." Social Work. 34, 485: 487. In Tusan, Christina. (May 1997). "Homeless families from 1980-1996: Casualties of declining support for the war on poverty." *Southern California Law Review*. 70 S. Cal. L. Rev. 1141, pp. 27, 28.

Mueller B.A., Rivara F.P., Shyh-Mine L., & Weiss N.S. (1990). "Environmental factors and the risk for childhood pedestrian-motor vehicle collision occurrence." *American Journal of Epidemiology*. 132:550-60.

National Park Service. (2006a). Federal Historic Preservation Tax Incentives. http://www.cr.nps.gov/hps/tps/tax/brochure1.htm

National Park Service. (2006b). National Registry Information Center. Last assessed by Internet on February 28, 2006. http://www.nr.nps.gov/nrloc1.htm

Oakley A., Rigby A.S., & Hickey D. (1994). "Life stress, support and class inequality." European *Journal of Public Health*; 4:81-91. In Ian Roberts & Barry Pless. (1995, Oct. 7). "Social policy as a cause of childhood accidents: The children of lone mothers." *British Medical Journal*; 311: 7011-925, Intl. Ed., London.

Pope, S. (2002, April 30). “From the Suburban Dream to the Urban Nightmare: The Federal Housing Administration from 1934 through Today.” Unpublished paper. Occidental College. Last assessed by Internet on March 13, 2006. http://departments.oxy.edu/uepi/uep/studentwork/popemain.htm

Practice of Local Government Planning. (2000). Charles Hoch, Editor, 3rd Edition. ICMA: Washington, D.C.

Primoli, M. (2006). Tax Aspects of Historic Preservation. Frequently Asked Questions & Answers. National Park Service, Heritage Preservation Service and Internal Revenue Service. Last assessed by Internet on February 28, 2006. http://www.cr.nps.gov/hps/tps/tax/IRSanswers.htm

Quinn, L.M. and Pawasarat, J. (2003, January). Tables 2 and 3. Modified Author: Comparison of Black-White “Segregation Index" Rankings to Percentage of Metro Population Living on Black-White Integrated Blocks. Racial integration in urban America: A block level analysis of African American and white housing patterns. Employment and training institute. School of Continuing Education, University of Wisconsin-Milwaukee. http://www.uwm.edu/Dept/ETI/integration/integration.htm

Rosenbaum, E. and Argeros, G. (2005). Holding the line: Housing turnover and the persistence of racial/ethnic segregation in New York City. *Journal of Urban Affairs*, Vol. 27:3. 261-281.

Schweinhart L.J., Barnes H.V., & Weikart D.P. (1993). *Significant effects*. Ypsilanti, MI: High Scope Press. In Ian Roberts & Barry Pless. (1995, Oct. 7). "Social policy as a cause of childhood accidents: The children of lone mothers." *British Medical Journal*; 311: 7011-925, Intl. Ed., London.

Section 42(d)(4)(B) Revenue Reconciliation Act of 1993. *A Developer's Guide to the Low Income Housing Tax Credit: How Much Credit Can You Obtain for Your Property-The Federal Rule*. p. 24. In Landgraf, Tom. (Fall 2002). University of WI-Madison. RE 611, p. 328.

Section 42(i)(2)(D). Revenue Reconciliation Act of 1993. In *A Developer's Guide to the Low Income Housing Tax Credit: How Much Credit Can You Obtain for Your Property-The Federal Rule*. p. 16. In Landgraf, Tom. (Fall 2002). University of WI-Madison. RE 611, p. 320.

Section 42(i)(2)(E), enacted by Act Section 13142(b)(5) of Revenue Reconciliation Act of 1993. In *A developer's guide to the low income housing tax credit: how much credit can you obtain for your property-the federal rule*. p. 43. In Landgraf, Tom. (Fall 2002). University of WI-Madison. RE 611, p. 347.

Sewell, J. & McCormick, B. (1997). "Building on the Basics: Wisconsin's Experience with Preservation Tax Incentives." *CRM*, 20, 6:25.

Tan, L. (May 2000). "Spending patterns of public-assisted families." *Monthly Labor Review*, pp. 33, 34.

Tusan, C. (May 1997). "Homeless families from 1980-1996: Casualties of declining support for the war on poverty." *Southern California Law Review*. 70 S. Cal. L. Rev. 1141, pp. 27-29.

Turetsky, B. (2003, June). "The lack of affordable housing and its impact on minorities." Lawyer's Committee for Civil Rights Under Law. www.lawyercomm.org.

Vale, L.. (1993). "Beyond the Problem Projects Paradigm." Housing Policy Debate. 4, 2:155. In Husock H. *Repairing the ladder: Toward a new housing policy paradigm* (Policy Study No. 207), pp. 9-20.

Vandell, K.D. “FHA Restructuring Proposals: Alternatives and Implications.” *Housing Policy Debate*. 6, 2: 299-393.

Vandell, K. (2006, February 23-24). *Real Estate Investment and Feasibility Analysis: An Introduction with Applications Reader*. Center for Real Estate. University of Wisconsin-Madison School of Business. Page 1-95.

Wisconsin Housing Economic Development Authority (WHEDA). (2005a, September 26). Low Income Housing Tax Credit. 2005-2006 Amended Draft Qualified Allocation Pla for the State of Wisconsin.. Last assessed by Internet on March 6, 2006. http://www.wheda.com/cat_tca/ QAP_2005-06_Amended.pdf

Wisconsin Housing Economic Development Authority (WHEDA). (2005b, February 11). Estimated Maximum Family Income and Rent Limits Based on HUD Estimated 2005 County Median Income. Last assessed by Internet on March 6, 2006. http://www.wheda.com/REPORTS/ MF_inc_rentcurrent.pdf

Wilson, W. (1996). "From institutional to jobless ghettos." *From When Work Disappears: The World of the New Urban Poor*. In Richard LeGates and Frederic Stout, eds. *The City Reader*. 2nd Ed. London and New York: Routledge: 2000, p. 512.

Wood, D., Valdez, R.B., Hayashi, T. & Shen, A. (1990). "Homeless and housed families in Los Angeles: A study comparing demographic economic and family function characteristics." American Journal Public Health. 80:1049, 1050, tbl.2. In Tusan, Christina. (May 1997). "Homeless families from 1980-1996: Casualties of declining support for the war on poverty." *Southern California Law Review*. 70 S. Cal. L. Rev. 1141, pp. 27, 28.

Zorza, J. (1991). "Woman battering: A major cause of homelessness." *Clearinghouse* Rev. 24, 421: 421. In Tusan, Christina. (May 1997). "Homeless families from 1980-1996: Casualties of declining support for the war on poverty." *Southern California Law Review*. 70 S. Cal. L. Rev. 1141, pp.29.

Appendix 1—Project Financing for Affordable Housing

PROJECT FINANCING	
Total Cost of Project	
Acquisition	$1,950,000
Rehabilitation*	$13,375,237
Total	$15,325,237
Total Rehab Cost Per Unit	$111,052
**Represents total costs-not just qualifying costs*	
SOURCE OF FUNDS	
Grants/Subsidies	
Energy grant-Madison Gas & Electric	$200,000
DEBT FINANCING	
Total Amount	**$15,325,237**
Bank One WI-Land Development Loan	$1,508,000
Bank One WI-Construction Loan	$3,850,000
City of Madison-Community Development Authority-TIF Loan	$1,338,800
City of Madison-Community Development Authority-Development Fee Loan	$1,038,000
WHEDA-Low cost gap loan	$213,437
HOME Loan at 4 percent Interest Rate	$3,400,000
Bank One Community Development Authority-Tax Credit Equity	$3,777,000
What If Analysis	
HISTORIC REHABILITATION TAX CREDIT (HPTC)	**Project**
Total Development Costs	$15,325,237
Total Qualifying Expenditures	$10,000,000
Rehabilitation Tax Credit percent	0.20
Total Rehabilitation Tax Credit percent	$2,000,000
Equity Yield for Rehabilitation Credit	0.95
Equity raised from Rehabilitation Credit	$1,900,000
LOW-INCOME HOUSING TAX CREDIT (LIHTC) ANALYSIS	
Project Financing	
Total Development Costs	$15,325,237
Total Qualifying Expenditures	$15,300,300
Less Rehabilitation Tax Credit	[$1,900,000]
Eligible Basis	$13,400,300
Low-Income Bonus QCT Proportion	130 percent
Qualifying Basis	$17,420,390
Annual Credit percent	9 percent
Annual Credit Amount	$1,567,835
Total Low-Income Housing Tax Credit	$15,678,350
Equity Yield for Low-Income Credit	0.78
Total Equity Raised from Low-Income Credit	$12,229,113
Total Combined Equity	$14,129,113

Notes:
WHEDA LIHTC was sold for 78 cents on the dollar to a bank.
NPS HPTC was sold for 95 cents on the dollar to a bank.
LIHTC total is.$17,420,390 (eligible cost of development -combined equity and debt)*.09(annual credit percent)*10 (years).
Total Combined Equity=Total Equity from LIHTC + Equity raised from Rehabilitation Credit

Source: (1999, September 23). Community Development Authority of City of Madison. This financial data from is the Waunona Wood-Monona Shores Revitalization Project. The data has been adjusted to reflect the effect of using HPTC on rehabbing this project. The format of the financial information was taken from the NPS Affordable Housing Case Studies website. http://www.cr.nps.gov/hps/tps/Affordable/index.htm

Appendix 2—National Park Service Historical Preservation Tax Credits: 10 Standard Qualifications

NPS 10 STANDARDS

1. A property shall be used for its historic purpose or be placed in a new use that requires minimal change to the defining characteristics of the building and its site and environment.

2. The historic character of a property shall be retained and preserved. The removal of historic materials or alteration of features and spaces that characterize a property shall be avoided.

3. Each property shall be recognized as a physical record of its time, place, and use. Changes that create a false sense of historical development, such as adding conjectural features or architectural elements from other buildings, shall not be undertaken.

4. Most properties change over time; those changes that have acquired historic significance in their own right shall be retained and preserved.

5. Distinctive features, finishes, and construction techniques or examples of craftsmanship that characterize a historic property shall be preserved.

6. Deteriorated historic features shall be repaired rather than replaced. Where the severity of deterioration requires replacement of a distinctive feature, the new feature shall match the old in design, color, texture, and other visual qualities and, where possible, materials. Replacement of missing features shall be substantiated by documentary, physical, or pictorial evidence.

7. Chemical or physical treatments, such as sandblasting, that cause damage to historic materials shall not be used. The surface cleaning of structures, if appropriate, shall be undertaken using the gentlest means possible.

8. Significant archeological resources affected by a project shall be protected and preserved. If such resources must be disturbed, mitigation measures shall be undertaken.

9. New additions, exterior alterations, or related new construction shall not destroy historic materials that characterize the property. The new work shall be differentiated from the old and shall be compatible with the massing, size, scale, and architectural features to protect the historic integrity of the property and its environment.

10. New additions and adjacent or related new construction shall be undertaken in such a manner that if removed in the future, the essential form and integrity of the historic property and its environment would be unimpaired"

Source:http://www.cr.nps.gov/hps/tps/tax/brochure2.htm#The%20Secretary%20of%20the%20Interior's%20Standards%20for%20Rehabilitation. Last assessed on Internet on February 28, 2006.

Appendix 3—WHEDA Self-Scoring LIHTC Exhibit

Points Earned	Total Possible Points in Scoring Category	Scoring Category	Answer	Reason
15	15	**1. Lower Income Areas**	■ Qualified Census Tract (QCT)	■ Locating the development in a QCT gets the project 30 percent more in tax credits (TC)
40	40	**2. Location**	■ Attach site map, land use plan, & dated plat map. ■Use certified surveying (ATSM).	■ Less expense to city (Hutch 3), taxpayers & developers than sites without sewer/water lines.
27	27	**3. Local Support**	■Letters of favorable support on official letter-head or form from Mayor, City Planning Director, neighborhood group, community leaders, County Supervisor, & Alderperson. ■Also letters from city showing substantial government-funded offsite improvements (e.g., streets, streetscape, utilities) that will benefit the development. ■Must be a minimum of 5 percent of development budget	■Must be a minimum of 5 percent of development budget ■This shows community approval and that essential background work was done. ■This shows a public-private partnership, the city's investment and goodwill in the project.
35	35	**4. Mixed Income Incentive**	■Set-aside low income (LI) units and show the percent of subsidized units to the total of non-subsidized units. Select either a 20 percent LI at 50 percent or less of County Median Income (CMI) or 40 percent LI at 60 percent or less of CMI. ■IRS states at the time the building is placed in service this select is an irrevocable election (Landgraf 329).	■Mixed income developments have the potential to have lower maintenance cost, crime (Hutch 2), and social welfare costs (Hutch 2) than majority low income developments. ■Shows potential project to be financially stable. ■Decrease racial isolation and promote integration (PLGP 239), and stabilize residential neighborhoods (PLGP 256; Wilson 512) & prevent slum creation (DuBois 58). ■Mixed income apartments help to decrease development costs and prevent higher rents (DuBois 58), because LI housing has low profit margins.
12	12	**5. Serves Large Families (3-bedroom or larger units)**	■Plan to have units with 3 bedrooms and justify their market need with Census data. Three bedroom units should not be the majority of apartments.	■ Accommodates families with children.
45	45	**6. Serves Lowest-Income Residents**	■Depending upon what income mix is financially feasible using your Net Operating Income (NOI), the Debt to Loan ratio (DLR) and Loan to Value (LTV) ratio choose the number of units in each CMI category (30 percent-60 percent) that will maximize profits and comply with federal program preferences.	■Housing stock for very low income people is decreasing. The developer has to find an income mix by CMI that will allow the building to not only pay back the debt but also be attractive to tax credit equity investors. These investors do not want the development to fail before they receive their expected/promised tax credits.
20	20	**7. Resident Populations with Special Needs**	■Need a service plan which must in included in the marketing plan. ■Someone on the developer's team must be experienced with this type of housing or service delivery. ■Architectural features must reflect serving the population.	■Some people not work due to a disability or illness, which may be the cause of them qualifying as low income tenants. ■The resell/reversion of the property may be higher when handicap amenities are added. ■The developer could use the property as an elderly condo or living lease property after the required number of years in low income service has passed.
24	24	**8. Small Developments**	■ Qualify if historic building is 24 units or less.	■Less money to borrow and tax credits to acquire and distribute. ■More manageable than large buildings.

Appendix 3, continued—WHEDA Self-Scoring LIHTC Exhibit

36	36	**10. Market Appeal**	■Meal Services (Excluding Meals on Wheels) ■Laundry Services ■Beauty/Barber Services ■Public bus transportation on-site or near site. ■24 hour on-site manager/security ■Banking/Financial Services ■Emergency call system ■Exercise room ■ Most of these services can be contracted out by third party vendors. These will be placed in visible sections on the first floor for safety concerns. ■Community space ■Washer/dryer in units ■Playground/Recreation area ■Both dishwasher and garbage disposal ■Garage ■High-speed internet access in units	■To attract and retain residents. ■To create sense of place. ■To create revenue. ■To create a better quality of life for residents. ■To enhance market appeal ■To promote long-term project viability
20	20	**11. Accessible Design**	■Handrails on both sides of common area hallways ■Automatic door openers at the main entry ■5 foot turning diameter in kitchen and bathroom ■Switches for garbage disposal, fans, and receptacles mounted on the front of cabinets or on an end wall ■Adjustable height countertops and cabinets ■Roll in showers ■Closets with adjustable rods and shelving	■ Architectural features that increase accessibility will broaden the market for many units
40	40	**12. Financial Participation**	■ Written conditional financial commitment for permanent financing from one or more of the following: ■ Tribal, federal, state, county, or city government ■ Public housing authorities ■ Tax-exempt bonding authorities ■ Unaffiliated public or public foundations ■ Unaffiliated nonprofits ■ Federal/State Historic Tax Credit	■ More partners to share the risk and support the financial needs of the development
6	6	**13. Ownership Characteristics**	■ 51 percent owned and controlled by a minority group member	■ Create diversity-ownership opportunities
60	60	**14. Project Development Team**	■ Past performance of team members	■ Reduce financial risk
15	15	**15. Readiness to Proceed**	■ Developments with permissive zoning	■ Reduce political, regulatory, and legal risk
395	395	**TOTAL SCORE**		

FOCUS ON INVESTMENT CONDITIONS

Something Has to Give—Or Does It?

BY KENNETH P. RIGGS, CRE

As the new year gets underway, many of us are taking stock of the economic outlook for the year ahead. We've watched as the U.S. economy has demonstrated its resilience over and over again during the last 5 years. It has survived the bursting of the dot.com bubble, major terrorist attacks on U.S. soil, wars in Afghanistan and Iraq and the ongoing war on terrorism, and corporate and accounting scandals, along with numerous smaller shocks. We knew, however, with Hurricanes Katrina and Rita late last summer and higher gasoline prices that the strength of the consumer would be challenged. Our concerns have been whether the business sector would prove to be strong enough to pick up the slack as consumer spending faced strong head-on challenges and whether inflation could be held in check in a rising interest rate environment.

These shifting currents create quite a balancing act for the economy and reflect just a few of the challenges impacting real estate and other investments. In looking at the strengths and weaknesses in our dynamic economy, real estate has offered outstanding returns as compared to the stock and bond markets. However, the new challenges we are facing give rise to a host of new concerns related to real estate performance. Will consumer spending slow, and how will the retail property sector be affected? How will a reportedly slowing housing market affect apartment returns? Will business hiring continue and will rents for office and industrial space increase? With capitalization rates so low, what will drive returns? And more importantly, will real estate returns in 2006 be significant enough to take on the risk associated with this asset class? Given these imbalances, it seems that something has to give—but does it?

ECONOMIC STRENGTHS AND WEAKNESSES HEADING INTO 2006

Despite the uncertainty, the broader economy continues to strengthen. The impact of Hurricane Katrina, the costliest natural disaster in U.S. history, has been about what many forecasters expected. There was a short-term negative impact to the national economy, but as clean-up and rebuilding got underway, the economy began to respond positively. In fact, third quarter real gross domestic product (GDP) grew at an upwardly revised annual rate of 4.3% in third quarter 2005. Surprising most experts, this half-percentage point increase over the seasonally adjusted annual rate released a month ago is the best showing since the first quarter of 2004.

About our Featured Columnist

Kenneth Riggs, Jr., CRE, is chief executive officer of Real Estate Research Corporation (RERC). RERC offers research, valuation, independent fiduciary services, portfolio services, corporate advisory services, litigation support, and other real estate-related consulting services. RERC also provides research, analysis, and investment criteria (cap rates, yield rates, expense and growth expectations, recommendations, etc.) for nine property types on a national and regional level and for 40 major U.S. markets through the quarterly RERC Real Estate Report*, the annual* Expectations & Market Realities in Real Estate*, and the* RERC DataCenter.
(E-mail: riggs@rerc.com)

This growth was supported by strong spending during third quarter 2005 by consumers and by businesses. Consumer spending rose 4.2%, with purchases of durable goods increasing by 10.5% and nondurable goods spending increasing by 3.6%. Business spending increased 8.8%, with spending on equipment and software rising 10.8%.

As one of the strongest indicators of the health of the economy, the U.S. deficit fell to $319 billion for fiscal year 2005, down $94 billion from the previous year's record, reports the Treasury Department. This is due to a surge in tax revenues, with receipts for the year totaling $2.154 trillion, up from $1.880 trillion a year ago.

Table 1—What Do The Financial Markets Tell Us?

Total Return % as of 9/30/2005 Market Indices	YTD	1-Year	3-Year	5-Year	10-Year
Consumer Price Index	3.21%	3.42%	2.76%	2.49%	2.52%
10-Year Treasury Bond[1]	4.19%	4.20%	4.15%	4.46%	5.20%
Dow Jones Industrial Average	-0.34%	7.23%	14.19%	1.91%	10.33%
NASDAQ Composite	-1.09%	13.44%	22.45%	-10.14%	7.50%
NYSE Composite	5.28%	16.17%	17.46%	1.72%	8.71%
S&P 500	2.77%	12.25%	16.71%	-1.49%	9.48%
NCREIF Index	13.93%	19.25%	13.19%	11.06%	11.68%
NAREIT Index	6.94%	22.63%	24.90%	19.43%	14.24%

1 Based on Average End of Month T-Bond Rates
Sources: Morningstar, NCREIF, NAREIT

However, the housing market has been showing signs of slowing down during the last few months. A recent report from the National Association of Realtors indicated that their index of pending home sales for October 2005 declined 3.2% from September and was down 3.3% from a year earlier. A slowdown in consumer spending is expected, although it appears holiday sales have been strong thus far this season.

And although new productivity numbers are strong (4.7% during third quarter 2005, the largest gain in productivity since mid-2003), corporate profits after taxes fell by 3.7% during third quarter. Even so, year-over-year profits increased 9.4% as compared to third quarter 2004. Employment remains strong, although predicted job losses by Ford and General Motors will have a huge impact in those regions where the affected plants exist.

In addition, the U.S. trade imbalance continues to be a drain on the economy. Imports increased nearly 2 ½ times the rate of exports.

HOW DOES THIS AFFECT REAL ESTATE?

Despite the pressure on real estate values, Real Estate Research Corporation's (RERC's) third quarter survey respondents continued to rate real estate as a better investment option than stocks, bonds, or cash. Third quarter 2005 returns (shown in Table 1) reflect the wisdom of their recommendation, with NCREIF year-to-date returns at 13.93% and NAREIT returns at 6.94%, while the Dow Jones and NASDAQ returns were in negative territory and the NYSE composite and S&P 500 positive but less than the two real estate indices. Up-to-date scores are reported in the RERC Real Estate Report each quarter. (Table 1)

Required capitalization rates and discount rates across the board have declined by approximately 200 basis points (a decline of over 20%) since first quarter 2001. This level of compression is unlike anything RERC has seen in the past, and is what has allowed commercial real estate values and prices to increase to their current levels.

Going forward, strong positive leverage, similar to that realized during the past few years, will be difficult to achieve on properties where capitalization rates have been driven down to levels near interest rates. Even so, RERC expects capital to continue to flow to real estate during 2006, although returns are expected to come down to a more sustainable level on both a capitalization rate and total return basis.

OFFICE

The key demand drivers of the office market recovery—employment growth and business spending—continue at a steady pace, and as a result, office space market fundamentals are improving at a reasonably steady pace in most markets. We expect office demand to continue to increase during the next several years, and as a result, vacancy will continue to decline, assuming new supply stays relatively constrained.

As shown in Table 2, required capitalization rates for all property types are lower than they have been since RERC began reporting them 15 years ago. With further significant capitalization rate compression unlikely, upside in the

Table 2—RERC Required Return Expectations[1] by Property Type

	OFFICE		INDUSTRIAL		RETAIL			APARTMENT	HOTEL	AVERAGE ALL TYPES	RERC PORTFOLIO INDEX
	CBD	Suburban	Warehouse	R&D	Regional Mall	Power Center	Neighbor/ Comm.				
Pre-tax Yield (IRR) (%)											
Range	7.3-10	7.5-10	7-10	7.5-11	7.5-9	7-10	7-10	7-10	11-12	7-12	7-12
Average*	8.4	8.9	8.5	9.4	8.3	8.8	8.6	8.3	11.3	8.9	8.6
Going-In Cap Rate (%)											
Range	6-8	6.5-8.5	6-8.5	6.5-9.5	6-7.5	6.3-8	6-8	5.5-7.5	8-10	5.5-10	5.5-10
Average*	6.9	7.4	7	7.8	6.7	7	6.9	6.4	8.7	7.2	7
Terminal Cap Rate (%)											
Range	6.5-9	7.3-9	6.5-9.5	7.3-10.5	6.5-8	6.5-9	6.5-9	6-8	8.5-10.5	6-10.5	6-10.5
Average*	7.6	8.1	7.7	8.5	7.3	7.6	7.6	7.2	9.4	7.9	7.7
Rental Growth (%)											
Range	0-4	0-4	0-4	0-4	2-4	0-3	0-3	0-4	3-6	0-6	0-6
Average*	2.7	2.8	2.4	2.3	2.9	2.4	2.4	2.7	4.4	2.8	2.7
Expense Growth (%)											
Range	2-3.5	2-3.5	2-3.5	2-3.5	2-3.5	2-3.5	2-3.5	2-3.5	2.5-3.5	2-3.5	2-3.5
Average*	2.9	2.9	2.8	2.8	2.9	2.8	2.8	2.9	3	2.9	2.9

[1]This survey was conducted in April, May, and June 2005 and reflects expected returns for Second Quarter 2005 investments.
*Ranges and other data reflect the central tendencies of respondents: unusually high and low responses have been eliminated.
Source: RERC Investment Survey

office market will occur primarily from space market fundamentals including rental growth, which is beginning to improve from previous quarters (Table 2).

INDUSTRIAL

Having reached a turning point in third quarter 2004, space market fundamentals for the industrial property sector have continued to strengthen throughout 2005. RERC expects occupancy to continue to improve throughout 2006, but it will be a gradual rather than a robust recovery due to elevated levels of new construction and continued productivity gains in transportation logistics. Landlord pricing power and rents are increasing, but it will be gradual, especially given the negotiating strength of large users.

While required capitalization rates for the industrial sector have fallen to levels lower than what RERC expected, further compression is a thing of the past and the driver of investment performance growth going forward will depend on net operating income (NOI). The outlook for warehouse valuation and pricing levels remains bifurcated, with larger and high-quality properties experiencing the greatest user demand and properties in secondary markets or those with few supply constraints finding it challenging to achieve sustained upside.

RETAIL

Having spent most of the 1990s as an investment performance underachiever, the retail sector has been the "darling" of the current decade. Retail fundamentals are quite strong and consumer spending has had more strength and longevity than expected due to low interest rates, improving personal income and job growth, relatively low vacancy rates, consistent rental growth, and significant capitalization rate compression. As a result, retail property total returns have been outpacing those for all other property types.

However, the risk of a slowdown in consumer spending due to elevated energy prices, higher interest rates, and a slowdown in the housing market is very real, and increasing retail performance is expected to slow. RERC's outlook is for retail to return to a more sustainable investment performance level, with realized returns closely matching investor return expectations.

APARTMENTS

Apartment fundamentals have continued to improve during 2005, with net absorption outpacing new supply for the second consecutive year. In addition, rents have been increasing as vacancy rates and rental concessions declined, which is due in part to condominium conversions removing apartments from the rental market.

Apartment investment performance is expected to remain strong with declining home affordability, rising long-term

interest rates, and strong population growth. However, given how low apartment capitalization rates are, apartments will likely need to rely even more heavily on landlord pricing power going forward than will the other property types.

HOTELS

Hotels are well positioned to outperform the other property types over the next few years. Pricing power is allowing room rates to move upward, and business travel should increase as corporations increase business spending. But risks still exist, including high energy prices that could reduce discretionary travel. Compared to other property types, however, hotels are not as fully priced and thus have a somewhat higher margin for investment error.

CONCLUSIONS

■ Real estate has come of age, fully regaining its credibility as an asset class and re-establishing itself as an integral part of asset allocation models. Returns are at historical highs, space market fundamentals are improving, and capital continues to pour in.

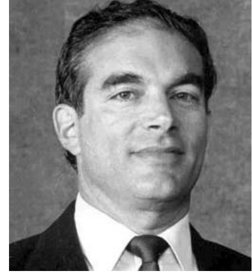
■ In an era of post capitalization rate compression, real estate appreciation will be a function of income growth, which will be tied to improvements in space market fundamentals. However, improvement in fundamentals will not be uniform across property types or markets. Unevenness exists across markets in terms of demographics, employment growth, and supply constraints, resulting in heterogeneity of landlord pricing power and investment performance.

■ Given high real estate prices and low current capitalization rate and cash flow yields, recent double-digit returns are unsustainable and will revert to the single-digit level for core real estate on an unleveraged basis. Despite expectations of lower returns going forward, real estate continues to demonstrate strong relative value compared to stocks and bonds.

■ Real estate increasingly appears to be priced for perfection, but is faced with significant global and domestic imbalances and the inherent challenges of accurately assessing the nature, timing, and magnitude of eventual corrections. As such, investors should keep absolute return expectations low and risk awareness levels high.■

FOCUS ON THE ECONOMY

The Certainty of Uncertainty: The Economy



BY DR. MARK LEE LEVINE, CRE

NUMEROUS TELECASTS, RADIO COMMENTARIES, SPEECHES, NEWSPAPER ARTICLES, MAGAZINE ARTICLES, THE INTERNET, ETC. create great confusion when looking to opposing views on many economic issues that can and will impact future positions.

The following is a smattering of numerous articles and commentaries that support or attack the vitality of the U.S. economy. What is troublesome for the constituent is to attempt to reach a conclusion after examining many incongruities in these statements. Consider the following comments as evidence of the conflicting commentaries: "The market is great!" and "The market is depressed."

POSITIVE AND NEGATIVE POSITIONS: PARRY AND THRUST

POSITIVE:

1. POSITIVE: PRODUCTIVITY: Michael J. Mandel, in a commentary entitled,"Sure, the Trade Deficit Is Scary - But We Can Handle It," *Business Week* 41 (5/23/05), stated an overall positive position of the U.S. economy. Mr. Mandel conceded the position that there are "different points of view." In this article he stated: "Everyone has a favorite statistic, and those who are pessimistic about the U.S. economy love to cite the trade deficit." Mr. Mandel noted that although the trade deficit was substantially larger for 2004 than expected, and 2005 is running ahead of 2004, he was still not too concerned with the deficit.

Mr. Mandel raised the question as to what was more important: Big trade deficits, or high productivity? He concluded that productivity is the area of focus, because the net wealth of the United States is gigantic relative to what it was 10 years ago; therefore, we are in a more positive position. In fact, he concluded that the U.S. economy is getting a lot better. He conceded, by hedging somewhat, that the ability to deal with trade deficits will be dependent in part on the ability to continue efficient productivity and to maintain strong technology. He concluded that optimists are winning the race in the economy.

2. In an article by James C. Cooper and Kathleen Madigan, "Job Growth Will Get Over Its January Blahs," Business Week 25 (February 21, 2005), the authors concluded that the economy for 2005 would be expected to generate a significant amount of jobs; therefore, they concluded that 2005 will be a fairly solid business year.

The authors concluded on a positive note relative to year 2005: "Despite the slow January start, payrolls should post their best gain since 1999 and generate solid income

About our Featured Columnist

Mark Lee Levine, CRE, PhD, is a professor and the director of the Burns School of Real Estate and Construction Management at the University of Denver. (E-mail: mlevine@du.edu)

Note: This article was written with a focus on the end of 2005. The 2006 position will follow in an upcoming issue.

growth for consumers, which will keep demand on the upswing."

3. POSITIVE: GROWTH: A summary article by editor Andrea Parker and economist Dr. Michael Bergmann, in the AMG Guaranty Trust Publication (February, 2005), prognosticated a positive, good, but not great, 2005. Their position was that growth for 2005 would probably be 3.7% for GDP (Gross Domestic Product).

The prognostication was that the Federal funds rate, the rate banks charge one another for overnight loans, will probably move to around 4% by the end of 2005. "The economic expansion will remain in tact; growth is slowing but will remain above trend for 2005, around 3.7%."

4. POSITIVE: BALANCE: If one desired a panoply of positive economic commentators on the 2005 economy, see one of the better articles which captured and summarized many of these positions in "Real Balance," *REALTOR*, Page 26 (January 2005). This article noted: "The winning combination of low interest rates, strong home price appreciation and moderate job growth that drove record-setting home sales last year will continue to fuel the home sales market this year."

A collection of economists was listed in this article, including David Lereah, Chief Economist for NAR (National Association of REALTORS), Paul Merski, Chief Economist, Independent Community Bankers of America; Mark Dotzour, Chief Economist, Real Estate Center, Texas A & M University; Frank Nothaft, Chief Economist, Freddie Mac; Doug Duncan, Chief Economists, Mortgage Bankers Association; and Steve Dunn, Chief Economist, C.B. Richard Ellis, Information Management. These professionals gave their comments as to the U.S. economy. They stressed the need for balance and equilibrium in residential and commercial markets.

The article concluded: "With home sales expected to sustain at near-record levels and the commercial sector looking up, economists say this year will be the picture of balance for real estate."

5. POSITIVE: NEXT 10 YEARS: For an overview of the economy of where it is now, and where it is going in the next ten years, see the article by Donald Ratajczak, "A Look Ahead At the Economy and Investments: 2005-2015," *Journal of Financial Service Professionals* 37 (January 2005). Dr. Ratajczak examined a number of factors that he considered very important in impacting the economy. These included: 1. Changes in productivity per labor input; 2. Changes in the employment rate; 3. Changes in hours worked per year; 4. Changes in the percentage of the working-age population; and 5. Growth of the working-age population.

After examining these factors, along with related economic issues, Dr. Ratajczak was rather positive. However, he admitted, like most good economists, that all of the prognostications, even if originally on target, could be modified by some of the unforeseen, major events that could change the prognostications. Dr. Ratajczak ended his article by stating: "I am glossing over looming problems such as medical costs for the aged, Social Security problems... U.S. competitiveness and the entire baby boom generation as retirees. But there are opportunities that will allow us to address these problems, if we find the will to do so."

6. POSITIVE MORTGAGE RATES: In the article by James C. Cooper and Kathleen Madigan, "The Walls Won't Come Tumbling Down," *Business Week* 25 (January 17, 2005), the authors noted that mortgage rates for 2005 will probably remain low enough to keep housing affordable and active.

The authors noted that, although housing has contributed to much of the strength during the last few years in the U.S. economy, it will not be the case for 2005. However, they added that it will probably not subtract much from the economy, either.

A discussion of the potential of bursting of the housing "bubble" was noted. The authors concluded that it was very unlikely that such housing bubble, if any, will burst.

7. POSITIVE: RECOVERY? Is there a wave of recovery? See the article by Delisle, James, Dr., "The Wave of Recovery: Capital Flows and Spatial Ripples," The *Appraisal Journal* 5 (Winter, 2005). Dr. Delisle noted major areas that impact the U.S. economy. With many problems behind us, many other issues remain that must be addressed for the year 2005. However, for 2005, Dr. Delisle commented that he believed there will be a moderately improving fundamental position in the real estate market. Dr. Delisle concluded: "As such, 2005 should see an extremely active real estate market with a balance of power beginning to shift from the seller to buyers, although such adjustment may be a prolonged process."

8. POSITIVE: HOUSING MARKET: In the Meyers Housing Market Study (April 4, 2005), the Study concluded that the Market is in fairly good shape. New home sales are fairly strong, and generally existing home sales also remain fairly strong. Rating various areas, the mortgage rates and median price for existing homes all rank at A+.

Unemployment was still fairly strong at B+. Many other parts of the market saw very strong grades, portending for an overall strong economy, as indicated in the Meyers Study.

(The Meyers 6/8/05 Study also supported this continuing trend of favorable interest rates, very good pricing for median-priced home sales [existing and new homes] and for inventory. However, the "affordability" category received a poor score from the Meyers Study. More and more potential homeowners cannot qualify to acquire a home, absent very favorable rates and strong financial incentives provided by builders, lenders and third parties.)

NEGATIVE:

1. NEGATIVE: IS THE WORLD ECONOMY SLOWING? According to views in an article, "Running Out of Puff," *The Economist* 63 (April 16, 2005), there are "... nascent signs of slowdown and worries about oil." Whether this article is correct as to the market, certainly there are signs that indicate a slowing within the market. A slowdown and reduction in oil prices are welcome signs in most parts of the world.

2. NEGATIVE: TRADE DEFICITS: Focus on the trade deficit continues. Authors James C. Cooper and Kathleen Madigan noted in their article, "Time to Cope With Co-Dependency," *Business Week* 29 (February 28, 2005), that there is a great deal of concern with the trade deficit and budget deficit.

The authors noted the trade deficit position, as expounded by Federal Reserve Chairman Alan Greenspan, when he stressed his concerns on numerous occasions early in 2005. The authors stated that one could argue there should be less demand for imports, given the weakening dollar. However, apparently that has not been the case. Mr. Greenspan covered this same point.

As to the import of the U.S. trade deficit, the authors concluded: "But whatever the mix of remedies, the trade gap has taken center stage, and don't expect it to go back into the shadows anytime soon." *Business Week* 30 (5/23/05). On this issue, Dr. Scott Anderson, Senior Economist with Wells Fargo Economics (June 7, 2005), noted that the rising cost of oil fans the fires of concern with inflation and the trade deficit.

3. NEGATIVE: FISCAL BUDGET: Dr. Cynthia Saltzman commented in her Note, "Federal Budget Deficits: It's Not If, But When They Matter," *Journal of Financial Service Professionals* 22 (March, 2005), that the trade deficit is huge; it should be of great concern.

According to Dr. Saltzman, the concern with fiscal budget issues was focused when there was testimony by Mr. Alan Greenspan before the U.S. House Budget Committee on February 25, 2005, and by subsequent comments by Mr. Greenspan. Dr. Saltzman noted our imports substantially exceed our exports, creating the U.S. trade deficit. This must change, at least in the opinion of Dr. Saltzman.

Dr. Saltzman also noted that the dollar has continued to drop in value over the last few months. The expectation is that such weakness in the U.S. dollar will continue, at least for the reasonably foreseeable future. Dr. Saltzman concluded that it is important for the U.S. Federal budget deficit to gradually be reduced and to reduce the financing of our Federal deficit by foreign funds. (More recent activity has shown the dollar gaining strength.)

4. NEGATIVE: PRODUCTIVITY: In an article by James C. Cooper and Kathleen Madigan, "A Job Market This Strong Comes With Strings," *Business Week* 33 (5/23/05), the authors concluded that productivity is slowing and one may be justified in being concerned with the potential of inflation.

The lead from the article noted the April 2005, U.S. Employment Report and that one should look to inflation and stagflation, since there have been many new jobs created, but there are also concerns with inflation. The authors concluded that the Fed will likely increase interest rates to rein in inflation. With the increase in jobs, and unemployment holding at 5% or less, the authors concluded that from an economic position, it is likely that inflation will be the big issue in 2005.

5. NEGATIVE: HOUSING BUBBLE: Much of the argument today on the residential side is whether the rapid pace of sales will continue and whether there is a housing "bubble" in many areas throughout the United States. In an article by Patricia Hill of the *Washington Times*, and the Report by RES Media, in http://www.RESmedia.com , the position by Chairman Greenspan is clear: "Federal Reserve Chairman Alan Greenspan yesterday (February 18, 2005), said he sees a housing bubble in 'certain areas' and suspects prices are vulnerable to declines, but they will not collapse in any way that threatens the economy." In Mr. Greenspan's opinion there is a bubble; and, in some areas that bubble will be problematic for many homeowners. According to the article, the Federal Reserve estimates that

home values have doubled from $8 trillion to $16 trillion since 1996.

6. NEGATIVE: HOUSING MARKETS: TOO HOT? In an article by Opdyke, Jeff, "Hot Housing Markets Face New Risks," *The Wall Street Journal*, D2 (Wednesday, March 2, 2005), the author noted many areas in which housing is very risky and overpriced.

Mr. Opdyke stated: "Homeowners in the hottest markets are facing a greater chance that the value of their houses will decline, according to a new study, though risks have lessened slightly for the nation as a whole."

The ten most risky housing markets, as noted by Mr. Opdyke, regarding a Study by PMI Mortgage Insurance Company, are: "Boston-Cambridge-Quincy, MA-NH. San Jose-Sunnyvale-Santa Clara, CA. San Francisco-Oakland-Freemont, CA. San Diego-Carlsbad-San Marcos, CA. Providence-New Bedford-Fall River, RI-MA. Sacramento-Arden-Arcade-Roseville, CA. New York-northern New Jersey-Long Island, NY-NJ-PA. Los Angeles-Long Beach-Santa Ana, CA. Riverside-San Bernadino-Ontario, CA. Detroit-Warren-Livonia, MI."

Mr. Opdyke holds that these markets have substantial risk and appear to be overpriced. Whether this is a correct conclusion remains to be seen, since many comments over the years have referred to the California market as being overpriced; yet, the California real estate market seems to continue to rise in most locations.

7. NEGATIVE: HOME MARKET: BUY OR NOT BUY: In an interesting Note on the issue of whether one should buy or not buy, concern was expressed on the overpricing of the housing market. See the commentary, "To Buy Or Not To Buy? That Is the Question," *The Economist* 11 (March 5, 2005). This Commentary noted the confusion faced by many homebuyers or potential homebuyers on the question of whether to buy now and avoid missing out because of rising prices of homes. However, the article concluded that maybe there is too much risk with the potential of a housing "bubble." As such, the conclusion was: "Some day prices will fall relative to rents and wages. After they do, it will make sense to buy a home. Until they do, the smart money is on renting."

In another article addressing the same issue as to whether to buy or not to buy, now, see the article in *The Economist* 71 (March 5, 2005). The authors noted: "According to our latest house-price indicators, it is now much cheaper to rent than to buy a house in many countries."

8. NEGATIVE: STORM CLOUDS: An article, "Storm Clouds Ahead," *The Economist* (January 29, 2005) noted that the economy may seem bright presently, but with higher interest rates the economy may be very difficult in coming months and storm clouds seem to be rising. The article pointed out that some economists are puzzled by inconsistencies within the market as to inflation, pricing, long-term interest rates, etc.

On the gloomy side, one comment in the article stated: "The most gloomy theory is that America's economy is, in fact, rather more fragile than the current statistic suggests ...." Along with other theories, the article concluded that there may be great concern that long-term interest rates could rise sharply and very suddenly. (Page 28).

9. NEGATIVE: COLLYWOBBLES: The Collywobbles article, *The Economist* (February 24, 2005), referenced concerns within the financial market. One of the most telling comments was the reference to Mr. Alan Greenspan's concern: "The problem started last week, when Alan Greenspan, the Chairman of the Federal Reserve, professed himself puzzled by the 'conundrum' presented by the flattening yield curve: The more he raised short-term rates (6 times since 2004, by 25 basis points on each occasion), the more already-low long-term rates fall. Markets don't like it when the man who sets interest rates says he doesn't understand them." (As of July 2005, the Feds raised the rate 9 times in succession.)

Many argue this great concern as to uncertainty, especially by the brightest of our leaders, creates the "wobbling effect" within the market.

10. NEGATIVE: EDUCATION: Education, or lack thereof, and underproduction in the United States to produce enough engineers, scientists and others who will continue to foster and support the lead of the U.S. in many technical areas, continues to be of great concern.

In an article by William Symonds, *Business Week* 122 (January 10, 2005), the headline exemplified this concern: "U.S. Schools: Underperforming." The sub-headline noted: "The No-Child Left Behind Act isn't doing the trick and higher education costs are squeezing out lower-income students."

The argument is that if those in the lead in the U.S. do not change direction, the educational system is on a dangerous course. This was exemplified in a comment by Patrick Callan, President of the National Center for Public Policy

and Higher Education: "We're on a collision course that could lead to a real decline in U.S. competitiveness...."

Mr. Symonds stated that the attempt to reverse the course of weakening higher education training within the United States is difficult; it requires, he said, very bold action. If we fail to act, results will be even more painful, noted Mr. Symonds.

11. NEGATIVE: RETIREMENT: Arguably, one of the most damaging issues that could impact the U.S. economy deals with retirement. Examining this issue was an article by Gleckman, Howard, "The Real Retirement Time Bomb," *Business Week* 72 (January 31, 2005). The argument in this article was that if there are not substantial, positive changes made, Medicare premiums will destroy Social Security.

The author noted that the U.S. government will not pick up the entire cost for seniors; and, unless changes are made, the retirees will have to accept a major reduction in their standard of living for health insurance. Mr. Gleckman noted that this is a trade-off that society may choose to make or not make. However, it appears that the issue, at least in Mr. Gleckman's view, is not being properly addressed. He concluded his article by saying: "… between Medicare and Social Security, both parties in Congress and President Bush have been moving forward with their eyes wide shut."

12. NEGATIVE: TAX CUTS: The concern with tax cuts and the impact on the fiscal budget remains a major issue.

Mr. Greenspan said that he favors tax cuts only if they are offset by appropriate changes to balance the spending position.

In Mr. Greenspan's position, the pay-as-you-go rules, as they are sometimes referred to, require a balance between the tax cut and the spending cut positions. Mr. Greenspan said: "I argued a year ago that my support for tax cuts is in the context of a pay-go-rule."

For a discussion of this issue and connected points, see the article by Stamper, Dustin, "'No Tax Cut Extensions Without Offsets,' Says Greenspan," *Tax Notes* 887 (February 21, 2005).

13. NEGATIVE: TAX CHANGES: DUMP THE SYSTEM? In a position clearly opposing the suggestion to dump the existing position, Federal Reserve Chairman Alan Greenspan and former Treasury Secretary James Baker support the view that one cannot realistically get rid of the existing tax system, even though it is "defective." Rather, it requires a major overhaul or change within the system. These were the conclusions in testimony before President Bush's Tax Reform Panel on March 3, 2005. See the article by Glenn, Heidi, "Greenspan, Baker Look Back to 1986 For Tax Reform Future," *Tax Notes* 1119 (March 7, 2005).

14. NEGATIVE: WEAK DOLLAR: See the article by Kuttner, Robert, "Bush's Worrisome Weak-Dollar Policy," *Business Week* 27 (March 14, 2005). Mr. Kuttner noted concern with the weakness in the U.S. dollar and the ability of the Bush Administration to properly control and deal with such weakness.

Mr. Kuttner stated: "The gap between the Bush Administration's expansive geopolitical goals and its relinquishing of financial stewardship is becoming unsustainable." Mr. Kuttner then referred to the comments made in South Korea as to the weakness of the U.S. dollar and consideration by the South Korean banks to look for other markets. Although this created some jitters for a short period of time, it did focus the issues, said Mr. Kuttner, on the "chilling reminder of the vulnerability of the dollar and the precarious position by the U.S."

15. NEGATIVE: INTEREST RATES: SLOW INCREASE? In an article by Cooper, James, and Madigan, Kathleen, "Time To Waive Goodbye To A 'Measured' Pace," Business Week 25 (March 28, 2005), the authors concluded that maybe, given the nature of the economy in its current state and the many issues on the plate for President Bush, it may be that the Fed may have to raise interest rates much more quickly than previously anticipated. The authors concluded: "The new question confronting the Fed is this: How fast should it take policy to neutral? Recent data on growth inflation hint that the Central Bank is moving too slowly. If that's true, then given the lag inherent in policy adjustments and the Fed's desire to act preemptively, any change in the policymakers' intentions will need to come soon."

16. NEGATIVE: VALUATION OF REALTY: See the article by Dr. Anthony Downs, CRE, "Why Selling Assets Now Makes Great Sense," *NREI* 124 (April, 2005), In this article, Dr. Downs stated that no one can predict the exact high point, but because most properties would enter in what he considers to be the peak of their earning power or renovation, one should seriously consider selling them now. In fact, he concluded that if owners wait too long in this peaking market, "... their fortunes could sour quickly."

CONCLUSION

One can examine the "parry-and-thrust" of the POSITIVE and NEGATIVE arguments within the economy, including arguments focusing on medical costs, Social Security, retirement funds, cost of oil, trade deficit, monetary and fiscal deficits, housing issues, currency concerns, war, terrorism, other conflicts, threats of nuclear positions, and many other items. Mixed signals are coming forth, thereby confusing sophisticated investors as well as, and most certainly, the novice investor. Confusion abounds. Inconsistent economic signals create problems when making investment decisions.

This means to many that money will remain on the sidelines, pending a clear, consistent direction that does not constantly result in an upside-downside viewing of the marketplace. As for now, many viewing the market consider that the only consistency in the market is inconsistency.■

REAL ESTATE ISSUES

CONTRIBUTOR INFORMATION

Real Estate Issues publishes four times annually (Spring, Summer, Fall, Winter). The journal reaches a lucrative segment of the real estate industry as well as a representative cross section of professionals in related industries.

Subscribers to *Real Estate Issues* (REI) are primarily the owners, chairmen, presidents, and vice presidents of real estate companies, financial corporations, property companies, banks, management companies, libraries, and REALTOR® boards throughout the country; professors and university personnel; and professionals in S&Ls, insurance companies, and law firms.

Real Estate Issues is published for the benefit of the CRE (Counselor of Real Estate) and other real estate professionals, planners, architects, developers, economists, government personnel, lawyers, and accountants. It focuses on providing up-to-date information on problems and topics in the field of real estate.

REVIEW PROCESS

Member and non-member authors are encouraged to submit their manuscripts to:

Real Estate Issues, c/o The Counselors of Real Estate, 430 North Michigan Avenue, Chicago, Illinois 60611. All manuscripts are reviewed by three members of the editorial board with the author's name(s) kept anonymous. When accepted, the manuscript and any recommended changes is returned to the author for revision. If the manuscript is not accepted, the author is notified by letter.

The policy of *Real Estate Issues* is not to accept articles that directly and blatantly advertise, publicize, or promote the author or the author's firm or products. This policy is not intended to exclude any mention of the author, his/her firm, or their activities. Any such presentations however, should be as general as possible, modest in tone, and interesting to a wide variety of readers. If a product, service, or company is featured, it should be informational vs. promotional in nature. Potential conflicts of interest between the publication of an article and its advertising value should also be avoided.

Every effort will be made to notify the author on the acceptance or rejection of the manuscript at the earliest possible date. Upon publication, copyright is held by The Counselors of Real Estate (American Society of Real Estate Counselors). The publisher will not refuse any reasonable request by the author for permission to reproduce any of his/her contributions to the journal.

DEADLINES

See Editorial Calendar on inside back cover for deadlines.

MANUSCRIPT/GRAPHICS PREPARATION

1). Manuscripts must be submitted via e-mail or disk (along with hard copy). All submitted materials, including abstract, text and notes, are to be double-spaced. Number of manuscript pages is not to exceed 25 single-sided sheets (approx. 7,000 words). Submit a 50- to 100-word abstract* and a brief biographical statement, including author's e-mail address. Computer-created charts/tables should be in separate files from article text. (*If the manuscript is accepted for publication, the abstract/brief synopsis would appear on the table of contents page.)

2). Graphics/illustrations are to be considered as "Exhibits," numbered consecutively and submitted in a form suitable for reproduction.

3). Number all graphics (tables/charts/graphs) consecutively. All graphics should have titles.

4). All notes, both citations and explanatory, are to be numbered consecutively in the text and placed at the end of the manuscript.

5). If appropriate, and of good quality, include photographs to clarify and enhance the content of the article.

6). Article title should contain no more than eight to 10 words including an active verb.

7). For uniformity and accuracy consistent with our editorial policy, refer to The Associated Press Stylebook.

THE BALLARD AWARD MANUSCRIPT SUBMISSION INFORMATION

The REI Editorial Board is accepting manuscripts in competition for the 2004 William S. Ballard Award. All articles published in *REI* during the 2004 calendar year will be eligible for consideration, including member and non-member authors. The $500 cash award and plaque is presented annually each spring, during The Counselors' Midyear Meetings to the author(s) whose manuscript best exemplifies the high standards of content maintained in the journal. The recipient is selected by a three-person subcommittee comprised of members of The Counselors of Real Estate.

Subscription Information

As the adage goes, *"the only constant is change."* For 29 Years, *Real Estate Issues* has been a *constant* source of ideas, insights, and methods,

assisting industry experts in meeting the challenges of a *changing* market.

Why not give the gift of a REI subscription to a colleague or

business associate? *Real Estate Issues* publishes four times per year

(Spring, Summer, Fall, Winter). Place your order today!

Order online at www.cre.org; or call 312.329.8881, or order by mail, below:

REAL ESTATE ISSUES

Subscribe

❍ 1-year, $48 (4 issues)
❍ 2-year, $80 (8 issues)
❍ 3-year, $96 (12 issues)

❍ Single copy(ies) qty: ____ @ $15 each *(plus shipping: $3 U.S.; $6 foreign)*: Vol.#(1-28): __________; No.(1-4): __________

❍ My check is enclosed for _________________ payable to The Counselors of Real Estate

❍ Please bill my credit card: ❍Visa ❍Master Card ❍American Express ❍Diners Club

Card Number ______________________________________ Expiration Date __________________

Signature ______________________________________

Name ______________________________________

Address ______________________________________

City ______________________________ State __________ Zip ______________

Telephone ______________________________________

Mail to: The Counselors of Real Estate, 430 N. Michigan Avenue, Chicago, IL 60611

REAL ESTATE ISSUES

EDITORIAL CALENDAR

Summer 2006

Articles on general real estate-related topics

(deadline for manuscript submission—June 30, 2006)

Fall 2006

Articles on general real estate-related topics

(deadline for manuscript submission—August 31, 2006)

Winter 2006

Articles on general real estate-related topics

(deadline for manuscript submission—October 27, 2006)

Visit www.cre.org for information on submitting a manuscript for publication consideration or contact info@cre.org; 312.329.8427.

SUBSCRIPTION INFORMATION

Real Estate Issues publishes four times per year (Spring, Summer, Fall, Winter). To subscribe to *Real Estate Issues* or for additional information, contact The Counselors at www.cre.org; info@cre.org; 312.329.8427.

ADVERTISING OPPORTUNITIES

Real Estate Issues will bring your advertising message to users of counseling services in targeted industry sectors. To maximize your networking opportunities and reach leading real estate professionals, visit www.cre.org or call 312.329.8427 for pricing information.

CRE

THE COUNSELORS OF REAL ESTATE

www.cre.org

430 North Michigan Avenue
Chicago, Illinois 60611-4089

Telephone: 312.329.8427
Fax: 312.329.8881
E-mail: info@cre.org
Web site: www.cre.org