

REAL ESTATE ISSUES

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Number 2
Fall/Winter 1989

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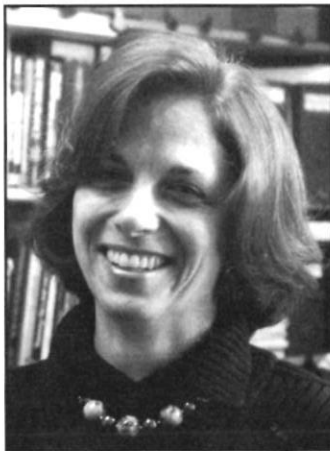
The Friendly Enemies

Henry Hart Rice, CRE



Published by the **American Society of Real Estate Counselors**
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LYNNE B. SAGALYN, CRE, RECEIVES 1989 BALLARD AWARD



Lynne B. Sagalyn, CRE

How Boston's risk taking venture with a private developer became a financial success summarizes the 1989 William S. Ballard Award article by Lynne B. Sagalyn, CRE, "Measuring Financial Returns When the City Acts As an Investor: Boston and Faneuil Hall Marketplace". This award, presented annually, is given to the author whose work exemplifies the journal's high standards of content.

In this Fall/Winter 1989 edition of *Real Estate Issues*, Sagalyn presents the terms of the city of Boston's deal with The Rouse Company, a private developer, and an analysis of the costs and lease-revenue flows considering the effects of time, inflation and trade-offs during renegotiation. In conclusion, Sagalyn cites the immediate financial success of Boston's risk taking with the Faneuil Hall Marketplace and the profitability realized from the spillover benefits on the property values of the surrounding area.

Sagalyn is an associate professor of Planning and Real Estate Development, Department of Urban Studies and Planning, at M.I.T., Cambridge, Massachusetts. She has been conducting research on

deal making in city development and the ways in which public agencies and private development firms plan and implement downtown complex developments.

She received a Ph.D. from M.I.T., an M.C.R.P. from Rutgers and a B.S., with distinction, from Cornell University. As a real estate counselor, Sagalyn has done extensive work on the performance of real estate investments as evidenced in her co-authorship of a book and subsequent speaking engagements on the topic of financial benefits from public-private partnerships.

The Ballard Award, with an honorarium of \$500, is funded by the generous contribution of the William S. Ballard Scholarship Fund in memory of Ballard, a late CRE.

All articles to be considered for next year's William S. Ballard Award competition must be submitted to the Society's Chicago office by August 1, 1990.

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Third class postage paid at Chicago. Subscription rates: \$24 per year (\$40 for two years, \$54 for three years); \$18 per year to students and faculty; \$26 foreign rate, submit in U.S. currency; single copy \$15. Remittances may be made by personal checks, drafts or post office or express money orders payable to the American Society of Real Estate Counselors. Remittances, change of address notices, undeliverable copies, orders for subscriptions and editorial material should be sent to Real Estate Issues, the American Society of Real Estate Counselors, 430 North Michigan Avenue, Chicago, Illinois 60611. 312/329-8257 FAX: 312/329-8881.

THE AMERICAN SOCIETY OF REAL ESTATE COUNSELORS

The American Society of Real Estate Counselors, a professional affiliate of the NATIONAL ASSOCIATION OF REALTORS®, was formed in 1953 to establish professional standards for those who provide the public with expert, independent real estate advice for compensation. Membership is by invitation only. The privilege of using the respected CRE (Counselor of Real Estate) designation obligates the Counselor to a strict Code of Ethics and Standards of Professional Practice.

Library of Congress card number LC 76-55075

Printed in U.S.A.

Leading Counselors and Academics Share Views

Each edition of Real Estate Issues presents ideas and knowledge from some of the finest real estate experts in the world. This edition is particularly notable because of contributions made by a group of highly respected and widely published counselors and academics.

Articles by Maury Seldin, CRE and Charles J. Delaney, and Lynne B. Sagalyn, CRE, present provocative thoughts from a Counselor's perspective. Christopher B. Leinberger, David C. Prosperi, Norman J. Quinn, III, James R. Webb and Robert J. Shedlarz, Karen Martin Gibling and Austin J. Jaffe and Michael Janov provide academic and practitioner viewpoints on contemporary real estate issues.

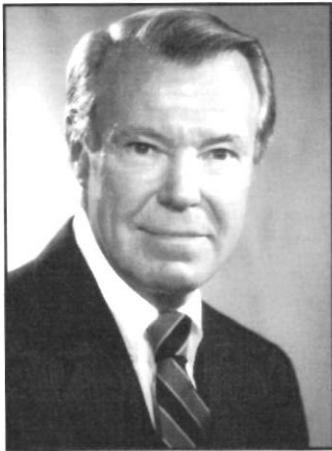
We are also fortunate that John Robert White, CRE and Henry Hart Rice, CRE, well known and widely respected within the Society and the industry, present their opinions to our readers.

Many thanks to all our contributors for their hard work and valuable insights.



Editor in chief

JOHN ROBERT WHITE, CRE, HONORED WITH 1989 LANDAUER AWARD



John Robert White, CRE

In recognition of his demonstrated outstanding professionalism in real estate and for furthering the ideals of the American Society of Real Estate Counselors and the CRE (Counselor or Real Estate) designation, John Robert White, honorary chairman and director of Landauer Associates, Inc., New York, has been named the 1989 recipient of the James D. Landauer Award.

A member of the Society since 1960, White served as president in 1969 and presently is a member of the *Real Estate Issues* Editorial Board. White also is known as the ongoing chairman and moderator of the Society's annual Economic Forecast, a highly acclaimed program where nationally prominent business experts gather to provide the public with their prognostications for the coming year.

Regarded as a leader in the field of real estate counseling, White has negotiated many of the best known counseling assignments of this decade including the \$400 million sale of the Pan Am building and the \$500 million refinancing of the General Motors building in Manhattan.

As chairman of Turner Equity Investors, a publicly owned realty trust, he negotiated the 1988 merger of Turner and MCI Properties of Boston in a \$220 million transaction.

Author of numerous articles and books on real estate valuation, economics and finance, White has received national recognition for his civic, business and literary accomplishments, including New York University's prestigious Urban Leadership Award.

White is also a member of the American Institute of Real Estate Appraisers (MAI), the Urban Land Institute and the New York State Appraisal Society.

The Landauer Award is named for the late James D. Landauer, CRE who was instrumental in the establishment of the Society and the preeminence of the real estate counseling profession. Other recipients have included CREs Roland Rodrock Randall (1986), James E. Gibbons (1987) and Roy P. Drachman (1988).

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- 1 **Real Estate in the 21st Century: A Delphi Perspective**
Charles J. Delaney and Maury Seldin, CRE
Members of the American Society of Real Estate Counselors, in their response to a survey conducted in 1988-1989, offer an interesting and diverse perspective of real estate in the next century. This article presents an analysis of the survey results, namely those issues which drew a lack of consensus by the respondents. Also discussed are the Counselors' expectations for the future and how these assumptions will impact real estate.
- 7 **Measuring Financial Returns When the City Acts As an Investor:
Boston and Faneuil Hall Marketplace**
Lynne B. Sagalyn, CRE
This article examines the financial implications of city deal making by analyzing, from an investment perspective, the return from Boston's arrangement with The Rouse Company for the redevelopment of the Faneuil Hall Marketplace. For Boston, city risk taking proves to be profitable, although a series of tradeoffs made during renegotiation of the deal limits this return.

Reprint Information

You can order single and multiple copies of articles that have appeared in any edition of *Real Estate Issues*. For further information and fee structure, contact *Real Estate Issues*, 430 N. Michigan, Chicago, IL 60611 or call (312) 329-8257.

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Christopher B. Leinberger
In the past two decades, dozens of Class A “urban village cores” have appeared across the nation. In this article, the author focuses on a new trend where Class A cores are being built from scratch, according to master plans, at the outskirts of several metropolitan areas. Cited are Tysons Corner in northern Virginia; Perimeter Center, north of Atlanta and Costa Mesa/Irvine/Newport Beach, south of Los Angeles.
- 20 **The Use of Computerized Property Tax Data for Urban and Regional Analysis**
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The availability of computerized parcel level data is revolutionizing the potential capability of urban and regional analysts to further articulate urban growth dynamics. This article reviews, explores and suggests applications for the use of property assessor data in both theoretical and empirical research.
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Norman J. Quinn, III
For tax purposes, real estate is assessed periodically on the basis of the market value on a set valuation date. The market value of real estate varies with supply and demand in the local economy. Exploiting the real estate assessment cycle requires understanding the mechanics of the process plus knowing the opportunities to minimize assessments.
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Robert J. Shedlarz and James R. Webb
The real estate broker’s liability to the buying public in this country continues to evolve. However a solution to the present confusion may not be long in coming. Government regulation, with a high probability of added expense and delay, is the alternative, if the real estate profession should ignore this problem for too long.
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The 55 and over age group is a vast growing segment of the U.S. population which should be of interest to home builders. Current trends indicate that this group is better educated, earns higher income and is more mobile than other segments of the population. With proper attention to market segmentation and product design, location, pricing and promotion, home builders may be able to take advantage of the opportunities this market affords.
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The authors recognize that tragic results await future generations as common resources become scarce. They argue for the establishment of stronger and better defined property rights to alleviate many of the problems which have been developing since the founding of the national park system at the beginning of this century.
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Professionalism and skill are hallmarks of the real estate counselor. Both nationally and internationally, the counseling function is expanding to meet the needs of an increasingly complex real estate industry.
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Henry Hart Rice, CRE
Developers and planners often find themselves as adversaries depending on the area’s investment opportunities.

REAL ESTATE IN THE 21ST CENTURY: A DELPHI PERSPECTIVE

Survey results disclose the Counselors' expectations on life in the next era and those areas which pose a lack of agreement.

by Charles J. Delaney and Maury Seldin, CRE

Counselors of Real Estate (CREs), members of the American Society of Real Estate Counselors, participated in a survey requesting their expertise on the major forces influencing real estate over the next two decades. The respondents provided a diverse perspective as to:

1. transportation changes and residential location decisions;
2. population growth in the Sunbelt states;
3. government ability to control the budget deficit;
4. rent control;
5. the effect of technological innovation on the structure of the domestic economy.

The survey used a Delphi approach, developed by researchers at the Rand Corporation in the 1950s, to elicit expert opinion from CREs. The Delphi technique uses an iterative methodology whereby survey responses are continually refined until a group of consensus statements is ultimately reached. Three rounds of the survey were conducted over a period of approximately nine months.

Survey Series

The first iteration of the survey asked the real estate counselors to identify the five most important forces

Charles J. Delaney, assistant professor of real estate, Baylor University, received his doctorate degree in real estate from the University of Florida. His articles have appeared in leading real estate publications, and he is the recipient of numerous grants and awards from governmental agencies including the U.S. Department of Energy.

Maury Seldin, CRE, is president of Hoyt Advisory Services and Homer Hoyt Institute, an independent, nonprofit organization focusing on research with relevance. He is also Realtor Chair Professor at The American University, Department of Finance and Real Estate. Seldin has authored or co-authored numerous books on real estate including the forthcoming *Real Estate Analyses* and the *Real Estate Handbook*.

The Delphi Study conducted in 1988 and 1989, was supported as a joint effort of the American Society of Real Estate Counselors and the Homer Hoyt Institute (HHI) an independent, nonprofit organization, focusing on research with relevance.



affecting real estate in the next 10-20 years and the likely effects of those forces on the real estate markets. The responses were grouped into 19 broad categories and the five categories identified most often were used as the basis of the second survey.

The second survey, incorporating Likert-type scales, offered members of the Society a chance to indicate their level of agreement with the importance of and their expectations regarding the effects of the five major forces identified in the first survey. As anticipated, respondents were in general agreement regarding the importance of these forces on real estate over the next two decades. However, the results of this second iteration revealed a significant divergence of opinion pertaining to the effects of the five major forces. The desire to understand better the nature of the differences prompted a third iteration of the survey.

The third round presented only those issues resulting in a significant divergence of opinion and asked CREs to once again indicate their expectations for the next 10-20 years. In addition, CREs were asked to provide the assumptions behind their expectations, and to identify the specific impacts of their expectations on real estate in the next two decades.

Long Range Program To Elicit Expert Opinions

The study, while illustrative in itself, is part of a long range program to elicit expert opinion from field practitioners. Recent fluctuations in the real estate market have brought increased attention to the need for professional input on real estate matters. While such expert opinion is available from a variety of sources, the Society is most widely recognized as the professional organization with a constituency expert in a broad range of real estate markets.

Survey Results

There were numerous issues on which the counselors agreed. Figure I shows the second questionnaire including the Likert scales. The percentage of participants recording a given response is noted immediately below each choice.

The respondents agreed overwhelmingly that the economic environment of the U.S. would be an important force affecting real estate in the next 10-20 years. In particular, 75 percent of the respondents indicate that the balance of trade would improve. Sixty-four percent of survey participants believe that the ability of the U.S. to compete in world markets in the next two decades will get better or much better. About one-half of the respondents believe that interest rates would remain at about the same level for the next 10-20 years. Of the remainder, about twice as many expect rates to increase as expect rates to decrease.

Ninety-three percent agree that income levels and the changing demographics of the U.S. population are expected to be important forces affecting real estate over the next two decades. As to the specifics, household size had mixed reviews, with 62 percent of CREs expecting the level of household size to remain about the same, but virtually all responding CREs expect the trend toward greater longevity to continue to increase. Furthermore, 63 percent expect more amenities and services to be demanded by tenants and purchasers of real estate.

Seventy-four percent of the responding CREs expect technological innovation in the U.S. to be an important force affecting real estate in the next 10-20 years. Sixty-seven percent of the respondents expect the trend towards decentralization of employment to continue based upon advances in telecommunications and other innovations. Additionally, more than 90 percent expect the trend towards a global economy to continue, while 80 percent of the respondents believe access to air transportation will become increasingly important. There was also general agreement that the use of robotics in U.S. industry would continue to grow.

Governmental restrictions and environmental regulations are expected to continue to be important forces. Specifically: 76 percent of survey participants expect the problems of hazardous waste disposal to get worse or much worse. Regarding the extent of asbestos contamination in the next 10-20 years, 57 percent expect the problem to be less serious in the future. Over 90 percent of respondents expect government will require developers to pay more of new infrastructure cost in the next two

decades. Exactly half of the survey participants expect the structure of the federal tax system to remain about the same regarding the investment potential of real estate.

Slightly more than 70 percent of the respondents expect that societal management of domestic affairs, both public and private, will be an important force affecting real estate over the next two decades. Over 50 percent of the respondents expect the boom and bust in real estate development to continue. Slightly more than 50 percent of survey respondents expect the problem of providing affordable housing to worsen. In considering the relationship between developable land and the cost of housing, 70 percent of CREs expect the availability of developable land to decline. Fifty-five percent of the respondents expect the crisis in the U.S. savings and loan industry to improve in the next 10-20 years. More than 50 percent of the respondents expect the quality of our infrastructure to decline over the next 10-20 years.

Issues For Investigation

The remainder of this article presents the issues for which consensus was lacking among survey participants. The format of subsequent discussion is as follows: First, each statement resulting in a lack of majority agreement from the second iteration of the Delphi Study is given. An analysis of survey participant responses to the request for future expectations follows each statement. Second, from the third iteration of the study, is a discussion of respondents' assumptions underpinning their expectations for the next 10-20 years. Finally, also from the third round, is a discussion of study participants' beliefs concerning the specific impacts of these issues on real estate problems they expect to encounter most often over the next two decades. No attempt is made to explain the results. This task, hopefully, will be undertaken by researchers with an interest in exploring the nature and effect of these controversial real estate issues.

Increasing Migration To The Sunbelt

As to the continuation of the trend of increasing migration to the Sunbelt, 34 percent of survey respondents indicated they believed this trend would continue over the next 10-20 years, while 41 percent said the trend would remain about the same, and 25 percent indicated they felt a decline would be experienced.

Those who believe that the trend will increase indicated assumptions of immigration from Latin America and Asia, as well as attractiveness to employers because of lack of labor unions in the area, climate and lower cost housing.

Those who expect a decline in Sunbelt population growth focused on problems of a deteriorating and inadequate infrastructure in the South, environmental problems associated with past growth, water problems and equalization of wage rates as labor unions lose power. Also noted was a resurgence of manufacturing industries in the North (the Rustbelt). The salient conflicting assumptions relate to the ability of the North, particularly the Rustbelt, to compete

(continued on page 5)

FIGURE I

Results of Second Delphi Questionnaire

I. The economic environment in the U.S. is expected to be an important force affecting real estate in the next 10-20 years

<u>strongly disagree</u>	<u>disagree</u>	<u>neutral</u>	<u>agree</u>	<u>strongly agree</u>
2%	1%	1%	22%	74%

A. The international balance of trade for the U.S. has been quite unfavorable (negative) in recent years. Do you expect the balance of trade in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
0%	9%	16%	69%	6%

B. The ability of U.S. manufacturing to compete globally has dwindled in recent years. Do you expect the ability of U.S. manufacturing to compete in world markets in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
1%	11%	24%	60%	4%

C. Technological innovation is changing the structure of production in the U.S. from manufacturing to service. Do you expect the trend from a manufacturing economy to a service economy in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	15%	38%	45%	2%

D. Interest rates have been trending upward in the last quarter century. Do you expect the trend in interest rates in the next 10-20 years will be

<u>down sharply</u>	<u>down</u>	<u>remain about the same</u>	<u>up</u>	<u>up sharply</u>
1%	17%	49%	31%	2%

E. The federal budget has operated in the red in recent years. Do you expect the current budget deficit in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
1%	21%	31%	46%	1%

II. Income levels and the changing demographics of the U.S. population are expected to be important forces affecting real estate in the next 10-20 years

<u>strongly disagree</u>	<u>disagree</u>	<u>neutral</u>	<u>agree</u>	<u>strongly agree</u>
1%	3%	3%	48%	45%

A. Population growth in recent years has been greatest in the Sunbelt. Do you expect this trend in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
1%	24%	41%	33%	1%

B. Household size has been decreasing in recent years. Do you expect the trend to smaller households in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	17%	62%	21%	0%

C. The average life span of Americans is increasing and with it demand for specialized housing and services. Do you expect the trend toward greater longevity and demand for specialized housing and services in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	0%	4%	73%	23%

D. Real per capita income has been declining in recent years and with it a reduction in the purchasing power of the majority of Americans. Do you expect the decline in real per capita income in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
0%	23%	48%	29%	0%

E. More amenities and services are being demanded by tenants and purchasers of real estate. Do you expect the demand for amenities and services in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	7%	30%	58%	5%

III. Technological innovation in the U.S. is expected to be an important force affecting real estate in the next 10-20 years

<u>strongly disagree</u>	<u>disagree</u>	<u>neutral</u>	<u>agree</u>	<u>strongly agree</u>
1%	6%	19%	50%	24%

A. Advances in telecommunications and other innovations have made possible the decentralization of employment centers in many U.S. cities. Do you expect the trend toward decentralization in U.S. cities during the next 10-20 years because of technological advances will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	7%	26%	62%	5%

B. Improvements in ground transportation and declining oil prices in recent years have made it feasible for the labor force to live further away from its place of employment. Do you expect the trend of employees to live further away from the CBD and employment centers in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
1%	29%	34%	34%	2%

C. Technology's contribution to the globalization of the world's economies is increasing at a rapid rate. Do you expect the trend toward a global economy in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	0%	7%	73%	20%

D. With respect to the globalization of the world's economies, access to air transportation has become increasingly important in recent years. Do you expect that the importance of access to air transit in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	1%	19%	68%	12%

E. The use of robotics in U.S. industry is growing. Do you expect the trend in the use of robotics in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	0%	10%	75%	15%

IV. Governmental restrictions and environmental regulations are expected to be important forces affecting real estate in the next 10-20 years

<u>strongly disagree</u>	<u>disagree</u>	<u>neutral</u>	<u>agree</u>	<u>strongly agree</u>
1%	1%	4%	37%	57%

A. Disposal of hazardous, toxic, and other solid wastes is a problem with no immediate feasible solution which has implications on future land use. Do you expect the problems with waste disposal in the U.S. in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
29%	47%	9%	10%	5%

B. Asbestos contamination of buildings is a costly and hazardous problem. Do you expect the extent of asbestos contamination in buildings in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
2%	12%	29%	44%	13%

C. Development exactions, such as impact fees and land dedications, and more stringent permitting and zoning laws are causing the costs of construction to rise. Do you expect the trend in government requirements that development pay more of the cost of new infrastructure in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
0%	1%	6%	72%	21%

D. Recent changes in the federal tax structure have served to reduce the tax shelter aspects and, hence, the allure of investment real estate. Do you expect the trend of the federal tax structure to the investment potential of real estate in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
1%	19%	50%	28%	2%

E. Rent control is used in many cities to provide affordable housing. Do you expect the trend toward rent control as means to provide affordable housing in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
2%	28%	49%	19%	2%

V. It is expected that how our society manages its domestic affairs, both public and private, will be an important force affecting real estate in the next 10-20 years

<u>strongly disagree</u>	<u>disagree</u>	<u>neutral</u>	<u>agree</u>	<u>strongly agree</u>
1%	5%	23%	49%	22%

A. In recent years overbuilding has characterized the real estate industry in many parts of the U.S. Do you expect the amplitude in the volume of construction in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
1%	33%	52%	14%	0%

B. There is growing concern over the lack of affordable housing for many Americans. Do you expect the problem of providing affordable housing in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
4%	47%	30%	18%	1%

C. The lack of developable land contributes to the high cost of housing. Do you expect the availability of developable land in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
5%	65%	25%	5%	0%

D. There is a crisis in the savings and loan industry. Do you expect the problems being experienced by U.S. savings and loan associations in the next 10-20 years will get

<u>much worse</u>	<u>worse</u>	<u>remain about the same</u>	<u>better</u>	<u>much better</u>
7%	26%	12%	50%	5%

E. The cost of providing new infrastructure as well as repairing and maintaining existing infrastructure is a major problem for local governments. Do you expect the quality of our infrastructure in the next 10-20 years will

<u>decline sharply</u>	<u>decline</u>	<u>remain about the same</u>	<u>increase</u>	<u>increase sharply</u>
5%	47%	28%	20%	0%

for job location. Part of that competition relates to growth of services versus manufacturing employment.

The impacts of a continuing growth trend are a greater demand for all types of housing in the short and long-run with associated higher prices, long-run demand for more office space, higher taxes to provide for infrastructure and public services, shift of political power in Congress to Sunbelt states and overall higher real estate appreciation as compared to other parts of the United States.

The specific impacts noted by respondents believing the trend in population growth will decline in the Sunbelt focused on this trend's impact on the North. Included are expansion of manufacturing and related industries and increased demand for office space.

Consequences Of Living Further Away From Place Of Employment

The statement that improvements in ground transportation and declining oil prices in recent years made it feasible for the labor force to live further away from its place of employment implies residential location decisions are a function of time and expense of travel. The divergence of opinion on the consequences of living further away from place of employment is almost evenly divided.

While 34 percent of the CREs thought that travel factors would continue impacting housing location choices at about the same rate as evidenced today, 36 percent felt that transportation impacts would increase or sharply increase over the next 10-20 years. Thirty percent felt a decline in the influence of transportation factors would be noticed.

Those expecting a continuation of current trends in the impact of transportation on people's choice of housing location assumed that petroleum prices would remain relatively stable and improvements in infrastructure will keep pace with increased demands of commuter traffic.

Another 36 percent of respondents, however, anticipated an increase in the trend toward suburbanization. They based their expectations on the growth in housing costs in urban areas, greater interest in leisure time and recreation, and increasing tolerance for commuting.

The 30 percent of CREs believing that transportation impacts on housing choices will lessen based their expectations on rising energy prices combined with inadequate mass transit and a deteriorating infrastructure. These factors will impose limits on feasible commute distances. The critical issues are related to energy costs and public investment in mass transit.

A continuation of the trend toward a deteriorating transportation situation will strongly affect real estate, especially the current proliferation of suburbs. Specific impacts will include, more commercial and retail development in outlying residential areas and more sprawl in general. Those areas which are drawn into development will experience higher pricing.

Respondents believing the suburbanization era has peaked predict increased urban revitalization, improved

urban mass transit, more infill and high density development and more close-in residential development.

Service-Based Rather Than A Manufacturing-Based Economy

The trend toward a service-based, rather than a manufacturing-based economy is expected to increase according to almost 47 percent of the survey participants. Thirty-eight percent of the CREs assert that the current rate of change will remain about the same. However, 15 percent of the respondents expect a decrease in the trend.

Those who expect the current shift to increase noted that technology advances, especially automation, will continue to displace industrial workers. Labor costs and benefits enjoyed by U.S. workers, however, will continue to outpace those of labor in foreign countries, and advances in computer and communication technology will continue.

Those expecting the current rate of change from manufacturing to service industries to remain about the same assume that the discrepancy between U.S. and foreign wages is decreasing and that exchange rate differences between the U.S. dollar and major foreign currencies will continue to encourage foreign investment in U.S. industry.

A substantial minority of CREs responding felt that the trend towards a service economy is declining. Their assumptions included a belief that current levels of U.S. manufacturing are necessary to support a service-based economy. These respondents also strongly suggested that public opinion, in the form of increased pressure for federal protectionist policies as well as general emphasis on "made in the U.S.A." products, would help reverse the trend.

Those who expect to see a continuing shift in production from manufacturing to service predicted specific real estate impacts, especially in regard to decreased demand for industrial real estate and increased obsolescence and loss of value in older manufacturing properties. On the other hand, they predict that demand for light industry complexes, office and commercial real estate will increase along with demand for suburban business parks. A final impact of continued growth in the service sector, they report, will be the growth of computer-based work at home.

Those expecting a decline in the shift of production from manufacturing to service predict such specific real estate impacts as less demand for office space in conjunction with increased demand for industrial and warehouse properties. A phenomenon such as the resurgence of the Rustbelt, they observe, also indicates increasing demand for housing as a mobile industrial workforce moves back into Rustbelt states.

Status Of The Federal Budget In The Next 10-20 Years

Regarding the statement that the federal budget has operated in the red in recent years, 47 percent of the respondents indicated they expect the budget deficit to get

better or much better in the next 10-20 years, and another 31 percent said it would remain at about the same level. Twenty-two percent of the responding CREs said it would get worse or much worse.

Overall, responding CREs expressed optimism that the federal budget deficit would decrease over the next two decades. Assumptions underlying their positive expectations were increasing pressure on government to decrease spending and the inevitability of new taxation coupled with reduced defense spending. In addition, these respondents pointed to the resolve of the Bush administration to shrink the deficit, the impact of Gramm-Rudman, and increasing levels of personal savings.

On the other hand, those expressing doubt that deficit budgets would decrease likewise based their convictions largely on governmental response. In this case they foresaw increased governmental bail outs of ailing industries and an inability to stave off an impending recession. Moreover, these respondents predicted a lack of commitment in public rhetoric to buy American.

The specific impacts on real estate projected by those believing the deficit will get better include increased taxation on real estate investors and decreased demand for real estate around military bases as defense spending declines. In addition, they predict increased preference for the most modern properties, although as interest rates decline, the mortgage demand for all types of property will increase along with increased capital investment in real estate.

Those expecting a worsening of the federal budget deficit predict impacts on real estate, such as high interest rates, will result in a decline in demand for all real estate. Others, possibly conflicting, predicted impacts include increased foreign demand for U.S. real estate, higher taxes and less capital outlay for industrial development.

Rent Control, As A Means Of Providing Affordable Housing, Will Remain At Current Levels

Forty-nine percent of the CRE respondents concurred with the statement that rent control, as a means of providing affordable housing, will probably remain at current levels for the next 10-20 years. Twenty-one percent, however, projected an increase in rent controls while 30 percent predicted a decline in this method of providing housing assistance.

Assumptions behind the belief that rent controls would remain at current levels focused on the overwhelming political implications of rescinding controls currently in effect. While few or no CREs felt that such controls achieved their purpose, many recognized the political peril inherent in changing current law. Likewise, almost all respondents predicting an increase in the use of rent controls cited political expediency, not efficacy, as the underlying motivation.

Those respondents who felt that rent controls might decrease cited the general ineffectiveness or outright counterproductivity of such measures as the reason. In addition, these respondents also noted political pressure

as a motivating force in the reduction of rent controls.

Specific impacts of rent controls remaining the same or increasing, focused on the further disincentive for the private sector to invest in the type of development subject to rent controls.

Those predicting a decline in rent controls felt the general disenchantment with government controls, coupled with inherent beliefs in the free market system, would lead to a reduction of controls and stimulate private sector construction of multi-family housing in areas previously under rent control.

Concluding Comments

Those areas where Counselors achieved consensus indicate areas of minimal research value unless an academic has some reason to believe the prevailing opinion is an error. The areas in which consensus is not reasonably obtainable, however, provide a productive research field. While the Delphi Study attempted to separate divergences of opinion relating to assumptions, it did not attempt to develop explanations of the system.

The challenge of any discipline, including real estate and land economics, is to explain the system to reasonably forecast the outcome of different courses of action. Such explanations generally engender models, some simple, others quite sophisticated.

To forecast the outcome of future courses of action, researchers use analytical systems such as feasibility analysis, market analysis, valuation analysis, highest and best use studies and others. These and other analyses are the analytical tools frequently used by CREs. Research efforts have been underway for some time to classify these analyses seeking out common components and explaining relationships¹. This information can only aid real estate decision makers and enhance the quality of their decision making.

NOTES

1. Seldin, Maury., "A Reclassification of Real Estate and Market Analyses: Toward Improving the Line of Reasoning," *Real Estate Issues*, 1984. Vol. 9, No. 1.

MEASURING FINANCIAL RETURNS WHEN THE CITY ACTS AS AN INVESTOR: BOSTON AND FANEUIL HALL MARKETPLACE

The financial payback to the City of Boston from the development of Faneuil Hall Marketplace provides a starting point for analyzing the benefits of public-private downtown project development deals.

by Lynne B. Sagalyn, CRE

In the 1970s, public finance took on new meaning for city officials intent on rebuilding their downtown areas. Pressed by ongoing cutbacks in federal aid and existing demands on municipal treasuries, cities as diverse as Baltimore, Boston, Cincinnati, Los Angeles, Milwaukee, Philadelphia, San Diego and St. Paul adopted businesslike practices. To attract the retail centers, hotels, sports stadiums and public amenities they wanted for downtown, city officials negotiated development agreements with private real estate firms, custom-tailoring financial assistance to match the specific needs of individual projects. To pay their share of the bill, cities leveraged public dollars, packaging diverse sources of money with ingenuity and resourcefulness. Increasingly, as part of their agreements with developers, cities also bargained for loan paybacks, lease participations and profit sharing. These financial interests were the symbols of a new practice: public-private deal making. By the mid-1980s, this practice was widespread in big and small cities alike.¹

Deal making marked a turning point in the way cities managed and financed downtown redevelopment.

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The author especially thanks Bernard J. Frieden, co-author of *Downtown, Inc.: How America Rebuilds Cities* (Cambridge, MA: MIT Press, 1989), the larger research effort from which this paper is derived. Appreciation also is extended to Lawrence E. Susskind, Lawrence S. Bacow, John McMahan, CRE, A. Jerry Keyser, an anonymous referee for comments on an earlier draft, and Denise DiPasquale for useful conversations on this topic. John Avault of the Boston Redevelopment Authority assisted with data collection. Financial support was provided by the MIT Center for Real Estate Development.

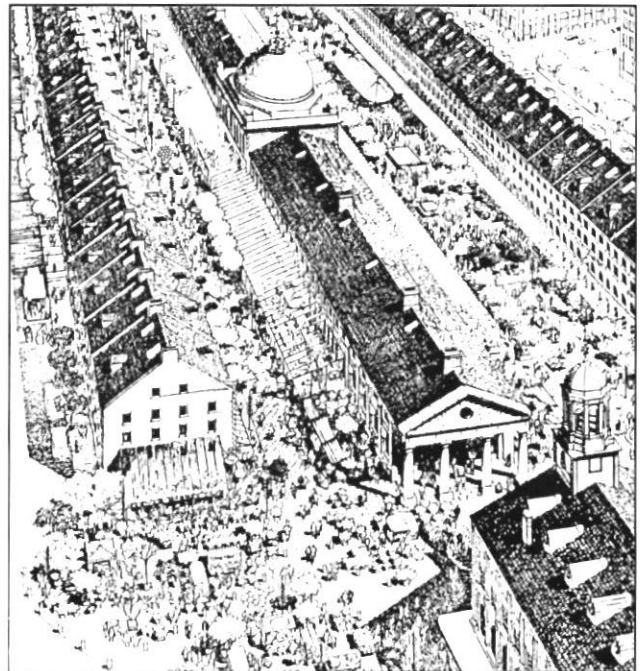


Photo credit: The Rouse Company

Under the federal urban renewal program, which for two decades had funded the rebuilding of downtown, cities worked with developers at arms-length as required by the program's guidelines. After the urban renewal program was shut down in 1974, cities dropped the cumbersome regulations and embraced a new strategy that brought them into face-to-face negotiations with developers.² As they charted their own course, cities became co-investors in private development projects. This new role gave cities a right to share in major decisions throughout the development process, not just during the early approvals stage. And the new financial agreements, unlike redevelopment's traditional fiscal dividend of rising property tax assessments, specified the rate and timing of the return on public investment.

As successful as the new public-private strategy has been in changing the course of downtown investment, neither government officials nor policy analysts have evaluated the actual financial returns that accompany public-private deals. First, the deals are complex; they involve many players, many sources of funds and layers of subsidies financed directly with budgeted funds and indirectly through off-budget expenditures. In addition, the terms of these business deals are not always covered in a single document or negotiated with a single agency. As a result, it is hard to unravel the complexity of the deals, and few people understand them.

Second, there is no clear technique for evaluating the deals. Prospective (pro forma) analysis of a project typically reveals how public assistance can close the gap between development costs and investment value to make a project financially feasible for a private developer, but it does not ensure that cities will design minimum aid packages. Most important, it is not a balance sheet for public accounting of public-private projects. For this, cost-benefit analysis is an appropriate conceptual framework,³ but it must be adapted so it may be used to evaluate the financial outcomes of negotiated development. In particular, it is crucial to analyze the trade-offs that are at the heart of public-private deal making as well as the ultimate financial payoff. In this way, government officials may learn what types of deals are most beneficial to cities.

Understanding how to price deals is important to a city's ability to manage its public resources, especially as the trend toward strategic management of publicly owned sites grows.⁴ Economic development strategies and land use policies rely heavily upon a growing inventory of financial incentives that make demands on local resources, and as the commitments accumulate, government officials and civic groups are calling for greater accountability.⁵ The payback revenue streams are important by themselves; in an era of sparse federal assistance, these revenue streams have significant political appeal and economic potential as a source of capital for future public investments.

Boston's Faneuil Hall Marketplace provides a good case for analysis. The negotiation process leading to the renovation of the three historic structures is well documented. The marketplace has a 14-year track record as one of the most successful downtown projects of its kind, and data on public costs and public revenues are available. Further, the city's agreement with the developer of the project, The Rouse Company, represents a prototype profit-sharing arrangement: in exchange for leasing the property and financing the heavy upfront costs of redevelopment, Boston receives in-lieu-of-tax payments tied to the annual financial performance of the project.⁶

The objective of this article is to analyze Boston's financial participation in a public-private development venture from an investment perspective. The analysis differs from traditional cost-benefit analysis of public projects, which factors in additional fiscal benefits from increasing property values in surrounding areas and employment

generation as well as other, more elusive public benefits. By focusing only on the project's direct financial payback, the article intends to clarify how the terms of the deal and their renegotiation shaped public financial returns. The first part of the article describes the city's deal with The Rouse Company. It is followed by an analysis of costs and lease-revenue flows. Next, the effects of inflation, time and the terms of the deal on investment returns are explained. Finally, the concluding section comments on the findings.

The Deal For Redeveloping The Faneuil Hall Markets

Attracting major new retail investment downtown was a formidable task in the early 1970s. With populations still growing and environmental regulations not yet restricting development, mall developers had numerous opportunities in the suburbs, and most were uninterested in tackling the thorny problems of building retail structures downtown. Construction was approximately 20% more costly on downtown's smaller and more congested sites. Large garages, needed to meet industry's standards for parking, were expensive because each downtown space cost about three times more than a developer typically spent to pave over suburban, open-field acreage. Department stores and national chain retailers, who insisted upon following the suburban mall formula, were skeptical of downtown locations, and lining up financing was close to impossible without these big name players. Given the times, cities that wanted a shopping center downtown had to put together big assistance packages to make development attractive.

Redeveloping Boston's Faneuil Hall markets presented additional, special circumstances. First, the city, through the Boston Redevelopment Authority (BRA), wanted to keep the historic buildings under public ownership and retain control over the project's design. Second, the city offered the deteriorated markets in "as-is" condition, and the high cost of interior rehabilitation in addition to the expense of the downtown land had to be borne. Third, a historic landmark preservation mandate imposed design constraints on any private developer's attempt to adapt the structures to the conventions of 20th Century retailing.

To meet its objectives and keep the economics of the deal manageable for a developer, the city decided to lease the buildings instead of following the typical urban renewal assistance formula and selling the site at a below-market price. Leasing offered the city an additional benefit: payments would not have to be returned to Washington as would proceeds from a sale disposition.

With the urban renewal formula out of the way, there was no obvious way to price the lease. First, the city wanted to secure guaranteed income from the property. In addition, officials no longer thought of themselves as donors who were making a grant to assist the development of a project in the public interest, but as co-investors in a potentially profitable venture. They consequently wanted a share of the Faneuil Hall markets' gross revenues. At the same time, officials recognized Rouse's interest in keeping development costs in line with the actual performance of

the project, which was hard to predict. For the city, the basic need was to make the project politically defensible; for the developer, the need was to ensure a strong bottom line. A workable deal had to take care of both of these considerations.

The negotiations over the Faneuil Hall markets' lease stretched out over 14 months. For both city and developer, projecting performance of the project was an exercise in uncertainty because suburban malls provided few reliable parallels to the innovative plan the developer and his architect had conceived for food merchandising and specialty retailing without department store anchors. Timing was a factor, too. By the early 1970s, Boston had added several new office buildings to its aged inventory, but its downtown area was still in the doldrums. As a result, lease negotiations took place in an atmosphere of economic stagnation and financial maneuvering as both sides worked to line up the necessary commitments.

Rouse and his negotiating team, represented by the project manager plus two attorneys, saw the Faneuil Hall markets as historic but worthless in economic terms. They bargained hard for economic concessions that would reduce their risk and enhance the ability to recoup their investment. They also pushed for total control over design and related matters, believing that the project would proceed more quickly if the entire job was placed in private sector hands. The city team was represented by the BRA's director, deputy director and two attorneys. Experienced in real estate matters, the BRA's deputy director looked critically at Rouse's numbers and, based on his own financial analysis, questioned the developer's demands. The city team did eventually give some on the economic terms of the deal because it wanted the developer to have sufficient incentive, but it did not compromise on design matters.

The city and Rouse finally settled on a 99-year lease and a two-tier formula in which rent took the form of annual payments in lieu of property taxes. Rouse agreed to pay the city 20% of gross rental income, *plus* 20% of revenues in excess of \$3 million. According to the agreement, the gross rental income included any tenant payments made to the developer for utilities, taxes and other passthrough expenses. To share the exceptionally high costs of maintenance and security downtown, however, the city allowed The Rouse Company to deduct 33.3% of the gross revenues from retail subtenants who were assumed to occupy 60% of the rentable space.⁷ Total payments in any one year were capped at 25% of this adjusted gross rental income. The deal had two politically desirable features: a guaranteed income from the property plus a chance to share in upside gains. At the same time, the deal limited Rouse's payments to the guaranteed minimum unless the project was a big success.

There were other parts to the tax agreement. For the first three years during construction, the guaranteed payment was abated. Originally, Rouse had agreed to a payment schedule of \$200,000, \$400,000 and \$600,000 corresponding to the successive completion of the three

market buildings. Within six months after the company had been selected to develop the markets, Rouse wanted to renegotiate the amount of these payments because restoration workers found the buildings in worse shape than anyone had realized. Water leakage over the years had rotted many of the old foundation beams, and Rouse estimated that their replacement would add \$1 million to construction costs. To compensate the company for this unanticipated burden, which the BRA could not afford to absorb under the terms of its federal renovation grant, and to avoid the problems of verifying costs, the city reduced Rouse's guaranteed payments over the three year phase-in period to \$50,000 per year, for a total abatement of \$1.05 million.

Analyzing Public Deal Making

Measuring the city's ex post financial return from the lease-tax agreement raises a number of conceptual issues and practical problems. They may be grouped in three categories: accounting for costs, adjusting for policy decisions and evaluating negotiated trades. Each entails a kind of probing atypical of traditional financial analysis. Yet to understand the financial dynamics of public-private deal making, a framework is needed to explain how the terms of an agreement contribute to performance outcomes.

Accounting For Development Deals

How much public money went into the project? Table 1 presents a static analysis of public development costs and net lease revenues.

Tracking project development costs is difficult because cities rarely attempt to document the full expenses of development, e.g., soft administrative costs as well as hard construction expenditures. Typically, cities do not spend money out of their own budgets but instead rely on federal grant dollars, tax-exempt revenue bonds and other off-budget financing techniques. In addition, costs often are spread across a number of different departments and agencies.

An accounting of the cash outlays for Faneuil Hall Marketplace reveals that over 14 years, Boston contributed \$12.4 million of public funds, or 28% of the total combined development cost. These dollars covered the cost of acquiring the two market buildings that were still in private hands, renovating the exteriors of all three buildings, relocating the remaining merchants, removing a poorly placed highway ramp, installing new utility lines and improving the streets and open spaces surrounding the market buildings. This figure also includes expenses for consultants and staff time associated with managing the project. Boston officials made financial commitments for these activities early, operating under the belief that the way to get a project done was to put together a complete package before searching for a developer. Thus, by the time The Rouse Company was designated as the developer of the project, nearly two-thirds of the funds had been committed.

TABLE 1

Static Analysis of Public Development Costs and Net Lease Revenues for Faneuil Hall Marketplace: 1962-1987

Public Cost Model *	Nominal Dollars (000)				Inflation-Adjusted 1962 Dollars (000)				Payback Status:		Average Deflation Factor	
	Total Development Cost †	Net Lease Revenues ‡	Revenue Cost Ratio	Break-Even Year	Total Development Cost	Net Lease Revenues	Revenue Cost Ratio	Break-Even Year	Total Development Cost	Net Lease Revenues	Total Development Cost	Net Lease Revenues
Base-Case Model:												
Static property tax assessment	\$14,333	\$15,450	1.08	1987	\$9,714	\$4,773	0.49	1995	(\$4,942)		0.68	0.31
Perfect Foresight Model A:												
Property tax assessment adjustment for growth in downtown land values	\$15,541	\$11,723	0.75	1989	\$10,400	\$3,596	0.35	1999	(\$6,804)		0.67	0.31
Perfect Foresight Model B:												
Property tax assessment adjustment for growth in downtown land values —minus 50% attributable to Faneuil Hall Marketplace's own effect	\$15,298	\$12,430	0.81	1989	\$10,259	\$3,818	.037	1999	(\$6,440)		0.67	0.31

* Public cost models differ with regard to the estimation of foregone property taxes.

† Total development cost = direct development costs (1962-1975) plus estimated foregone property taxes.

‡ Net lease revenues = in-lieu-of property tax lease payments minus estimated property taxes if the privately owned North and South Market buildings had remained unrenovated.

Implementation problems also affected the timing of cost/revenue flows. Even though it was pushed forward by the BRA director and a supportive mayor and city council, redevelopment of the markets took a long time. After Boston's downtown waterfront project was formally announced in 1960, more than four years passed as studies were conducted, plans were prepared and federal approvals for the urban renewal grant were secured. Six more years passed before the BRA completed site assembly and issued the request for development proposals. Then financing problems encountered by the first development team kept the project from moving ahead smoothly. After Rouse was selected as the second developer, negotiations over the tax-lease agreement and difficulties in lining up private financing consumed two more years. By the time The Rouse Company made its first full lease payment in 1979, 17 years had passed since the first public dollars had been committed.

Foregone property taxes on the unimproved buildings, vacant during the redevelopment process, were another cost. For nine years, beginning in 1970 after the last tenants had been relocated and ending in 1979 when The Rouse Company started making the full lease payments, the city did not collect taxes on the North and South buildings. Cumulatively, this added 16% to the public bill for the Marketplace.⁸

Adjusting For Policy Decisions

Between 1962 when planning for the Faneuil Hall markets started and 1979 when the renovations stopped, property values in downtown Boston increased at an average annual compound rate of growth of approximately 4%, after adjusting for inflation.⁹ A more exacting estimate of foregone property taxes would account for the opportunity costs associated with rising property values. On the other hand, it would also have to reflect restrictions or special conditions prescribed by the city as a matter of policy. In this case, the city was not prepared to let the land go for the highest and best use. The Faneuil Hall markets could not be razed and the site used for a new office tower or a hotel; the buildings had to be preserved, and they had to be renovated in accordance with strict design standards.

To account for these policy constraints, the improvements component of the assessed valuation of the site was fixed at the 1962 level, while the land component was adjusted annually based on estimates of changing land values in downtown Boston (Perfect Foresight Model A).¹⁰ As Table 1 indicates, this adjustment increased costs by 10% over the direct expenditure bill and brought the total public development cost up to \$15.5 million.

On the revenue side, the lease payments made by The Rouse Company represented the gross receipts collected by the city following renovation. (Sales tax receipts would be included, too, but the city of Boston does not have a sales tax, nor does it receive, by statute, a fixed proportion of state collections.) By the end of 1987, after nine years of full payments, receipts totaled \$17.9 million. After accounting for the property taxes the city would have

collected if the buildings had remained privately owned and unimproved, net lease revenues totaled \$15.5 million, under base-case model assumptions about property tax assessments.

Measuring Trades

Over the course of negotiations, the terms of a deal came to reflect several factors—different bargaining strengths among participants at the table and political considerations for the city at large and economic rationales for particular cost sharing arrangements. To understand the financial implications of negotiating development agreements, trade-offs made during negotiations must be quantified. This process involves tracking changes in the deal over the course of negotiations and measuring the impact of those changes on the ultimate financial return of the project.

For example, in negotiating the tax agreement with The Rouse Company, Boston officials made two key trades to enhance the feasibility of the project for the developer. Initially, city officials agreed to share the high costs of operating a downtown festival market in exchange for participation in the cash flow of the project. Later, they agreed to cover unanticipated renovation costs (by increasing the tax abatement) in exchange for greater participation in cash flow. In principle, the trades offered the city potentially higher revenues in the future in exchange for concessions today. In both instances, however, the trade was constrained by a cap on the developer's total payment to the city. How important was this cap? By breaking down the lease payment into its base and participation components and projecting returns for the deal as it changed over the course of negotiations, the marginal impact of these trade-offs may be analyzed.

The Return From Deal Making

One indicator of the project's performance was the steady increase in annual lease revenues collected by the city since Faneuil Hall Marketplace opened. Between 1979 and 1987, net lease revenues grew at an average annual compound rate of 10.9%, from nearly \$1.0 million to \$2.1 million. Measured as a single year return on total public development investment and adjusted for inflation, the real return for 1987 was 5.8%, up from 4.2% in 1979. The participation formula accounted for this level of performance, although it did not compensate for the 17 years during which the city was spending money but not getting returns.

To present a true picture of the financial performance from the public investment in Faneuil Hall, one that captures both the intervening inflation and the delayed returns, the yield and net present value are calculated using a discounted cash-flow model which applies a real interest rate to constant-dollar flows over a long-term holding period of 40 years.¹¹

Discounting lays bare the heavy impact of the delayed returns. Inflation-adjusted net lease revenues drop by more than 50%. Table 2 shows, as of 1987, the net present value of the base-case model (at 3%) is a negative \$4.6

TABLE 2
Inflation-Adjusted Costs, Net Lease Revenues and Returns: Faneuil Hall Marketplace
(Discounted, 1962-Dollars, 000)

	As of 1987: Discounted at 3%			40-Year Holding Period: 1962-2002	
	Total Development Cost	Net Lease Revenues	Net Present Value	Net Present Value (with Residual)	Internal Rate of Return (with Residual)
Public Cost Model					
Base-Case Model:					
Static property tax assessment	\$7,070	\$2,476	(\$4,594)	(\$1,225)	2.54%
Perfect Foresight Model A: Property tax assessment adjustment for growth in downtown land values	\$7,528	\$1,858	(\$5,670)	(\$2,301)	1.22%
Perfect Foresight Model B: Property tax assessment adjustment for growth in downtown land values — minus 50% attributable to Faneuil Hall Marketplace's own effect	\$7,432	\$1,974	(\$5,458)	(\$2,089)	1.48%
					3.79%

million. If lease payments are projected to continue increasing at the 1982-1987 rate adjusted for expected inflation, the project breaks-even in 1999, 20 years after the city received its first full lease payment. After 40 years, the real-dollar yield, or internal rate of return, on the public investment in the marketplace is 2.5%.

Including an estimate for the residual value of the buildings at the end of the holding period nearly doubles the return to 4.5%. The substantial 200 basis point increase varies slightly with the assumption about cap rates but does not alter the conclusion that the city's direct return from the public investment in Faneuil Hall Marketplace is dependent upon long-term performance. Or, compare the investment yield to-date with and without the residual, -6.1% and 1.6% respectively.

Time had another hidden, if double-edged, impact. As the city worked its way through the redevelopment process, land values downtown were increasing gradually. Clearly, from the city's overall fiscal perspective this trend was important—it provided early evidence that the city's urban renewal efforts would produce a fiscal dividend. From the narrower perspective of project analysis, however, the process of putting the redevelopment package together was costly. Even small increases in land values downtown, compounding over many years, raised the foregone property tax bill and thereby reduced the net benefits from the markets' lease payments. After accounting for increased land values downtown, as shown in Table 2, the real-dollar yield of the project for the 40-year period drops to 1.2%; 3.6% with the residual value. To some unknown extent, the success of the marketplace itself contributed to this incremental land-value effect. (According to some participants in the Boston downtown market, the success of the marketplace raised surrounding property values by approximately 25%.¹²) If the land-value adjustment is cut back by 50% to account for the marketplace's own spillover impact (Perfect Foresight Model B), the real-dollar yield is 1.5%; 3.8% with the residual value. These are competitive returns for the city, even though they seem low in today's high rate environment.

When the tax-lease agreement was signed, city officials took comfort in their financial advisor's estimate that the project would generate annual revenues of \$1.5 million by the mid-1980s. This was almost seven times what the old dilapidated markets yielded before renovation. In addition, the city faced no additional public expense because, under the terms of the lease, The Rouse Company was responsible for maintaining the streets and providing security for the marketplace.

If the lease arrangement is considered a form of financing and the public financial return is compared with local government's cost of capital, the deal provides the city with an inflation-hedged investment. Assuming the city earned interest on dollars which were invested in high grade municipal bonds and following the same disbursement pattern for the marketplace, the return would have been -1.6% after accounting for inflation; 1.9%

TABLE 3			
Projected Revenues and Returns Under Successive Deals: Faneuil Hall Marketplace			
A. First-Year Expected Revenue (000): 1979 (Nominal Dollars)			
	Designation Deal	Preliminary Deal	Final Deal
Base payments	\$1,375	\$1,001	\$1,001
Additional kicker	—	\$ 210	\$ 250
Total	\$1,375	\$1,211	\$1,251
B. 40-Year Holding Period Internal Rate of Return: 1962-2002 (No Residual)			
	Designation Deal	Preliminary Deal	Final Deal
Nominal dollars	9.10%	8.45%	8.46%
Inflation-adjusted dollars	3.10%	2.53%	2.54%
C. The Role of the Cap: 40-Year Internal Rate of Return (No Residual)			
	Final Deal with Cap	Final Deal without Cap	
Nominal dollars	8.46%	10.55%	
Inflation-adjusted dollars	2.54%	4.40%	

Notes:

For the preliminary deal, the additional kicker payment was 10% of gross revenues above \$3 million, 11% above \$4 million and 12% above \$5 million. Total payments were capped at 25% of gross revenue. For the final deal, the additional kicker payment was a flat 20% of gross revenues above \$3 million. Total payments were capped at 25% of gross revenues.

Gross revenues as defined by the BRA-Rouse Co. agreement equaled total revenues minus a 33 1/3% deduction from retail revenues for extraordinary operating expenses downtown.

Inflation-adjusted dollars = 1962 dollars

including the redemption value of the bonds at the end of 40 years.

If the lease arrangement is considered a form of property tax and is compared with the productivity of major new downtown Class-A office buildings, it again compares favorably. In general, the lease arrangement is in line with prevailing agreements for downtown buildings that peg property tax payments to 20% of gross income.¹³ On a parcel-to-parcel basis, first-year payments on the marketplace were between 1.4 and 1.7 times the property tax revenues generated by several nearby office towers that were completed during the same period.

Costly Compromises

The city's competitive rate of return is only one side of the story; the other involves a series of trade-offs. During the two year negotiation process, three successive deals were

TABLE 4

Financial Net Gains (Losses) from Renegotiating the Faneuil Hall Marketplace Agreement
(Nominal Dollars)

A. With Cap from Designation Deal to Preliminary Deal				A. With Cap from Preliminary Deal to Final Deal		
Year	Cost of 33 ¹ / ₃ % Deduction	Benefit of Additional Payment	Net Gain (Loss)	Cost of Tax Abatement	Benefit of Additional % Payment	Net Gain (Loss)
1976				\$ 150.0		(\$ 150.0)
1977				\$ 350.0		(\$ 350.0)
1978				\$ 550.0		(\$ 550.0)
1979	\$ 373.9	\$ 210.5	(\$ 163.4)		\$ 39.7	\$ 39.7
1980	\$ 476.8	\$ 319.0	(\$ 157.8)		\$ 0.0	\$ 0.0
1981	\$ 461.5	\$ 308.8	(\$ 152.7)		\$ 0.0	\$ 0.0
1982	\$ 568.8	\$ 380.6	(\$ 188.2)		\$ 0.0	\$ 0.0
1983	\$ 616.0	\$ 412.2	(\$ 203.8)		\$ 0.0	\$ 0.0
1984	\$ 683.0	\$ 457.0	(\$ 226.0)		\$ 0.0	\$ 0.0
1985	\$ 733.1	\$ 490.5	(\$ 242.6)		\$ 0.0	\$ 0.0
1986	\$ 706.1	\$ 472.4	(\$ 233.6)		\$ 0.0	\$ 0.0
1987	\$ 736.8	\$ 493.0	(\$ 243.8)		\$ 0.0	\$ 0.0
Total	\$5,356.0	\$3,544.1	(\$1,811.9)	\$1,050.0	\$39.7	(\$1,010.3)

B. Without Cap from Designation Deal to Preliminary Deal				B. Without Cap from Preliminary Deal to Final Deal		
Year	Cost of 33 ¹ / ₃ % Deduction	Benefit of Additional Payment	Net Gain (Loss)	Cost of Tax Abatement	Benefit of Additional % Payment	Net Gain (Loss)
1976				\$ 150.0		(\$ 150.0)
1977				\$ 350.0		(\$ 350.0)
1978				\$ 550.0		(\$ 550.0)
1979	\$ 373.9	\$ 210.5	(\$163.4)		\$ 190.3	\$ 190.3
1980	\$ 476.8	\$ 375.7	(\$101.1)		\$ 300.5	\$ 300.5
1981	\$ 461.5	\$ 351.1	(\$110.4)		\$ 284.1	\$ 284.1
1982	\$ 568.8	\$ 523.5	(\$ 45.4)		\$ 399.0	\$ 399.0
1983	\$ 616.0	\$ 599.3	(\$ 16.7)		\$ 449.5	\$ 449.5
1984	\$ 683.0	\$ 706.8	\$ 23.8		\$ 521.2	\$ 521.2
1985	\$ 733.1	\$ 787.2	\$ 54.1		\$ 574.8	\$ 574.8
1986	\$ 706.1	\$ 743.9	\$ 37.8		\$ 545.9	\$ 545.9
1987	\$ 736.8	\$ 793.2	\$ 56.4		\$ 578.8	\$ 578.8
Total	\$5,356.0	\$5,091.1	(\$264.9)	\$1,050.0	\$3,844.1	\$2,794.1

made: a set of terms that were agreed upon when Rouse was selected as developer, or the *designation* deal; an interim agreement that was reached after detailed negotiating sessions, or the *preliminary* deal; and a revised set of financial terms that was formalized in a three page letter of agreement, or the *final* deal. In negotiating each deal, city officials made concessions that help explain the project's competitive returns.

Table 3 shows the projections for lease payments under the successive deals. Under the preliminary deal (when city officials allowed the developer a deduction to compensate for extraordinary operating expenses), the projected first year base payment was 27% lower than what it would have been under the designation deal. Yet more than half of this lost revenue was recovered through the additional participation payment; so the net drop was

only 12%. In the second round of compromises, however, the participation or “kicker” failed to play the same role. In this instance, the city agreed to a \$1.05 million tax abatement as a way to finance unanticipated rehabilitation costs. But, as shown in Part B of Table 3, the increased kicker resulted in little marginal gain: the projected 40-year return for the final deal was the same as that expected under the terms of the preliminary deal.

In retrospect, the problem was that nobody knew just how successful the marketplace would be. When they negotiated for a share of project gross revenues, city officials also agreed to cap total payments. When they renegotiated the deal, giving three year’s tax abatement in return for a higher degree of participation in the revenues, the cap limited the additional upside of the trade-off. A comparison of the different trade-offs in Table 4 shows that the cost of the obvious concession—the tax abatement— was relatively small because, in the absence of the cap, the trade was a potential winner. In hindsight, the cap was an error, as the results in Part C of Table 3 indicate. Over the 40-year investment period, the cap cost the city approximately 200 basis points in yield; without it, the kicker payment would have been almost two-and-a-half times as large.

Conclusions

Did the city get a good deal? Could it have done better? Did it give away too much? In retrospect, the tremendous unexpected success of Faneuil Hall Marketplace prompts these questions. Although they are fair questions, their answers cannot be found by applying financial logic but rather by looking at the political calculus of the negotiations. Acting as a co-investor in the project meant renegotiating the deal when there were major problems, and this renegotiation involved financial compromises. The concessions were costly, even though at the time they appeared reasonable. In the early 1970s when city officials were searching for a plan that would renew the deteriorated historic buildings, Rouse’s proposal for a festival marketplace was a radical departure from the norms of retailing, notably off track in light of industry’s abandonment of the downtown. In cutting a deal for the marketplace, city officials were motivated by a broad set of goals for downtown. They considered the project very risky and wanted Rouse to have financial incentives to get it done as soon as possible. When they analyzed the deal based on the most realistic numbers available at the time, the financial trade-offs appeared to be an equitable way of sharing risk.

The results of this ex post analysis suggest that cities can earn competitive returns from risk taking. As a financial player, the city took many risks to get the project started: it put up the early investment dollars, leased the property and renegotiated the deal when the project ran into problems. With its payments linked to project performance, the city also took a risk that those payments would vary—go down as well as up—as did happen twice in nine years. However, the deal gave the city limited exposure to downside risk with potential for

upside gain. Because the marketplace was an overnight success, the upside started flowing sooner than anyone expected. Lagging only a short while, the true upside was the fiscal dividend that flowed into city coffers from the marketplace’s impact on surrounding property values. Not yet quantified, these spillover benefits would be critical components of any future expanded cost-benefit analysis.

The city’s insistence on a lease-tax payment which tied its revenues to project profitability was a key factor contributing to the strong financial performance of the deal. Unlike conventional property tax revenues, payments were, in effect, automatically indexed and thereby not dependent upon value reassessments or city council approvals of higher tax rates. As a source of revenue for ongoing city operations, the profit-sharing revenue stream represented a small sum for any big city budget, but it offered another, non-financial advantage: political protection for city officials who were investing public funds up front and taking risks to further public interest objectives.

Evaluations of public development projects generally do not use profitability as a measure of success because, as in this case, cities most often seek a broader set of benefits when they initiate redevelopment. When public investments in private projects involve financial risk, however, profitability is a starting point. If the project earns a competitive rate of return, presumably it is producing benefits in excess of costs. Moreover, in an era of public-private deal making, understanding the financial consequences of the trade-offs cities make in their negotiations with private developers is as important as projecting their ultimate financial return. In bargaining with developers, cities are handicapped if they do not understand the financial value of the resources they bring to the negotiating table.

NOTES

1. Profit sharing accelerated in the early 1980s. An important stimulus was the federal Urban Development Action Grant program which placed heavy emphasis on loan payment and cash flow participations when making grant awards. For more on this topic see, Clark, Susan E. and Rich, Michael J. “Making Money Work: The New Urban Policy Arena,” *Research in Urban Policy*, Vol. 1 1985: 101-115.
2. See Frieden, Bernard J. and Sagalyn, Lynne B., *Downtown, Inc.: How America Rebuilds Cities*, Cambridge, MA: MIT Press, Fall 1989.
3. See Kayden, Jerald, *Incentive Zoning in New York City: A Cost-Benefit Analysis*. Cambridge, MA: Lincoln Institute of Land Policy, 1978.
4. Dowall, David E., “Public Land Development in the United States,” *The Journal of Real Estate Development*, Vol. 2 (Winter 1987): 19-28.
5. See “Accountability for the Development Dollar,” a report prepared by the Role of Cities in Real Estate Development Committee, (Minneapolis) Citizens League, June 20, 1985; Association of the Bar of the City of New York Special Committee on the Role of Amenities in the Land Use Process, “The Role of Amenities in the Land Use Process,” June 1988; Office of the New York State Comptroller, Office of the State Deputy Comptroller for the City of New York, “New York City Planning Commission Accountability for Cash Contributions,” August 15, 1988, Report A-10-88; Office of the New York State Comptroller, Office of the State Deputy Comptroller for the City of New York, “New York City Planning Commission Granting Special Permits for Bonus Floor Area,” September 15, 1988, Report A-23-88.

6. Financial returns were not the motivating factor behind Boston's initiative—city officials wanted to save the historic markets—but they were critical of the city's deal with the developer. The discussion of the deal draws from the account presented in Gordon, Jacques, "Case Study: Faneuil Hall Marketplace, Boston," prepared for curriculum use under the supervision of Frieden, B.F., and Sagalyn, L.B., revised March 1986, author's files.

7. By definition, Rouse would be paying 16% of total gross income when paying 20% of adjusted gross income.

8. Annual estimates of these foregone property taxes were derived using 1962 assessed values and current-year city tax rates; they averaged \$275,000 a year. This figure did not include the Quincy Market building because it has been city owned since its construction in 1826.

9. The data on property values in downtown Boston were estimated from a sample of 195 transactions (predominately repeat-sale transactions) covering 110 parcels. The transactions cover a 30-year period (1956-1986) and include more than 50% of the parcels in the area immediately surrounding Faneuil Hall Marketplace and stretching southward into the financial district of downtown Boston. To keep the trend analysis as close as possible to the renovated-building prototype, the sample included only parcels with existing structures, and it excluded vacant lots and other parcels acquired as part of a major office-building land assembly. In addition, parcels were removed from the sample if major renovation altered their quality.

10. There is no index of land values in downtown Boston. To estimate changing land values as a factor in the estimate of foregone property taxes on the Faneuil Hall markets, a subset of the above referenced sample data that included only repeat-sales transactions was analyzed. This subset included 149 transactions covering 55 properties. The average annual compound rate of growth for the period between two sales was calculated for each transaction, and these rates were used to derive average annual estimates of the change in property values for the study area. Changes in land values were derived as a residual, using the replacement-cost index (from *Means Square Foot Costs* for Boston) as a proxy for the building-value component. This was a roughly derived estimate; yet as the difference in returns for Perfect Foresight Models A and B in Table 2 attest, substantial changes in this estimate did not significantly affect the conclusions drawn from the results. The trend is in line with a recent study by Avault, John, with the assistance of Fitzpatrick, Elizabeth, "An Overview of Factors Influencing Commercial Real Estate Values in Boston 1977-1990," Boston Redevelopment Authority Research Department, October 9, 1986, draft.

11. The following model was used to calculate the public financial returns from Faneuil Hall Marketplace:

$$0 = \sum_{t=1}^{26} \frac{-TDC_t + NLR_t}{(1+r)^t} + \sum_{S=27}^{40} \frac{40 NLR_{87} (1.x)^{S-26}}{(1+r)^S} + \frac{NLR_{87} (1.x)^{14}}{(1+r)^{40}}$$

where:

- TDC = DC + (FPTB + FPTI), total development costs
- NLR = (BLP + PLP) - (PTB + PTI), net lease revenues
- DC = Direct development costs
- FPTB = Foregone property taxes, 1962 base-year assessment
- FPTI = Foregone property taxes, post-1962 land-value increment (for Perfect Foresight Models)
- BLP = Base lease payment in lieu of property taxes
- PLP = Additional, participation lease payment
- PTB = Property taxes on North and South Market buildings, if privately owned and unimproved, 1962 base-year assessment
- PTI = Property taxes on North and South Market buildings, if privately owned and unimproved, post-1962 land-value increment (for Perfect Foresight Models)
- r = Real discount rate for public investment at 3%
- x = Real growth rate in NLR at 2.4%, the 1982-1987 average (5.5%) adjusted for expected average inflation

All in 1962-constant dollars adjusted by the Consumer Price Index for Boston, all items, all urban workers.

12. Bolan, Lewis, "Harborplace and Faneuil Hall Area Study." Report prepared for Schlichter, Jerry, East St. Louis, Illinois, Legatt McCall Advisors, July 29, 1985.

13. Property assessments in Boston have a history of irregularity and nonuniformity. The conventional rule-of-thumb was that commercial properties might be assessed at rates that produce tax payments representing 20% to 23% of gross income. The city also negotiated tax payments covering parcels sold under urban renewal disposition procedures, so-called Chapter 121A agreements following the authorizing statute identification. There also were informal, non-binding tax letters of agreement. See Avault, J.E., and Ganz, A., *Tax Constraint and Fiscal Policy: After The Property Tax*. Final Report of the Tax Policy Analysis and Planning Study Effort, 1976-81, Vol. I, Ch. 4, October 1983.

The Appraisal Journal

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Nonmembers, \$25
Single Copy: \$7.50

Published quarterly:
January, April, July,
and October by

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REAL ESTATE
APPRAISERS
430 North Michigan Avenue
Chicago, Illinois 60611-4088

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CLASS A URBAN VILLAGE CORES FROM SCRATCH: THE GROWING TREND

Class A cores have great promise for the real estate industry, retailers, corporate and professional tenants, municipalities and the public.

by Christopher B. Leinberger

In the past two decades dozens of new Class A “urban village cores” have appeared in suburban areas across the nation—including such well-known sites as Costa Mesa/Irvine/Newport Beach south of Los Angeles, the Princeton Corridor in central New Jersey, Tysons Corner in northern Virginia and Perimeter Center north of Atlanta. Class A cores are high-quality, high-rise office-oriented districts whose predominant market segments include national or regional corporate headquarters and branches of leading professional firms. These cores also include regional shopping centers, business and luxury hotels, restaurants, entertainment facilities and often housing.

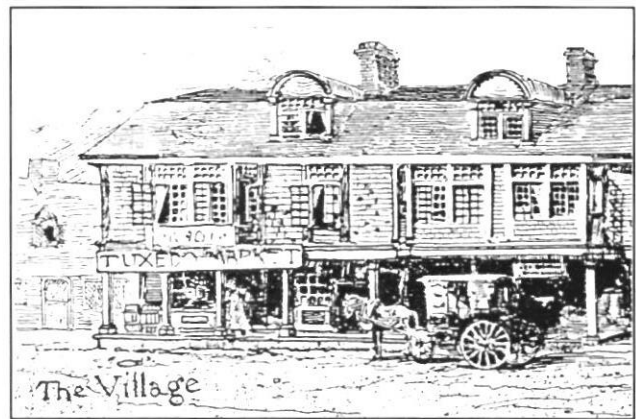
Despite their increasing visibility and importance, these prestigious office and retail cores generally have been the result of happenstance rather than planning. In almost every instance new Class A cores originated as Class C cores (devoted to business parks and light industry), changed into Class B cores (dominated by back-office space and business parks), and eventually evolved into Class A cores.

Now a new trend is emerging: Class A cores are being built from scratch at the outskirts of several metropolitan areas. Few real estate development trends hold more promise for the real estate industry, retailers, corporate and professional tenants, municipalities or the public. Yet to fully understand—and profit from—the new “Class A core from scratch” trend, we must understand how it fits into earlier real estate development patterns—specifically, the happenstance “first-generation” urban village cores.

The Costa Mesa/Irvine/Newport Beach Success Story

The growth of the Costa Mesa/Irvine/Newport Beach urban village core typifies the original urban village

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development trend. Twenty years ago this area of Orange County, CA, was a mixture of housing tracts, scattered neighborhood retail centers and some undeveloped farm and ranchland. The first phase in the creation of the Costa Mesa urban village core involved the construction in the early 1970s of a regional shopping mall adjacent to Interstate 405 (the San Diego Freeway) known as South Coast Plaza. Next modest one- and two-story office buildings nearby were completed for local professional firms and light industrial facilities were built for aerospace and high-tech firms.

But Costa Mesa/Irvine/Newport Beach's Class B and C phases were short-lived, because Orange County's population and employment (especially regional-serving employment) were growing rapidly. In the 1980s, developers erected Class A mid- and high-rise office buildings in this urban village core.

Where permitted by zoning, mid- and high-rise office buildings became the norm in Costa Mesa/Irvine/Newport Beach. Mid- and high-rise office buildings met several needs: the corporate and professional tenants' desires for prestigious space without paying rising land costs. Moreover, only mid- and high-rise office buildings and hotels created the necessary density and critical population

mass to support ancillary commercial, entertainment and cultural amenities.

Today, both the architecture and tenants of Costa Mesa/Irvine/Newport Beach's new office buildings often are equal to those of downtown Los Angeles and San Francisco. South Coast Plaza now has greater sales volume than any other shopping center in the nation; indeed, its annual retail sales surpass those for downtown San Francisco or Beverly Hills. This urban village core also boasts half a dozen business and luxury hotels.

As further evidence of its continuing growth and maturation, the Costa Mesa/Irvine/Newport Beach urban village core (Costa Mesa, to be specific) is the site of the several-year-old Orange County Performing Arts Center with its 3,000-seat theater. In the immediate vicinity, moreover, several large apartment complexes have been built at densities of 45 units per acre, and most tenants are younger business and professional people who often work in the nearby office buildings or South Coast Plaza.

Of course, the Costa Mesa/Irvine/Newport Beach first-generation urban village core is not an isolated success story. Across the nation first-generation urban village cores in suburban areas accounted for the vast majority of Class A office construction in the 1980s. In most cities—including Atlanta, Boston, Los Angeles, New York and San Francisco—the figure is 75% or higher.

Second-Generation Planned Class A Urban Village Cores

Several farsighted developers—whose depth of resources has matched the breadth of their vision—have planned and created Class A second-generation urban village cores from scratch. Such activity, it must be stressed, should not be attempted by the faint of heart or the lightly capitalized. Such projects are fraught with risk, and they require long-term staying power to reap all the potential benefits.

But the rewards can be enormous because creating Class A second-generation cores from scratch, in essence, turns farmland and suburban ground into downtown real estate gold. Of course, values vary from site to site, and acquiring large tracts of land at low cost is important for a project's success. In these 50- to 100-acre cores, however, a 100-fold rise in property values over a decade or two is entirely possible. Moreover, Class A second-generation cores developed according to a carefully thought-out plan avoid some of the problems that have troubled many of the first-generation urban village cores.

One problem is the lack of genuine pedestrian activity and interaction, which is typically found in big city downtowns and small town Main Streets. In many of these first-generation urban village cores, office workers virtually are compelled to drive their cars in order to visit the nearby shopping mall, meet a friend for lunch or conduct the simplest personal errands. Why?

Most of the new office buildings are just that and nothing more. If the ground floor of an office building does include some retail space, the tenants usually are banks,

brokerage houses or upscale restaurants. All of these activities fit a building's prestige image, but they do not contribute much to the area's activity or human interest, particularly after 5:00 p.m. or on weekends.

Even if ground floor retail tenants provided more everyday services—and included, for example, a dry cleaner, drug store, florist or moderate-price sit-down restaurant—pedestrian activity would be hampered because of all-too-common man-made barriers. Sidewalks are few and far between. Most of the office buildings are surrounded by grassy lawns and parking lots, which isolate the buildings and their workers from neighbors. The six- and eight-lane arterial streets and boundary landscaping, which are typical of most first-generation urban village cores, act as additional barriers, inhibiting pedestrian activity and segregating different uses from one another.

Another shortcoming of first-generation urban village cores is the usual absence of cultural institutions, schools and colleges, government offices and entertainment facilities. Surely a rewarding quality of life in urban villages requires more than office work, shopping and a few movie theaters.

Another pressing problem is the lack of housing near urban village cores. Residential uses, when combined with proper pedestrian amenities, give people the opportunity to walk to work, thereby relieving some traffic congestion. Housing, moreover, provides a population base to support local commercial and cultural activities during off-hours, thereby strengthening these uses for office workers during business hours.

Las Colinas, Irving, Texas

One of the first, if not the first, Class A second-generation urban village cores in the nation was Las Colinas in Irving, Texas. The 12,000-acre, 18-square-mile development between Dallas and Fort Worth has an urban core of nearly 1,000 acres, which is larger than downtown Dallas' central business district. Of course, along with the rest of Dallas, Las Colinas was severely affected by the mid-1980's recession in the Texas economy; indeed, such long-term costly undertakings as Las Colinas are particularly vulnerable to metropolitan economic difficulties. Although development came to a halt for several years, Las Colinas' difficulties were due to Dallas market conditions rather than deficiencies in its original vision and plan.

Once a working ranch, the Las Colinas property was kept intact by its farsighted owner who commissioned a master plan for the acreage and launched development of the property in 1973. Las Colinas was an immediate success; 16.85 million square feet of office and industrial/warehouse space were built in its first ten years.

Today Las Colinas boasts 22 million square feet of office and industrial/warehouse space—more than is found in many second-tier American cities. The Class A urban core is built alongside a 125-acre lake and is dominated by Williams Square, a 26-story tower flanked by two 13-story buildings. Las Colinas' roster of 900 resident firms

include such blue chip firms as GTE, Xerox, AT&T, Kimberly-Clark, General Motors and Hewlett-Packard. It also has attracted several dozen Japanese firms, including Hitachi, Sony, Panasonic, Pioneer and NEC.

Unlike other suburban Class A cores, Las Colinas has no regional shopping center—although a 100-acre site for one was included in the master plan and remains undeveloped. However, Las Colinas does have 150 retailers, including about 45 restaurants. Some 25 of those shops and restaurants are located in a European-style village at the heart of the urban core. The four hotels here have 1,100 guest rooms and two all-suite hotels under construction soon will add 268 more rooms.

In addition to its urban core, Las Colinas includes neighborhood retail centers, residential villages, university and college campuses and acres of golf courses and public parks. The community's daytime population is 150,000 and its nighttime population totals 50,000. Currently some 55,000 people work at Las Colinas, and about 20,000 people live in the residential villages' homes and apartments, many of which overlook the community's four golf courses.

One of the major reasons for Las Colinas' initial success was its strategic location in Dallas' growth path, bounded and intersected by major freeways and immediately adjoining Dallas/Fort Worth International Airport. The Dallas/Fort Worth metropolitan area has a population of 3.6 million, and in Las Colinas' formative years, it boasted a booming economy based on the oil industry, real estate, finance, petrochemicals and aerospace.

A spokesman for the Las Colinas Corporation reported that the development avoided bankruptcy during the recent disastrous years for the Texas economy and was converted this past June from a public to a privately held company. While the depressed local economy has not allowed Las Colinas to reach the level of development its planners and investors had hoped it would by now, Las Colinas has accomplished a great deal and offers urban planners and real estate investors/developers much to be learned. Certainly Las Colinas is well-positioned for future growth as Dallas' economy rebounds.

Owings Mills, Baltimore, MD

The initial success of Las Colinas has encouraged other visionary developers to create Class A second-generation urban village cores from scratch or to consider such plans. One such project is Owings Mills in Baltimore County, Maryland.

In contrast with Las Colinas whose land was owned, planned and developed primarily by one individual, the emerging Class A core at Owings Mills is the product of cooperative efforts among governmental agencies and a score of developers. The county's intent in planning a Class A urban core at Owings Mills is to direct growth into an area that is best suited for it, thereby reducing development of agricultural and forest land—almost half of Baltimore County is still rural, according to senior county planner Jack Dillon. Located 14 miles northwest of

downtown Baltimore, the area targeted for new growth covers some 6,000 acres.

Long-range planning for the Owings Mills core began in 1970 when the area was selected as the site for the terminus of a Baltimore Metropolitan Transit Authority subway line. Owings Mills was officially designated by the county as a growth area in 1979; a specific plan was adopted by the Baltimore County Council in 1983; zoning classifications were established and development was begun in 1984.

Of the 18 office buildings and two hotels totaling 2.3 million square feet which are planned for Owings Mills' urban core, two office buildings totaling 330,000 square feet have been built and are 98% leased. Alexander and Alexander, an insurance company, is the major tenant. Another 270,000 square feet of office space are under construction for a new Blue Cross-Blue Shield headquarters building, and 110,000 additional square feet will be built in 1990.

The keystone of Owings Mills' urban core is an 820,000 square-foot shopping center developed by The Rouse Company, famous for its festival marketplaces in Boston, Baltimore and New York. The two-story mall has three major department store anchors plus approximately 160 other shops, restaurants and services. The Metro subway—which runs on surface rail lines outside of Baltimore—was extended to the Owings Mills mall in 1987, and the station has parking for 3,800 vehicles.

Approximately 17 mid-rise office, hotel, retail, restaurant, light industrial and warehouse projects totaling 13.1 million square feet are in various stages of development or plan review in the Owings Mills area, and county planners say 11,000 units of housing have been approved for construction. Housing projects being planned or under construction range from high-rise and mid-rise towers through single family homes to townhouses and garden apartments. These office, industrial, retail and residential projects are being undertaken by a score of different developers.

The Owings Mills development is a success in spite of a generally stagnant metropolitan area. As the Baltimore area redistributes, however, business executives are finding that this large, new, master-planned development is more convenient to their homes and has many amenities such as great transportation, high-quality shopping and nearby affordable housing.

Stonegate/Denver, CO

One of the most visionary new Class A second-generation urban cores is planned for the Stonegate complex in metropolitan Denver's southeast quadrant. The developer is a subsidiary of Mobil Land Development Corporation.

Stonegate's Class A urban core will encompass 507 acres; 78 acres will be set aside for the pedestrian-oriented regional shopping center; 429 acres will be reserved for mid-rise and high-rise office buildings; and an additional 60 acres will support retail and power centers near the mall. Additionally there will be 673 acres developed for

residential use and 14 acres for neighborhood retail development.

Although metropolitan Denver's economy has been growing slowly for the last few years and its real estate markets have been stagnant, Stonegate offers significant promise as a Class A urban village core. Of importance is the fact it is located in Denver's southeast quadrant, the metropolitan area's most dynamic area. The Rockies west of the city geographically constrain development in that area, and the southeast quadrant is near existing business areas and high-end residential districts. However, close-in sections of the southeast quadrant, such as the Denver Tech Center area, have become congested. As a result there is a need for another urban village core located further out.

Of the outlying southeast quadrant sites, Stonegate has several advantages. It is directly accessible from one of Stonegate's two interchanges on Denver's new E-470 circumferential beltway. In fact, it occupies the southeastern-most spot on the E-470 before the highway turns northward in its loop toward the proposed new Denver airport. Stonegate is highly visible from E-470, Jordan Road and nearby Highway 83 (from across Cherry Creek).

The regional shopping center will act as the community's town center and the focus of its Class A urban village core. The mall will not be designed in the usual configuration, with shops lining a large-scale central gallery. Instead Stonegate's mall will provide open-air sections with a village scale and will offer specialty shops and cafes in a more intimate atmosphere. The mall will include recreational facilities such as an ice rink and other attractions that will create a vibrant nightlife with cinemas and nightclubs.

Stonegate's regional shopping center will be situated adjacent to a hotel and the high-density office district. Much of the parking for the office building will be located in the mall's parking garage, thereby eliminating the need for vast parking lots which surround and isolate the office buildings in most unplanned, first generation urban village cores. Stonegate's parking arrangements will allow a higher-density commercial/office district to surround the mall and will provide a genuine "downtown" feeling.

However, unlike traditional downtowns or unplanned urban village cores, Stonegate's extensive greenbelt system of walkways and recreational facilities will create pleasant pedestrian linkages between the buildings. Office workers and local residents will not need to drive their cars to the mall or from one building to another, thereby reducing traffic congestion. The location of these diverse uses in close proximity will foster an almost continuous flow of people between the mid- and high-rise offices, hotel, shopping center and recreational facilities and create a true Class A urban village core.

Conclusion

Carefully planned Class A village cores like Stonegate create benefits for developers, municipalities, corporate and professional tenants and the public.

Developers find that the advantages of planned, second-generation urban village cores make these projects more acceptable to the increasingly powerful populist leaders of no-growth/slow-growth movements and their political allies. Developers also find their proposed regional shopping centers and office buildings are more marketable because retailers and office tenants recognize the advantages of locating in a core that has a critical mass of services and amenities.

Municipalities stand to benefit from well-planned Class A cores because the cores attract more growth and increase revenues yet generate less pollution and stress on the infrastructure. Residents of the cores need not drive as often, and when they do take the car, the distances between their home, work and entertainment facilities are shorter. As a result, automobile pollution is reduced, and the traffic burden on streets and freeways is lightened.

Many Class A second-generation urban village cores allow the public to enjoy the original promise of the urban village, including shorter commutes between home, work and entertainment. Furthermore, the increased densities in the Class A cores provide the public with the lifestyle, conveniences and pedestrian-oriented amenities of traditional downtowns.

THE USE OF COMPUTERIZED PROPERTY TAX DATA FOR URBAN AND REGIONAL ANALYSIS

Property tax assessment data, with some modification of available databases, can be a powerful tool for theoretical and empirical research.

by David C. Prosperi

There are three reasons for pursuing an assessment of parcel level data in urban and regional research. The first focuses on the question of the informational value of data. Many models of urban and regional systems are made operational with census-like population and employment data. However, there are two major problems inherent in using census-like data: (a) their infrequency enables only snapshots to be obtained instead of the dynamics being studied; and (b) model structures and model solutions often are instrumentalized, that is, important theoretical concepts only are approximated by whatever data is available.

The second reason is directed at the twin issues of aggregation and scale in urban and regional modeling. Urban and regional models, such as economic base or land use distributions, are constrained by census-like geographic definitions such as the census tract or traffic analysis zone. While this level of aggregation is appropriate for understanding and building broad models of urban systems, it is particularly inappropriate for micro-level analyses such as impact assessments. Two important questions are: (a) is there an appropriate use for parcel level data among the myriad of urban and regional models; and (b) can parcel level data help achieve the level of disaggregation often desired by builders of more aggregated models?

The third, and least understood reason for exploring computerized parcel level information is the increasing use of this information as the base layer in the construction of geographic information systems (GIS). This is a generic name given to computer software that maps spatially distributed data. However, GIS is clearly more than just a simple computer cartography tool. One of its more powerful concepts is the ability to link information



on one map with information on another. For example, assuming that separate maps or geo-coded files exist for parcel identification, commercial square footage by parcel, may be linked with specific commercial use of properties by parcel. For example, it is a relatively straightforward task for a GIS to find and map the intersection of all commercial parcels containing auto-after-market stores with fewer than 1,000 square feet of usable space.

This article reviews the use of parcel level data in the urban and regional literature, then demonstrates how property tax appraiser data may be used to study urban growth and spatial structure in Orlando, FL. The final, more speculative section presents a brief agenda for future use of parcel level data aimed at geographic, planning and real estate researchers.

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Use Of Parcel Level Data In Urban And Regional Analysis

Several computer, economic, geographic, planning and real estate journals and conference proceedings provide an overall picture of the use of parcel level data in urban and regional analysis. The review presented here focuses on identifying major categories of use of the data and providing a brief assessment.

Identification

The identification stage reveals that parcel level data has been used in three broad research areas: housing, land use distribution and public policy. In the housing literature, parcel level data—including the data from the multiple listing service, county tax assessors and title companies—has been used to study development impact, the benefits of historic designation, the impact of proximate subsidized housing and more general questions of overall neighborhood change.

Published work outside this direct stream of housing research is dominated by housing-related concerns. Once again, parcel level data in the form of private databases has been used to map the spatial pattern of property values in small standard metropolitan statistical areas (SMSAs) and (with supplemental data) to study the spatial variation associated with crime and other social problems. Computerized parcel level files have been used to study such public policy questions as the influence of zoning regulations, the spillover effects of human service facilities on residential property values and the impact of different tax structures on development.

Assessment

Two assessment criteria examine the conceptual appropriateness of parcel level data in urban and regional analysis: informational content and the ability to operationalize key modeling concepts. Informational content focuses on the distinction between data, information and intelligence. Catanese provides a hierarchical definition as follows. At the lowest level is data, a unitary value for a single observation. Information is data that has been manipulated to transform original facts into succinct and salient knowledge. Intelligence is the use of information to assist decision-making.¹

Property tax rolls are clearly data. Information results from the aggregation of property tax roll data for specific variables, say, assessed value of all commercial properties. Analytical models which use property tax data or information to assist policy makers are a form of intelligence.

The second criterion, ability to operationalize key modeling concepts, focuses on the ability to measure important variables with parcel level data. Parcel level (usually property tax) data seems to be the data of choice when operationalizing residential transaction prices. If the geographic unit is constant or data can be aggregated to some constant area, parcel level data would seem to have a

major advantage in operationalizing other concepts such as density.

However, while parcel level data appears to be useful for micro-level analysis (such as estimating the impact of neighboring occurrences on residential transaction prices), there are important gaps. The most glaring is the nonuse of property tax data to support theoretical generalization or large-scale, full coverage urban and regional modeling efforts. Indeed, the literature reviewed above is almost exclusively related to housing and focuses on specific instances.

The Orlando Experiments

Understanding urban growth and spatial structure has long been a concern of economists, geographers, planners and real estate professionals. Attempts to build models have relied on census-like population and employment data. A pilot project used county tax appraiser data to first build a metropolitan-wide database and then to explore selected aspects of urban growth and change. This section outlines the data assembly procedures and some results obtained from the pilot project.

Orlando was chosen as the test site for this project for three reasons: the data was viewed by knowledgeable users as relatively clean; the size and complexity of Orlando and its data were considered to be manageable; and, from a theoretical perspective, Orlando was assumed to be a good place to conduct empirical tests of theory since it is close to an isolated, homogeneous plain.

Data Assembly

Florida's Department of Revenue, Division of Ad-Valorem Tax, Chapter 12D-8, requires the annual completion and submission of countywide property tax assessment rolls. The tapes contain, among other items of data, the following attributes for each parcel of land: parcel number, county number, 100 land use codes, total just value, total assessed value, land value, land units code, number of land units, effective or actual year built, total living or usable area, last and second most recent sales data, owner's name and address, various tax exemption

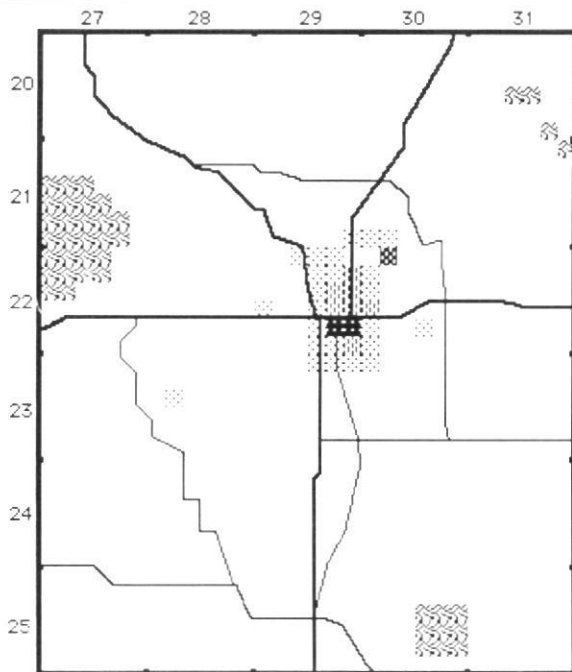
TABLE

Orlando Study Area, by County and Township and Range

	Range	27	28	29	30	31
Township						
20	Orange	Orange	Orange/ Seminole	Seminole	Seminole	
21	Orange	Orange	Orange/ Seminole	Seminole/ Orange	Seminole	
22	Orange	Orange	Orange CBD	Orange	Orange	
23	Orange	Orange	Orange	Orange	Orange	
24	Orange Disney	Orange	Orange	Orange	Orange	
25	Osceola	Osceola	Osceola	Osceola	Osceola	

FIGURE 1

Orlando, FL, Land Values (1955)



codes and location by township, range and section. In this pilot project, 1985 tax assessor tapes were used.

The Orlando area spreads across three counties in central Florida: Orange, which contains Orlando's central business district (CBD); Osceola to the south; and Seminole to the north and west. Consequently, three county property appraiser tapes were assembled into an overall database as follows. First, a study area was defined by eliminating all portions of the three counties outside of the sphere of influence of urban development. This somewhat arbitrary criterion resulted in a rectangular study area, 36 miles on a north-south axis and 30 miles wide on an east-west axis, covering 1,080 square miles (see Table).

Next, individual parcels were aggregated as follows. The pilot project was particularly interested in obtaining summary values for property value and usable space and in having these summary values reflect age (the attribute, effective year built, on the original tax tapes), location (the township-range-section on the original tax tapes) and use (the land use code on the original tax tapes). This manipulation of data into information resulted in a new database containing elements of the form:

$V(a,l,u)$

where:

V = property value

a = age

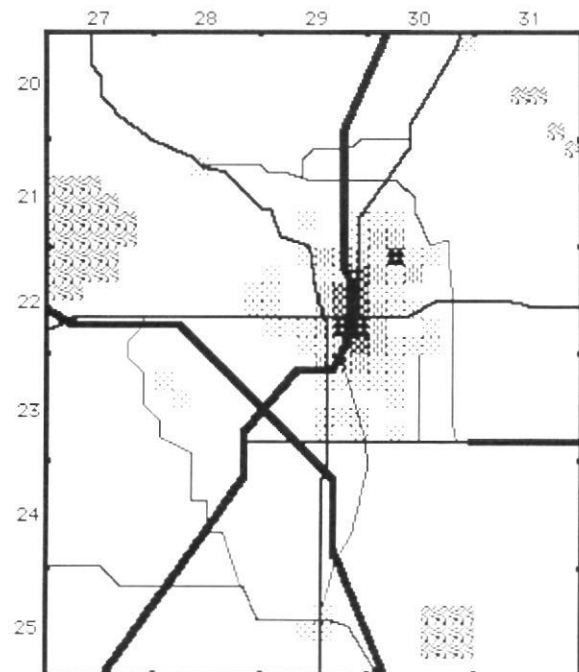
l = location

u = use

The structure of the $V(a,l,u)$ database fosters simple and complex queries (computerese for asking for data sorts) of interest to urban and regional analysts. Simple queries would use a single criterion, while more complex queries

FIGURE 2

Orlando, FL, Land Values (1965)



would use two or more criteria. For example, a simple query of the database for location would yield a new database $V(a,u)/l$. This new database would contain, for a single location, property values for all age-land use pairs. Clearly, the possibilities are endless.

Substantive Research: The Evolution Of Property Values

Prosperi, Smith and Decker generated a database that specified the amount of property value added to each location in ten-year increments by using a two variable query—age and use [i.e., $V(l)/(a,u)$]. The numbers in this database then were mapped.²

The changing pattern of property values shown in Figures 1 through 4 succinctly capture Orlando's growth from 1955 through 1985. The influence of prior centers (e.g., the CBD and the early suburban community of Winter Park), the developing road network and lumpy investments (e.g., the Disney complex in the southwestern portion of the study area) are clearly evident.

The structure of the $V(a,l,u)$ database also allows more conventional quantitative modeling efforts. To test this assertion, the database was supplemented with urban feature data such as distance from the CBD, highway interchanges and suburban activity centers. A dummy variable regression to explain the pattern of property values over time and space was specified and estimated. The R^2 value obtained through this regression was .52, which is significantly higher than the coefficients obtained in prior attempts to explain the same variable using conventional census-like population and employment data.

Substantive Research: Suburban Activity Centers

Efforts to explain the development of suburban activity centers have tended to articulate broad phases or stages. For example, Prosperi, et al, conceptualized, calculated and graphically portrayed the development path for selected suburban centers.³ The development path was defined as the cumulative magnitude of space absorption within a small geographic area. The V (a,l,u) database was subjected to a simple query by the attribute location, resulting in a new database containing values for the variable space across all time period-land use categories. The dataset then was analyzed using Lotus 1-2-3 software.

Figures 5 and 6 show the overall and sectoral development paths for Altamonte Springs, an activity center located in suburban Seminole County and centered on a major intersection between I-4 and SR 436 (a major non-interstate arterial connecting the airport and the northern portions of the area).

Altamonte Springs is clearly a residential community. Its overall space density is 1,760, 698 square feet per square mile. Eight percent of space is associated with office, industrial and wholesale land uses and another eight percent is devoted to retail and service land uses. Figure 5 shows the overall (housing and non-housing) development paths. Virtually undeveloped until 1964, the overall development path in Altamonte Springs has three clearly identified stages. The early stage (1964-1972) is dominated by residential development. The second stage (1972-1980) is a mix of housing and non-housing development. In the third stage (1980-1984), non-housing development appears to be increasing at a faster rate than housing development. Figure 6 clearly shows the takeoff

stage for non-housing development. A retail investment during the 1972-1974 period gives form to the development path graphic. The rate of change for retail and service space increases during that period, while the rate of change for offices and industrial and wholesale space remains constant. There is some recent movement in the industry and wholesale sectors.

A Research Agenda

Urban and regional analysis proceeds by advancing our understanding of both conceptual forces and empirical realities. While the Orlando experiments are only a beginning, the purpose of this section is to speculate on additional uses of parcel level data in urban and regional modeling and in terms of database development.

Enhance Urban And Regional Modeling Efforts

From a substantive perspective, parcel level data seems to be especially promising in a number of areas. The first is a series of working papers, by class of model, that focuses on how parcel level data may enhance analytical efforts. Urban density functions are one class of models that are capable of substituting parcel level data for census-like employment and population data. These models summarize the well-known manifestation of distance decay from either monocentric or polycentric structures. Estimation of urban density functions normally relies on the use of sampled census tract statistics which act as proxies for physical concepts. To date, these models have been used almost exclusively for employment and population distributions. Substitution of parcel level data, which can provide access to other parcel attributes, such as

FIGURE 3

Orlando, FL, Land Values (1975)

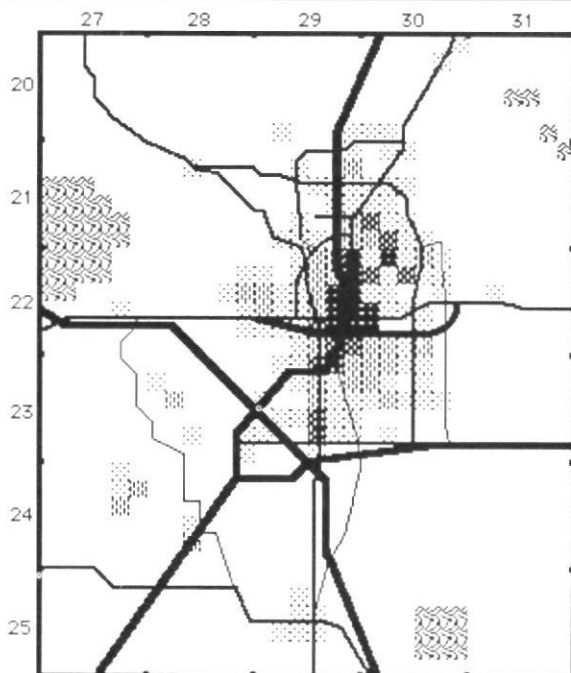


FIGURE 4

Orlando, FL, Land Values (1985)

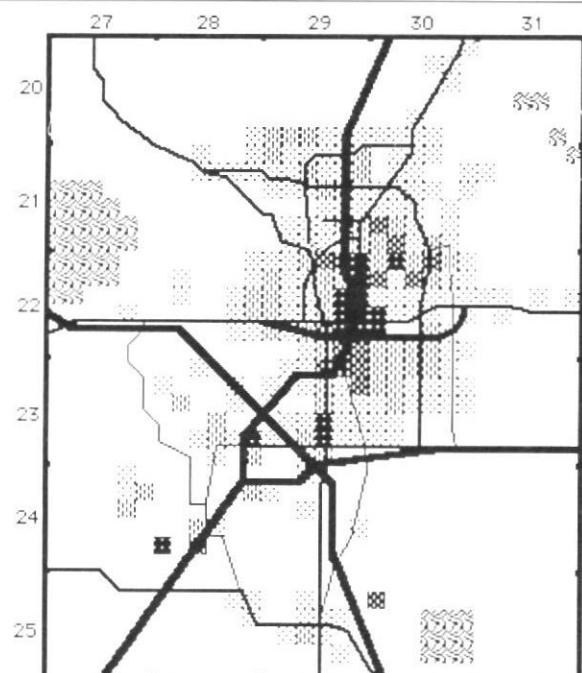
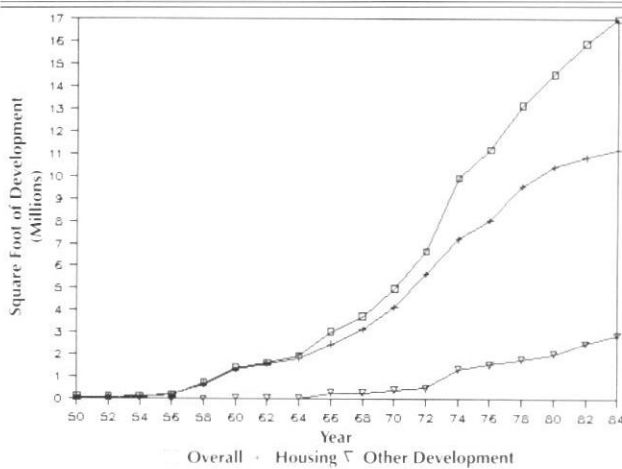


FIGURE 5

Altamonte Springs Overall Development Path
(1950-1984)



industrial, commercial and service space, will yield a much richer set of results. For example, aggregating parcel level data on commercial space to the section level and calculating distance from the CBD to all sections, allows physical commercial space distance decay functions to be calculated. Finally, if distance decay functions are construed as bid-rent curves, then verification and further articulation of spatial equilibrium theory is directly possible.

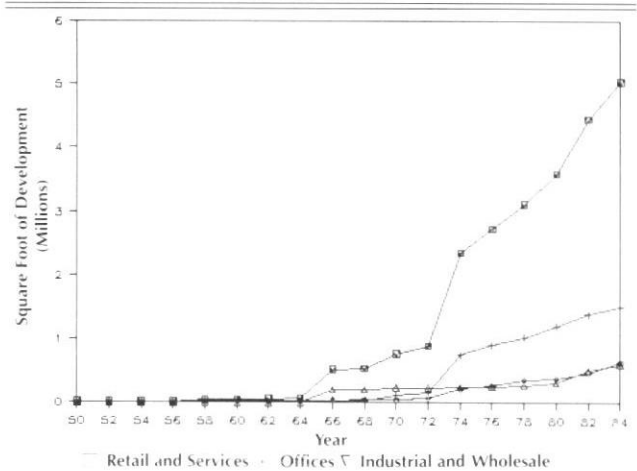
A second area is the development of a large-scale, multi-land use category model of urban density and spatial equilibrium. On a more pragmatic note, GIS environments may be used to do real economic geography, including market analysis, facility location analysis and operational transportation planning. Research in this area may include creation of new planning standards for commercial and service facilities.

Database Development

The Orlando experiments and the possibilities of using parcel level data to enhance urban and regional analysis provide a rich platform for speculating on a future research agenda that has both technological and institutional components. From a technological perspective, the Orlando work involves a variety of computers and operating systems. The database currently is maintained on a mainframe; non-mapping analysis is done by downloading to Lotus 1-2-3; mapping is done on a Macintosh

FIGURE 6

Altamonte Springs Non-Housing Development
(1950-1984)



computer using Hypercard; and statistical analysis is done on SPSS/PC+. Clearly, to be better functioning, a time-space-use database needs to be developed as an integrated system.

From an institutional perspective, two areas of research and training seem to be especially important. The first is making property appraisers more aware of the critical role they can play in generating meaningful data. For example, the Orlando data would be much more valuable if certain structural characteristics (e.g., number of bedrooms) were available. The second critical institutional research need is the conceptualization and development of models that combine agency interests, usually operational, with the needs of urban and regional analysts. The capability of GIS to move among layers of data is a start. The critical issue, however, is the development of systematic searches of data layers to produce simultaneously information and intelligence for use by both agency and urban and regional analysts.

NOTES

1. Catanese, A.J. *Scientific Methods of Urban Analysis*. Urbana, IL: University of Illinois Press, 1972.
2. Prosperi, D.C., Smith, M.T. & Decker, J. *The evolution of urban land values: The case of Orlando, Florida*. Paper presented at the Urban Affairs Association, Baltimore, Maryland, March, 1989.
3. Prosperi, D.C., Smith, M.T., Nutt, S. & Gatzlaff, D. *The "development path" of suburban activity centers*. Paper presented at the American Real Estate Society, Washington, D.C., April, 1989.

REAL ESTATE TAXES: FIXED OR VARIABLE

Owner, financing and operating profiles can significantly affect the market value of a property and therefore the assessment of real estate taxes.

by Norman J. Quinn, III

Outside the debt service, taxes normally represent a property's largest single operating expense. As a result, any tax savings achieved fall immediately to the bottomline, benefiting both the owners and lessees of a property. Yet taxes are seldom challenged unless they increase suddenly and dramatically, and they usually are challenged only after the bill is received. However, by the time the bill arrives, it is often too late in the real estate tax assessment cycle to achieve any reductions.

The obligation to pay real estate taxes is determined by legislative mandate, and the actual amount is based on the market value of a property as of a specified date. This value of property fluctuates with the supply and demand cycle of the real estate industry. Exploiting cyclical swings in assessed market value maximizes the return on a real estate investment and creates a competitive leasing advantage.

Of all the elements in the real estate tax equation, market value is the most variable, and changes in assessed value have, by far, the greatest impact on tax liability. The market value of a property is traditionally determined by applying one or more of the three methods of valuation: the replacement cost, sales and income approaches. As the real estate industry changes, however, several non-traditional factors can dramatically affect the value of a property, no matter which approach is used. These include the significance of owner, financing and operating profiles on the determination of the true "market" for a given property.

Owner Profiles

A growing trend is the inclusion of owner profiles in evaluating and contesting assessed real estate tax



valuations. Recognizing and understanding different owner profiles are critical in evaluating the comparability of assessed valuations and recorded sales transactions.

The characteristics of owner profiles change with the cycle of the financial and real estate markets, and they are impacted by federal tax rates, the length of the holding period, the cost of capital and the desired rate of return on the property. As real estate markets have reacted to the economic forces of the 1980s, two distinct groups of owners have emerged whose criteria for paying a given purchase price may include factors unrelated to, or no longer relevant to, traditional market value. Today, properties clearly are marketable to one group or another based on these owner profiles, and yet traditional tax assessment techniques may or may not take these into account.

Syndicators/Developers/Non-Institutional Owners

The first group of owners includes the real estate syndicators and developers who historically have been the originators of income-generating property. The determination

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of real estate market value for these owners has been affected greatly throughout the 1980s by federal tax laws.

The pre-1981 U.S. tax code was characterized by extended depreciation periods, the absence of accrued or deferred interest provisions on debt and a maximum individual tax rate of 50%. Supply and demand factors in the local real estate market determined the financial success of a project; so each of the three valuation methods, in general, yielded market values that were closely correlated.

The 1981 Economic Tax Recovery Act changed the accelerated depreciation computation, shortening the depreciable lives of properties from as much as 35 to as few as 15 years. This change increased the depreciation expense, which is a non-cash expense, and inflated net income after taxes. The increased income helped rationalize the utilization of accrued interest financing, which is also an accruable, tax-deductible expense. Capitalized income became the dominant method of determining market value as net incomes were inflated by the non-cash expenses generated by depreciation and accrued interest. A wave of inflation in property prices and new construction was triggered, resulting in market values that were far higher than the residual value of property as previously defined by the historical supply and demand variables of the local market.

The financial markets, perceiving the demand by investors for tax benefits, generated funding mechanisms that fueled the expansion in property prices. A higher purchase price generated greater tax benefits as the price acceleration cycle grew geometrically, creating an even greater discrepancy between residual economic value and sales value which, in turn, became federal tax value. Property assessments increased accordingly, based on comparable sales data and capitalized income.

The 1984 Tax Act eliminated the deduction of deferred or accrued interest but maintained a favorable, though modified, depreciation schedule. These changes only slightly slowed the price acceleration cycle. However, the 1986 Tax Act effectively doubled the depreciable life of assets back to the 30-year range, which decreased net income and capitalized values and cut the tax rate for investors from 50% to 28%. These tax law changes terminated tax-motivated investor demand for property and the resulting price acceleration cycle. The industry was caught with an abundance of supply and little demand for space. Market values in many areas plunged.

Today, evaluating property for tax appeal potential requires close analysis of the local market. In many taxing jurisdictions, prices have plunged as the post-1986 real estate investment market has searched for residual economic value, and as a result, tax bases have declined. A few markets, though, have continued to grow, fueled by local demand for new space.

Over the last few years, the local taxing jurisdictions that experienced the worst effects of this cycle, particularly those in the Southwest, have been giving more weight to other factors than comparable sales price.

Other jurisdictions have continued to hold the sales price as the primary determinant of assessed valuation, even though the volume of arms-length transactions has radically declined. These jurisdictions have required an annual review of transactions and considered any properties acquired before 1986 as potential tax appeal candidates.

The unfortunate investors are the continuous owners from pre-1981 whose property's assessed value increased with the market. By not selling, they are now dependent on occasional arms-length sales in a depressed market to re-establish former values. For many of these owners, litigation may help restore valuations to former levels. Owners of property purchased in the post-1986 environment may be able to confirm the achieved equalization of local supply and demand forces or may have to bear witness to further price deflation.

The challenge for the tax manager is to understand the dynamics of the localized market and to identify opportunities for substantially reducing valuations and resulting taxes. The tax manager needs to recognize that currently syndicators, developers and non-institutional owners are evaluating the underlying economic value of property for acquisition and financing purposes, and he needs to communicate the valuation methodology and the resulting market values to the tax assessing body.

Pension Funds, Institutional Investors And Foreign Investors

The second major group of owners is the pension fund/institutional investor/foreign investor. These owners differ drastically from the first group in the size of individual groups of owners, the nature and amount of their financial resources, the low cost of capital they can obtain and their desire for stability and long-term capital gain. The emergence of these property owners has created the real estate industry classification of institutional grade property. The growing activity in the industrial grade property submarket exemplifies the importance of evaluating owner profiles when comparing location valuations. Among the most dramatic inequities created by local tax assessing authorities is through the application of institutionally paid prices to non-institutionally owned real estate.

Pension Funds/Institutional Investors. The 1970s marked the entrance of pension funds and other institutional fund sources into the real estate markets. While pension funds are unique in their federal tax exempt status, other types of institutional funds—such as insurance company funds—have tax structures that are favorable or equivalent to direct ownership. Nevertheless, the vast financial resources and long-term orientation of these owners, plus the low cost of capital they can command, not only give these owners competitive advantages in purchase negotiations but allow them to achieve higher prices while maintaining favorable yields.

Foreign Investors. A variety of national and international political and financial developments has motivated the entrance of foreign investors into the U.S. real estate

markets. (The most prominent member of this group has been the Japanese.) The principal inducement has been the worldwide perception of the stability and continued growth of U.S. investments.

What distinguishes this owners' profile from other investors is their source of funds which is characterized by a low cost of capital and often 100% financing and a commitment to a long holding term. Pension funds and foreign investors often compete for the same class of property; however, foreign investors appear to be more willing to hold properties longer and take greater risks in ownership. The purchase price paid by foreign owners thus may be more significant to these purchasers' unique financial position than to the properties' position in their markets.

This new buyer segment of the market again emphasizes the importance of investigating owner profiles when evaluating transactions in a local market. The tax manager who represents institutional and foreign owners of property must understand the local real estate market and the potential buyers and their driving economic differences. These considerations must be conveyed to the tax assessor to achieve equitable market valuations. Tax managers may utilize the income approach to valuation, to compare similar property valuation and overall market trends and to cite such judicial decisions as the U.S. Supreme Court case of *Allegheny Pittsburgh Coal Company v. County Commission of Webster County, West Virginia*, decided in January 1989.

Financing Profiles: Governmental And Creative

Governmental financing programs and the new generation of creative financing which incorporates ownership rights in lending instruments, require specialized knowledge and understanding by the tax manager in order to present and achieve equitable assessed tax valuations. The variety of encumbrances these new financing programs entail can make a significant impact on the salability and lease potential of a property. Tax assessing authorities generally fail to distinguish properties with these encumbrances from other properties, which can result in over-assessing the properties and reducing comparative yields to their owners.

Government Financing

A number of federal and local housing programs, i.e., Section 236, 238, Section 8 and municipal bond financing programs, place varying operating constraints on property owners which affect the market value of the property. These programs frequently span decades and are subject to legislative mandates which may alter the programs' original intent. Common are limitations on rents, tenant mix and caps on return to investors.

One valuation method the tax manager may use to address the operating constraints imposed by public housing programs is the computation of the equivalent return. This may be approached by working backward from an accepted capitalization rate and forward from adjustments to the income or expense categories affected by the

encumbrances. Comparable encumbered complexes' values in the same or neighboring jurisdictions, as well as per unit or square footage values, should be researched. A tax manager must be aware that these encumbered properties require special analysis, presentation and possibly educational efforts in order for the taxing jurisdiction to determine equitable valuation.

For example, sales of municipally financed properties in many jurisdictions since the 1986 Tax Act have been less than or equal to the existing outstanding debt amount, which is usually more than the tax assessor's valuation. One method of overcoming the recorded title transfer price argument is to note the nonrecourse nature of the debt, when applicable, and the per unit value of comparable properties.

Creative Financing

New creative real estate financing mechanisms have equity participation features that are comparable to rights of ownership. Historically, ground leases and mortgages on occasion contained a kicker provision which allowed the holder to share in the increased income stream generated by the property. Mortgages have been indicators of value just as ground leases' present value computations often have been used to value land. The new hybrid of these traditional real estate ownership instruments, however, can effectively transfer the rights of ownership to a lender without creating the consequences of sales.

These encumbering instruments typically provide for extensive sharing in profits, management, options to market or purchase the property and extensive sharing in any sale's proceeds beyond the encumbrance's value. Such financing vehicles allow the property owners to cash out their equity and delay federal tax liabilities, while maintaining the incentive to maximize a property's potential. Essentially, the lender gets the operator's expertise and effective ownership control over the property, while the owner may receive the equivalent of sale proceeds with an additional financial incentive to operate the property effectively in the future through revenue sharing.

Taxing jurisdictions have not addressed these new financing methods primarily because mortgage activity generally escapes the assessor's information collection procedures. A ground lease component may be identified because of the recorded title change.

Tax managers dealing with property that utilizes creative financing should make sure that owners are informed of the disclosure process required in the jurisdiction before they pursue appeals based on these arrangements.

Operating Profiles

The different financial operating profiles of properties may have an impact on one or more methods used to value properties. Taxing jurisdictions that consider an income approach to value may provide for, or allow the inclusion of, stabilized financial figures and include both income and expenses in performing the computation

when revenue will be affected by a leaseup or vacancy or when repairs and maintenance expenses are expected to exceed actual expenses for a given year. The age, condition and comparative market position of the property determine the appropriateness of using this valuation adjustment.

The utilization of either economic rents or market rents will produce significant differences in a stabilized income statement for capitalization. In jurisdictions where rents are increasing, economic rents are advantageous; where they are decreasing, market rent arguments should be advanced.

Independent of the method of valuation, certain adjustments or allowances may be made in the determination of the final valuation. Adjustments may be made in income and expenses if income is to be capitalized, or they may be used as deductions from comparable or replacement cost values.

Older properties which may lag the market in terms of amenities, facilities or improvements may be allowed to deduct redevelopment or renovation costs that will keep or move them into a more comparable class of valuation. Normally, to be acceptable, these adjustments must be tangible, priced and intended to fall within a specific time period. An example of this type of adjustment for office buildings would involve changing from a large single tenant user to smaller multi-tenant offices. Generally, extensive improvements would be required to make the present, single tenant space rentable to the pool of prospective smaller tenants. The use of this type of expense to adjust value would be appropriate, particularly when a lease is nearing expiration.

Asbestos removal is another category of expense which may be treated as a deduction from valuation. Because many lenders will not finance redevelopment or renovation of properties with asbestos, tenants often will not rent space in buildings with asbestos and owners of these structures may be liable to injuries to third parties. Thus, asbestos reduces a property's value. One major concern in determining the usage of asbestos removal as an adjustment variable in the tax assessment process, is the impact from public disclosure of its existence. Owners and managers of property therefore, should be advised of the property tax consequences of an appeal on this basis. Another major concern is the different reactions to this argument among jurisdictions; some often want a specific time frame for completion of asbestos abatement.

Other types of future expenses that have affected market value include roofing repairs, parking lot additions, mandatory fire and life safety improvements and refurbishments in substandard residential complex amenities. A tax manager must understand the income statement components of a property and its market position in order to compute the most favorable method of valuation and communicate the logic of the calculations within the parameters of the assessing authorities.

It is important to know that appraisals used for real estate tax appeals may emphasize different factors than those

prepared for the acquisition or financing of property. Often, an appraisal conducted for the purposes of real estate tax valuation will result in a lower value than appraisal prepared for other purposes because of the conservative nature of the assumptions underlying the determination of market value. A tax manager is well advised to seek advice from those individuals within the appraisal industry who specialize in real estate tax appraisals and have been accepted as experts by the local taxing jurisdiction.

Achieving Reductions

The responsibility for achieving an equitable valuation of a property may be assigned to an individual within an organization who has a solid education in financial and operating areas as well as good communication skills. Or the responsibility may be contracted out. The size and complexity of the organization's portfolio, the nature of the jurisdiction and the ability and time of internal staff may be deciding factors. Organizations with large portfolios often benefit from designating one management person who has access to property operations and investment strategy as the coordinator of all tax appeals. This approach centralizes responsibility and maximizes synergy.

Whether or not an organization maintains such expertise internally, real estate tax consultants also may be required. Historically, expert consultants have come from the ranks of attorneys, accountants, appraisers, former tax assessors and brokers. Unfortunately, the recent lure of lucrative fees and industry franchising has attracted other, less qualified individuals to this field; so property owners are advised to screen prospective consultants thoroughly before hiring them.

The principal job of the consultant is to gain access to and utilize locally acceptable assessment practices and valuation techniques to secure an equitable valuation of property for the owner. The consultant therefore must understand the property, including its financials and operations; research the property valuation and comparables; meet deadlines; follow appeals procedures; apply an appropriate valuation approach and complete any real or personal property renditions. Upon formalizing an opinion of value for the owner, the consultant should meet with the assessor to negotiate the assessment, ideally before any formal appeal or legal proceedings are required. This procedure will vary based on different jurisdictional requirements.

Local appeals' procedures may necessitate representation by an attorney; certainly, as the appeal formalizes into the litigation stage, an attorney's representation will be necessary. Attorneys should be selected based on their experience and reputation before the tax appeals boards. Corporate counsel or local industry groups may be able to recommend a specialized tax firm.

The balance of industry consultants may be referred to as negotiators. National, regional and local firms and independent practitioners are available. These negotiators differ in their experience with certain types of property,

their qualifications and ultimately the basis for their compensation. Property owners should check negotiators' references, since they are looking for frontline tax valuation experience and ability, and should be comfortable with their selection.

The fee structure varies within groups of consultants and from one consultant to another. Fixed fees based on the size of the account or property are common. Following general guidelines, charges for securing equitable valuations of completed apartments range from \$3.00 to \$4.00 per unit or from \$1,000 to \$3,000 per complex. Charges for obtaining fair valuations of office buildings and shopping centers average between \$1,000 and \$3,000 depending on size. Regional differences and the amount of work required will impact these estimates.

Contingency fee arrangements based on an annual percentage or total savings achieved range from 30% to 100% payable over one or more years. Contingency arrangements are considered to be most cost effective for owners of property that already are considered to be fairly valued and who entered into a fixed fee arrangement the

previous year. Time and expense billing, with an optional incentive bonus, may be employed in jurisdictions that require attorney involvement. Matching the fee arrangement with the property's potential valuation reduction will control consultant costs while achieving an equitable valuation. The key to achieving an equitable valuation is knowing the property, the local market and the assessor's valuation process.

Trends

Multiple conflicting interests will impact future tax valuations. These include: slowed growth of tax bases; increased funding requirements of local government entities particularly for schools; decreased federal subsidies to state and local governments; increased interest by home owners in transferring the property tax burden to commercial or industrial owners; and increased interest in the passage of income or sales tax subsidies to offset property taxes. The environment is dynamic, and an active interest in the determination of tax valuations by property owners is essential to minimize ongoing tax liabilities.

EXHIBIT

The mathematics involved in the calculation of most tax bills is:

$$(\text{market value})(\text{ratio})(\text{equalizer})(\text{tax rate}) = \text{tax due}$$

where:

market value = The value determined by the tax assessment process as of a specified date.

ratio = A legislatively mandated percentage which is generally fixed by property type classification.

A property owner should always verify that the property is properly classified, particularly during any development or transition in use. The timing of any changes in classification can have a dramatic impact on the amount of taxes that are payable for one or more years.

Some jurisdictions create multiple market values which may be transitional values or part of additional tax calculations.

equalizer = A legislatively mandated or locally determined factor used to compensate for under- or overvaluations of all the property within the jurisdiction. The equalizer is applied against all properties irrespective of their individual level of assessment, and it is based on overall averages. Application of the equalizer generally results in overvaluation of new construction and recent sales and undervaluation of older properties. In some jurisdictions, the equalizer itself may be contested.

tax rate = The adjusted product of the sum of all projected cash requirements of local tax levying jurisdictions for the fiscal year, divided by the total real property valuations within the tax jurisdictions. The tax rate may vary by property type classification.

The determination of the tax rate via the tax levy is solely the product of the political process. In most instances the real estate investor is limited by time, distance and lack of political power to change the course of the local process. Local lobbies and chapters of organizations, such as the National Apartment Association, the Building Owners and Management Association (BOMA) and International Council of Shopping Centers (ICSC), may affect the political process. An example of an entity that was instrumental in stopping a levy is the Los Angeles Downtown Property Owners Association, which helped stop the collection of special assessments for the construction of the subway mass transit line in Los Angeles. Increases of over 100% in taxes have been suspended pending hearings and court resolutions.

The importance of these organizations is increasing as local governments' sources of funds shift from federal to state and local revenue sources.

COMMON LAW AND THE EVOLVING BROKER'S LIABILITY TO THE BUYER

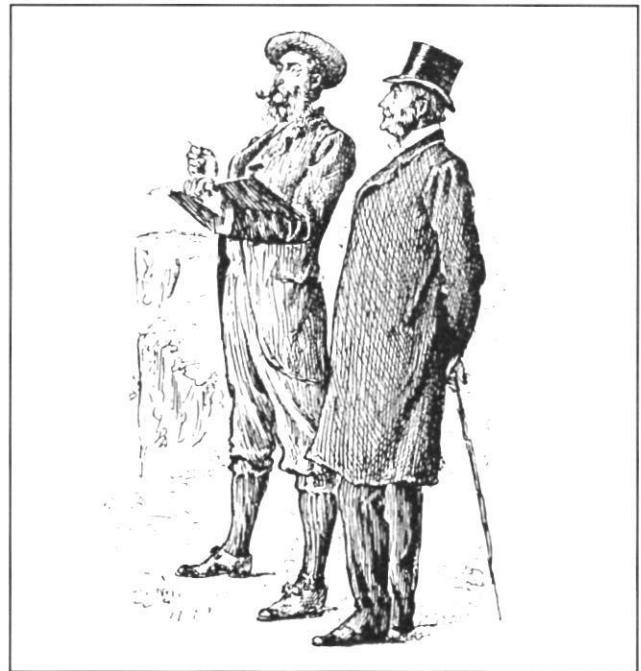
The government may intervene if the question of broker's liability is not resolved soon.

by Robert J. Shedlarz and James R. Webb

The degree of liability of a real estate broker to a purchaser of real estate has become a topic of intense interest over the last few years. Traditionally, the broker has been considered the seller's legal agent and thus has owed a fiduciary duty to the seller. The tenets of common law agency usually have been sufficient to describe this fiduciary relationship and provide remedies for any breach of the relationship. However, the nature of a broker's liability is changing. This article discusses the degree of duty owed to a buyer when the common law of agency is not generally known to the buying public and the buyer is relying upon the professional expertise and assistance of the broker. This article also presents a secondary issue: whether or not the parties to a real estate transaction may agree to alter the degree of responsibility that the law proscribes, i.e., of what effect are disclosures and/or disclaimers in attempting to reduce a broker's degree of liability to a buyer? The discussion assumes that particular statutes or administrative regulations do not deal with these problems. In states that have such statutes or rulings, brokers should refer to the relevant laws. It is also important however, for brokers to understand what case law has provided, by way of guidance.

History And The Rule Of Caveat Emptor

The ancient rule of business conduct, *caveat emptor*, has survived in the context of real estate transactions longer than in any other area of contract law. Despite trends leading toward more consumer (i.e., buyer) protection, there are still instances in which the buyer must beware; in which a buyer has a duty to inspect what he is buying and thus acts at his own risk. For example, between the seller and buyer of real estate, *caveat emptor*, is still alive and well in the State of Ohio.¹ Regardless of



consequences or logic (or lack thereof), however, *caveat emptor* has never been a device for protecting a broker from the claim of a dissatisfied buyer.

Even when *caveat emptor* applies to a situation, a broker may be liable to a buyer because of fraud. In the context of a real estate transfer, fraud has been alleged against a broker for failing to disclose that the state has taken easements across a property when such information was known to the broker;² for withholding knowledge that tap-ins were required, rather than optional, for a new sewer system;³ or for knowing that his statements concerning zoning requirements were incorrect.⁴ Another notable recent case involves a broker's fraudulent concealment of the presence of hazardous urea-formaldehyde foam (UFFI) insulation, which was regarded by the court as concealment of material information.⁵

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A broker's liability to a buyer thus unquestionably extends to situations involving fraud on the part of the broker, with fraud defined as intentional, material misrepresentation. Also, any attempt on the part of a broker to lessen liability by having the purchaser sign a document which purports to exculpate the broker's fraud is held to be invalid on the basis of public policy. Such documents usually are described as contracts of adhesion and are not enforced. Nevertheless, cases of purposeful fraud on the part of a broker are probably rare, given the requirements of licensing and the probability of losing that license for fraud (to say nothing of the specter of punitive damages that may result from the successful prosecution of a claim of fraud in a civil lawsuit).

Liability For Innocent Misrepresentation And Deceit

Some states have imposed upon a broker what appears to be a version of strict liability for any information the buyer relied upon to his detriment. If the information was material, regardless of whether or not the broker knew or should have known that the information he was giving was false, the broker may be held liable in some states. This was the view of the Supreme Court of Alaska in the case of *Bevins v. Ballard*.⁶ In the *Bevins* case, the court ruled in favor of the buyer on the theory of "innocent misrepresentation," even though the buyer's complaint did not explicitly allege this theory. The court carefully distinguished three types of misrepresentation (intentional, negligent and innocent) and then applied the following section of the 1977 Restatement of Torts:

One who, in a sale, rental or exchange transaction with another, makes a misrepresentation of a material fact for the purpose of inducing the other to act or to refrain from acting in reliance upon it, is subject to liability to the other for pecuniary loss caused by him by his justifiable reliance upon the misrepresentation, even though not made fraudulently or negligently.⁷

Although the Restatement of Torts does not specifically include brokers in this section, the Alaska Supreme Court did. Moreover, Alaska is not alone in applying this almost *per se* degree of liability to real estate brokerage.⁸ It would seem that the only path for a broker to take in states that apply this degree of liability is to refrain from providing any information about the property to a potential buyer. How this path could be followed by those engaged in real estate brokerage is open to question, and in a business sense there always would be some brokers willing to take the risk.

A somewhat less strict but nonetheless substantial theory of recovery against the broker is employed by those states that review a broker's conduct under the context of deceit. Ohio, for example, uses deceit as the measure of culpability for statements made by a broker to a buyer.

If a person makes a representation, not knowing whether it is true or false, he cannot be considered as innocent, since a positive assertion of a fact is, by plain implication, an assertion of knowledge concerning the fact.⁹

This theory produces an interesting dilemma for real estate professionals in that the standard of care, owed by a seller to a buyer in Ohio, is the low standard of *caveat emptor*. The much greater standard of deceit is owed by the seller's broker to the buyer. The practical, financial imbalance which may result from the use of this dual and opposite standard of care was noted by Judge Taft in 1956 in his dissent in *Pumphrey et al v. Quillen, et al*:

Q owns a house having no value. He employs T to sell it for him. T represents to P that the house is of masonry construction. If it were, it would be worth \$8,000. In reliance on that representation, P pays Q \$8,000 for the house and Q pays T a commission of \$200. Thus Q gets \$7,800 for nothing. Under the decision of this court, Q is allowed to keep the \$7,800 and P gets his \$8,000 back from T who had received only \$200 out of the transaction and did not know that his representation was not true.¹⁰

Deceit is thus defined as a lapse of "utmost good faith" which the broker owes, as a matter of law, to the buyer.¹¹

The Negligence Standard And Exculpatory Clause Effects

Clearly, a state that recognizes the enhanced liability standard of innocent misrepresentation is not likely to allow an exculpatory clause in a written document to reduce the standard of care. It may also be said that if the standard of care is deceit, no documentation by the broker will serve to reduce his liability for making untrue statements.

However, it should be noted that numerous states take a middle ground approach and use the negligence standard to determine a broker's liability. Under the negligence standard, a broker is required to exercise reasonable care in conducting an inspection of the premises and in making statements about it to the buyer. A broker is deemed to be negligent only if he fails to disclose problems that should have been discovered through reasonable inspection efforts. (In *Easton v. Strassburger*; the court stated the issue as follows:

The issue then, is whether a broker is negligent if he fails to disclose defects which he should have discovered through reasonable diligence. Stated another way, we must determine whether the broker's duty of due care in a residential real estate transaction includes a duty to conduct a reasonably competent and diligent inspection of property he has listed for sale in order to discover defects for the benefit of the buyer.¹²

In answering this issue in the affirmative, the California court stated that a cause of action may be brought against a broker for negligence based upon what the broker should have known and should have disclosed to the buyer. The Supreme Court of Washington took a similar view, i.e., brokers are not liable for innocent and non-negligent misrepresentations of material facts to buyers. The court refused to follow a strict liability standard, commenting:

This approach has been criticized for imposing a standard of strict liability for all misrepresentations that a broker might make or communicate, however innocent, in a real estate transaction. Another commentator observes the obvious—that there is a problem with subjecting brokers to liability for innocent misrepresentation without imposing a corresponding duty of inspection for defects, and that without such a duty, a broker may be tempted to provide less information to a buyer, fearing that his or her chances of exposure to liability for innocent misrepresentations will multiply with the quantity of information provided.¹³

The standard applied by the State of Washington thus requires an inquiry into whether or not the broker was “justifiably ignorant” of the problem.¹⁴

Proceeding further along this line of reasoning, if a broker is liable to a buyer under a negligence standard of care, can an exculpatory clause be legally effective, i.e., can a document lower the broker’s standard of care to the buyer by relieving the broker of his own negligence? The answer varies from state to state. In Ohio, the answer appears to be “yes.”¹⁵ In California, the answer is probably “no.”¹⁶

The Present Dilemma And Thoughts For The Future

As noted previously, a broker is held to professional standards of care; yet he does not receive the benefit of the malpractice standard of care that other professions, such as the medical profession, have evolved in order to temper their liability to the public. Nowhere in the cases quoted in this article is there any mention of a standard that is equated with a “reasonably prudent” broker or words to that effect. Nor has the brokerage profession had much success, except in a few states, in limiting its liability by statute. As long as brokers insist upon undertaking residential real estate transactions in a dual-agency capacity, liability will be imposed when a problem of substantial magnitude arises. The privity concept is no longer relevant, and a claim by the broker that he is a fiduciary of the seller and thus cannot disclose defects to the buyer will be ignored by the courts.

The nature of real estate brokerage may change to such an extent that a listing broker may insist that the buyer obtain his own broker (buyer broker) before any negotiations commence. States may legislate such an arrangement, but passage of such legislation does not seem to be likely anywhere at present. Despite the existence of multiple listing services and the fact that listing and selling brokers are often different individuals, the concept of separate representation, has not evolved. Indeed, many states place the listing and the selling broker in exactly the same position insofar as their collective liability to the buyer.

A more practical solution may be to collect litigation data indicating those areas that generate the greatest number of lawsuits. A checklist may be developed from this data and used by brokers and their agents to identify and deal with problem areas before actual problems arise. This is

not a perfect solution because new problems (such as the insulation problem described earlier) will constantly arise, and consumer alerts about such problems as radon levels will occasionally appear. However, if it is cost effective, a large brokerage firm or the Board of REALTORS may employ (or share employment of) a team of experts in such fields as insect infestation, insulation, boundary lines and encroachments and structural defects to examine each property listed for sale and issue a report to be appended to the original listing information obtained by the broker. This approach would be better than the present system, in which some of these items of information are handled by outside companies (such as termite inspection), undertaken by title companies (such as location surveys) or not examined at all (such as insulation problems).

If the brokerage industry does not develop its own system of oversight in these areas, then litigation will probably accelerate. Ultimately, the tendency for the government to directly intervene in this area, as a result of consumer protests about a lack of control, may result in greatly increased governmental regulation. Additional government regulation probably will increase expenses and delay the listing of properties for sale. Increased expenses and delays already are occurring in some states that require pollution inspections and reports prior to the transfer of some special-purpose properties such as gasoline service stations.

The nature of real estate brokerage is changing rapidly in the United States, and it is up to the real estate profession to determine the direction of this change. Litigation, particularly in the area of dual agency representation for residential real estate sales, is just beginning. If real estate brokers do not develop a practical way of dealing with their liability to the public, the government will invent a way to do it, and the results probably will be anything but practical.

NOTES

1. See *Lyman, et al v. Binns* (1988), 35 Ohio St. 3d 176.
2. *Gilbey et al v. Cooper et al*, Court of Common Pleas of Ohio, Columbiana County, June 20, 1973, 37 Ohio Misc. 119.
3. *Foust, et al v. Valleybrook Realty Co. et al*, Court of Appeals of Ohio, Wood County, June 26, 1981, 4 Ohio App. 3d 164.
4. *Silverman v. Bell Savings & Loan Association*, 533 A.2d 110 (1987).
5. *Roberts v. Estate of Barbagallo*, 366 Pa. 559, 531 A.2d 1125 (1987).
6. *Bevins v. Ballard*, 655 P.2d 757, (1982).
7. Section 552C(1) of the *Restatement (Second) of Torts* (1977).
8. See *Goldman v. Hart*, 134 Ga. App. 422 (1975).
9. Ohio Jurisprudence 377, Section 75.
10. *Pumphrey et al v. Quillen et al*, 165 Ohio St. 343 (1956).
11. See *Button v. Olson*, Ohio Appeals, 9th Dist., Summit Co. No 1344, Decided Jan. 31, 1928; *Garl v. Mihuta* (1975), 50 Ohio App. 2d 142; *Ridgeway v. Hartten, et al v. Bellamy, et al* (unreported), No. E-87-25, Court of Appeals, Erie County, Ohio (1988).
12. *Easton v. Strassburger et al*, 152 Cal. App. 3d 90, (1984).
13. *Hoffman v. Connall*, 108 Wash. 2d 69 (1987).
14. See *Tennant v. Lawton*, 26 Wash. App. 701 (1980).
15. *Sanfillipo et al v. Rarden et al*, Court of Appeals of Hamilton County, Ohio, 24 Ohio App. 3d 164 (1985).
16. *Akin v. Business Title Corporation*, 70 Cal. Rptr. 287 (1968).

THE POTENTIAL MARKET FOR HOUSING AMONG OLDER AMERICANS

The graying of America is impacting many parts of the U.S. economy including the home building industry.

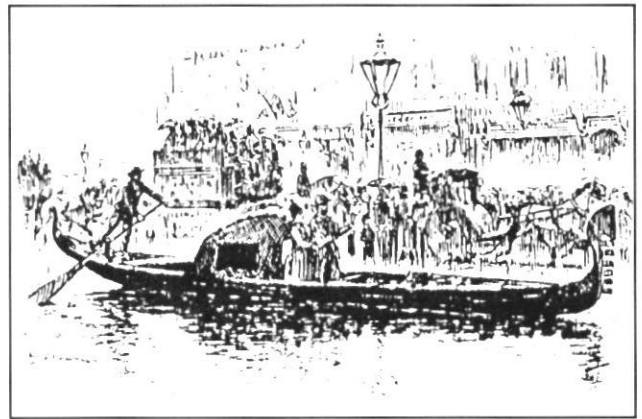
by Karen Martin Gibler

The trend of increasing numbers of older citizens in the U.S. population may be attributed to several factors. Low birth rates in recent years mean that fewer young people are in the population. Extended life expectancies mean more people are in the older age categories for longer periods of time. The graying of America is expected to continue as members of the largest single segment of the U.S. population by far, the Baby Boom generation, start reaching retirement age at the turn of the next century.

Traditionally, the new home market has been dominated by young, first-time buyers. However, with fewer young families in the population, home builders must look to other age groups for market expansion. The increasing mature and elderly segments of the population may provide opportunities for home builders if they learn about the tastes and preferences of older consumers, develop the housing products they want and effectively market to them.

When planning housing for older residents, builders should realize that these consumers cannot be placed into one generic group. Researchers have identified at least four age categories within the mature and senior citizen markets: preretirees aged 55 to 64, the active elderly aged 65 to 74, widows and married couples aged 75 to 84 with slight health problems and individuals aged 85 and older with more serious health problems.

Builders also should recognize that the housing choices made by members of previous elderly population segments may not be the best predictors of future housing demand. Each successive group of Americans who reach retirement age has different characteristics, and the people within these groups or cohorts vary tremendously. With rising income and educational levels and different



life experiences, the elderly population at the turn of the 21st Century may be substantially different from the current elderly population in terms of housing preferences. The more builders learn about the elderly retired and the people who are heading toward retirement, the better prepared they will be to serve these growing market segments.

The purpose of this article is to help home builders understand the characteristics and complexities of the 55 and older markets and present some ideas that builders may consider when developing housing for these market segments.

Market Size And Composition

The 55 and older population of the United States is growing and changing in composition, and both of these factors affect the housing industry. The sheer growth in size of the older population segment indicates a need for additional housing services, and the change in composition of this group affects the type of housing and location consumers will choose.

The greatest growth in total number and proportion of the U.S. population is currently occurring among the oldest

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population segment. According to the U.S. Census Bureau, the 85 and older segment is projected to be the fastest growing age group in the United States through the year 2000. These very old individuals often experience health problems and financial constraints that restrict their housing choices. Although the majority of those aged 85 and older maintain an independent living situation, they most likely live in a relative's home, congregate care facility or nursing home.

Growth among the oldest segment of the population also means growth in the number of widows. Most adults under age 65 are married and living with their spouses. Married individuals, regardless of age, tend to maintain independent housing because spouses help one another through illnesses and provide companionship. However, the proportion of married adults living together declines appreciably after age 65; by age 76, fewer than one-half of adults are married. Because women characteristically enjoy a longer life expectancy than men, it is usually the wife who is left alone and who, because of illness or financial difficulties, is not able to maintain independent living.

Educational attainment among the elderly traditionally has been lower than that of younger age groups; however, the gap is narrowing. In 1983, for example, 40% of those aged 55 and older were high school graduates; by 1987 the proportion of elderly high school graduates increased to 58%. This trend, which is expected to continue, results in a better educated elderly population¹ and more informed and discerning consumers of housing services.

Retirement is common for men aged 55 and over, and the present increase in the number of retired men is projected to continue through the end of the century. The trend toward early retirement among men probably is a result of the increased affordability of retirement, with more men taking advantage of private and public pension programs. Retirement implies freedom from geographic ties to an individual's place of employment, one of the major determinants of housing location among younger buyers. Retirement breaks the linkage between housing and the workplace and allows a wider choice of housing location, including major cross-country relocation.

Meanwhile, more women under age 65 are working and participating in financial and business matters while earning their own retirement benefits. Thus, fewer elderly widows in the future will face the financial difficulties that many widows currently experience.²

Although most retirees are considered to be poor, only the very old and rural residents have extremely low incomes. Real personal income for both older singles and married couples has risen over the last three decades, and median household income for those aged 55 to 64 is above the national median. Households headed by individuals aged 65 and older earn appreciably less than households headed by younger individuals. On a per capita basis, however, the differences in income levels by age group are noticeably reduced. In addition, some forms of retirement income are exempt from income taxes, and income figures do not consider assets such as

home equity, a major component of wealth among the elderly. Over 90% of all elderly people or their spouses receive Social Security benefits, with a median per capita benefit of \$4,600 per year. The expansion of non-cash benefits and government-subsidized services has freed up cash for other purposes.³ Meanwhile, housing expenses for older individuals may be minimal since they often own their homes free and clear with the furnishings and other assets, and they no longer support their children. In addition, because of homestead exemptions and circuit breaker provisions in state property tax laws as well as income tax capital gains exclusions, the elderly assume fewer housing costs than do younger home owners. Thus, more older Americans than may be immediately apparent have the financial resources to purchase new housing, although these financial resources may be more in the form of assets than income.

Contrary to popular belief, most older Americans live independently in single family homes. In 1960 only one-fifth of those aged 65 and older lived alone; now almost 40% of those aged 65 to 74 and over half of those aged 75 and older live alone. Women are twice as likely as men to live alone. Almost 70% of heads of households aged 65 to 74 and over 60% of those aged 75 and older live in single family homes.⁴

In summary, those who have reached or are approaching senior citizen status are increasing in number more rapidly than other age groups. Seniors today tend to be better educated and more financially secure than previous generations. Most of them live independently, either with their spouse or alone. For the most part, the elderly are financially able to purchase a new home, and they are willing to relocate, sometimes across great distances. Consequently, the elderly represent an ideal market for home builders. To address this population, however, home builders need to identify target markets, design products that meet the target consumers' needs and develop pricing strategies that suit customers' financial status.

Market Segmentation

The mature market is as heterogeneous as any other age group. Many in the 55 to 64 age group are actively working, but their children are raised and they have paid off most of their home mortgage. They tend to be in good health and have considerable discretionary income to spend on luxury items; indeed, consumers in this age group often are ready to buy and do the things they put off while they raised children and climbed the corporate ladder. Many want a home that requires less yard maintenance yet provides the amenities they have earned. The individuals in this age group who take early retirement may consider moving to an active environment such as a retirement community in a resort location.

The 65 to 74 age group includes more retirees who are settling into a new life-style. Some may remain in the house they bought 10, 20 or more years ago because it elicits fond memories and is located near friends and family. Others, now that their jobs no longer dictate

where they must live, may want to return to the communities in which they grew up. More grow tired of lawn maintenance and want to find a way to maintain their social ties but reduce maintenance requirements without trading down.

Health care assumes greater importance among those aged 75 and older. Often a widow is left alone during this period, and she may consider moving closer to her family or into a more supportive environment such as a congregate care community.

A greater proportion of the population aged 85 and older requires assistance with daily activities, provided either by family members, social service agencies or institutions. If individuals in this age group do move, often it is done involuntarily because of health or security problems.

As people age, they bring with them the attitudes, interests and spending patterns they developed in earlier life. Thus, many of the characteristics that we now attribute to older consumers may be due not so much to their chronological age but to their life experiences, and as currently younger groups reach retirement age, their characteristics may not resemble those we see in the elderly population. This phenomenon is known as the cohort effect, and it means that some of the housing tastes, preferences and choices we currently observe among the elderly may change as different cohorts move through the 55 to 85 age ranges and these cohorts perpetuate different life-style patterns.⁵

To accommodate the changing tastes of upcoming elderly cohorts, home builders must be prepared to modify their products to provide the housing features each cohort wants. For example, the current fitness trend among young and middle-aged adults may persist as people age, increasing elderly home buyers' demands for exercise space and facilities. With more working couples accustomed to eating out or preparing quick, convenient meals, elderly retirees may be looking for modified kitchen areas. Also, aging cohorts who are comfortable with high-tech products, such as computers, may expect to find more sophisticated climate control, security systems and entertainment facilities in new homes.

Segmenting the elderly home buying market solely by age categories will not be sufficient for designing and targeting housing in the years ahead. Education, income, interests and activities also must be used to discriminate among the different elderly market segments.

Product Type

Most older Americans currently own their homes, and the percentage of home owners among the elderly is growing.⁶ The trend toward home ownership among the elderly does not reflect a shift from renting to owning at a late age; rather, it is a result of earlier tenure choice. More younger people are home owners, especially by middle-age, and they tend to remain home owners as they age.

Renting is the preferred type of tenure for only a minority of older residents, and most older renters either were

renters at younger ages or they are very old and have fewer financial resources than other seniors.

The majority of older consumers prefer single family detached housing. The 1987 U.S. League of Savings Institution's Home Buyer Survey found that over 70% of new home buyers over age 55 bought single family homes. A 1988 national survey of recent new home buyers by the National Association of Home Builders (NAHB) showed that more than 80% of new home buyers aged 55 and over prefer a single family detached home.

The preferences and the relative importance of particular home features of older buyers vary from those of younger buyers in several areas. Older buyers usually want three bedrooms and two or 2 1/2 baths; few want a large yard or a larger house. Other features that are important to older buyers include access to shopping, energy efficiency, minimal exterior maintenance, security systems, quality of housing materials, recommendations of other buyers and warranties. Features that are less important to older buyers include access to work areas and schools, fireplaces, basements, brick exteriors, lot size and room size.⁷

Many older residents who leave single family detached houses and move to escape maintenance chores, obtain better security and address health problems. The housing options available to these movers have expanded in recent years to include apartments, condominiums, townhouses, congregate care settings, continuing care retirement communities or life care centers and shared housing. Many older individuals move to condominiums or lower maintenance houses just after retirement; more people move into congregate and other supportive living environments after reaching their 70s, after experiencing health problems or being widowed. Among the features that residents want most in supportive facilities are two-bedroom units, storage space for household belongings, in-unit medical alert system, natural lighting, energy efficiency, building security, transportation services, cleaning services and dining facilities in a low-rise building.⁸

To accommodate older individuals' housing preferences, home builders may provide low maintenance single family housing units on small lots. They may equip the units with such safety features as conveniently placed outlets and cabinets, easy-to-grasp handles, few steps, non-slip floors and contrasting textures and colors. Home builders may offer similar features in multi-family units, along with built-in security features.

Place

Older segments of the population historically have been less mobile than younger age groups; however, mobility among older residents is increasing as a result of an aging cohort that is more accustomed to relocating for corporate promotions, that has a higher educational level and that has improved financial status.⁹ For example, among the recent home buyers surveyed by NAHB, 6% of those aged 65 and over planned to move again in the next year

and 17% were unsure; among those aged 55 to 64, 11% planned to move and 19% were unsure.

There are several major paths of long-distance movement today—to Sun Belt destinations (Florida, California, Arizona and Texas), back to birthplaces (impacting such large population states as Illinois and Ohio) and from neighboring states to regional vacation centers (such as the Ozarks, Washington, New Jersey and New York).

These mobility trends point to two growing markets. One market consists of long distance movers who are relatively young and healthy new retirees who are looking for housing in a small town with a better climate and an active, independent living environment emphasizing recreation and social life.¹⁰ Individuals interested in moving over longer distances are motivated by retirement, a desire to reside in a warmer climate or to be in closer proximity to relatives. These retirees want quality housing with recreational opportunities located nearby, all at a reasonable price. They are good targets for retirement villages located in established amenity locations.

The second market is made up of local movers, many of whom are widows or individuals in failing health. Individuals interested in finding a new home in the same community where they have developed friendships and feel comfortable may be seeking a better home or a change to a leisurely life-style, or they may be forced to relocate due to poor health, widowhood or low income. They may be considering housing situations that provide additional security, require less physical activity to maintain or offer assistance with daily activities. Condominiums and rental retirement housing, including congregate care facilities, are attractive to these individuals. Because most of these movers want to remain in the same community, suburban locations in cities that have a large population of older residents are most desirable.

Price

Many older consumers appear to be as interested as home buyers of other ages in trading up to better and more expensive homes. However, they may react differently to the pricing and financing options commonly used by younger consumers.

Many elderly consumers are hesitant to use experiences, such as the Depression. According to the U.S. League of Savings Institutions, if older buyers do borrow to finance a home purchase, they more often use 15-year and adjustable rate mortgages than alternative financing techniques.

The older home buyer's biggest source of funds for financing a new home is often the equity that has been built up in previous homes. A recent report showed that the elderly hold close to \$800 billion in home equity, and 60% of that total is held by householders aged 70 and older. The average elderly home owner has over \$60,000 in home equity.¹¹ Several programs have been developed to give older home owners more financial options by tapping into their home equity. Some of these home equity conversion instruments, such as the reverse

annuity mortgage, reverse mortgage, sale leaseback and split equity, offer the home owner the option of continuing to live in his home while receiving income payments out of home equity. In addition, these instruments allow the lender to take possession of the home at the end of the term or lease or upon the home owner's death. Another option is for the home owner to use home equity to fund a rental living arrangement at a new location.

Home equity conversion programs have been slow to develop, partially because of a lack of lender interest and partially because of a lack of borrower interest. A recent survey of older residents in the Atlanta area revealed a general lack of knowledge about home equity conversion programs.

Pricing and financing techniques for elderly housing must be designed with certain limitations in mind. All-cash discounts and short-term financing make new homes more attractive buys for elderly consumers. If a housing developer wants to help home owners fund their new units through home equity conversion programs, then he must be ready to educate both lenders and borrowers about such programs. Developers offering continuing care or life care facilities face the even more difficult task of properly pricing units and health services based on life expectancy and growing medical costs.

Promotion

In promoting products designed primarily for the elderly, housing marketers must be careful not to repeat the mistakes of manufacturers whose products and promotions have been interpreted by seniors as threats to their self-esteem. Older consumers tend to be cautious and need a great deal of assurance before they act. They tend to be slower than younger people to adopt innovations and therefore must be shown how a particular new product meets their needs.

Seniors do not want to be singled out and reminded that they are old; they much prefer that emphasis be placed on the positive aspects of aging, such as gaining experience. Seniors also do not want to be stereotyped as loud and obnoxious old people or as timid and frail widows. Promotional appeal based on helping seniors identify with other age groups, a strategy referred to as "trans-generational," has been effective with this age group. Advertising based on this strategy shows both pre-retirement and post-retirement people enjoying products together.¹²

The manner in which information is presented to seniors also is important. Older consumers process less information than younger consumers when making purchase decisions, both because they are less capable of processing large amounts of information and because they have greater market experience. To accommodate the decreased processing capacity of seniors, promotional information should be presented in an uncluttered manner that allows self-pacing. To overcome the lack of information search, marketers must reach out directly to potential customers.

To reach older consumers, home builders must choose among various communication channels. In general, elderly persons are heavy consumers of television. Radio is much less popular; most seniors listen only to an AM radio station for one to two hours in the morning to obtain news and weather information. Newspapers are very popular among older Americans; most over age 65 read a daily paper, and many read one or two magazines per week.

The relative exposure to different media varies among seniors. As people age past 70, television viewing increases, and newspaper reading declines, perhaps due to failing vision. Still, a substantial number of individuals in this age group, particularly those with higher incomes and educational levels, continue to rely on print media.

There appears to be a difference in the effectiveness of advertising for younger and older seniors, with individuals in the younger group being more influenced by television, and magazine advertising being more influential among the oldest consumers.¹³

The elderly also place great reliance on informal sources of information such as word-of-mouth spread through friends and family; so reputation and customer satisfaction may be crucial to winning the mature consumer.

Due to these differences in media exposure, the housing marketer must know who the target audience is for a particular product. Home builders may use television to strengthen their name recognition and spark interest but communicate general information about developments through newspapers and magazines. Home builders may use direct mail for detailed materials which the older targeted consumer may read at his leisure. If the type of housing or financing arrangement is innovative, the builder is placed in the position of educator and may need to discuss housing and financing options in meetings of senior citizen groups, social events or with tours of the property. Once the units are partially occupied, residents themselves become a valuable source of referrals.

Builders of any housing development aimed for older residents should expect slower absorption rates than builders of units targeted to younger customers. It is a traumatic experience for older individuals to leave the family home of many years and relocate for what may be the last time. Older customers consequently may visit the development site repeatedly over a long period of time before making any decision. Older customers also may require extensive personal attention to obtain information and gain reassurance.

Summary And Recommendations

People aged 55 and older are a growing proportion of the U.S. population; they are also better educated, more financially secure and more mobile than their counterparts in years past. To successfully reach the older market segment, home builders must provide high-quality homes that are customized to meet consumers needs and are located in desirable retirement locations. In marketing these units, builders must recognize how seniors view

themselves; how their self-image is tied to their home and independence; and how these customers can be reached through the media.

There are many opportunities in this market that merit further study by home builders and market analysts. Identifying target market location, size and composition will require the study of both primary and secondary data on local areas. Builders must not only calculate the number of older people located in target areas, they also must assess the seniors' financial status, educational level, health status, family composition and previous home ownership. Competitive housing, as well as services that help older individuals live independently in single family houses, must be inventoried. In addition, the builder must work directly with potential residents to determine housing preferences and requirements. Although such specific analysis must be conducted for any housing project to be successful, some general suggestions may be made.

The states that are experiencing the highest rates of elderly immigration are the logical locations for construction of single family detached housing on low-maintenance lots. Because elderly, long distance movers have considerable income and wealth, moderate to large-sized homes and amenities may be planned. Promotions to attract out-of-state customers may include direct mail brochures, special vacation packages to familiarize pre-retirees with the area and finders' fees for referrals.

In contrast, communities that already have large numbers of older residents probably are better locations for the development of condominiums, rental retirement apartments and congregate care facilities. Consumers interested in moving into these communities face more income and price constraints in their choice of housing. The housing provider therefore may need to educate local residents about new facilities, services and financing techniques through senior citizen groups before approaching potential residents for a sale or lease. The provider may then begin a campaign of television spots to achieve name recognition in conjunction with newspaper advertising and direct mail pieces to attract the target market. Personal attention is the final key to selling seniors the housing that meets their individual needs.

The potential market for home builders is there—growing numbers of people with the necessary financial resources and interest in moving into a new home. The challenge for home builders who wish to develop this market is to design innovative products in the right locations and prepare sensitive promotional campaigns.

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PROPERTY RIGHTS AND THE TRAGEDY OF THE COMMONS IN THE NATIONAL PARK SYSTEM

Unless property rights are created to manage national parks more efficiently, the nation's park land resource will deteriorate as have other common pools of resources.

by Austin J. Jaffe and Michael Janov

The United States has chosen to protect the most spectacular and most beautiful of the nation's natural resources from the threats of commercialism and modernization by designating specific land areas as "national parks" that are available as common resources to the general public. In a letter to Stephen T. Mather, the first director of the National Park Service, Secretary of the Interior Franklin Lane outlined the administrative policy that would govern the parks:

First, that the national parks must be maintained in absolutely unimpaired form for the use of future generations as well as those of our own time; second, that they are set aside for the use, observation, health, and pleasure of the people; and third, that the national interest must dictate all decisions affecting public or private enterprise in the parks.¹

This policy is clear: to protect the aesthetic beauty and priceless attraction of land designated as national parks. Nonetheless, preservation and conservation efforts are costly endeavors, and presently, it appears that the U.S. National Park System is in trouble both financially and environmentally.

The troubles in the park system are manifold. One is that the supply of natural parks is essentially fixed while the demand for the parks' amenities continues to grow. The increase in demand is due to several factors, including:

1. The increase in the amount of available leisure time due to shorter work weeks, longer life spans, earlier retirements and longer vacation periods;
2. The increased tempo of daily life, coupled with the greater mobility of people;
3. The growing affluence of the American public and a



propensity among many members of the public for outdoor recreation; and

4. An increased awareness of the benefits of the National Park System.

Even if additional sites are added to the system, there remains the problem of finding unique attractions.

Yellowstone, Yosemite and the Grand Tetons cannot be readily duplicated.² Thus, if demand continues to increase at its present rate, given the relatively fixed supply of park land, the park system will show signs of wear.

The procurement of sufficient budgets to cover park expenditures also is in trouble. Funding for park services comes from a variety of sources including entrance fees, taxes and concessions, but it comes primarily from government appropriations. As costs have increased due to

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TABLE 1
National Park Service
Usage and Funding

Fiscal Year	Federal Acres	Visitors	Operating Funds	Capital Improvement Funds	Total Funding
	(000)	(000)	(000)	(000)	(000)
1955	23,889	56,573	\$ 18,697	\$ 14,218	\$ 32,915
1956	24,898	61,602	20,781	28,079	48,860
1957	24,410	68,016	22,976	45,056	68,032
1958	24,398	65,461	27,605	48,400	76,005
1959	24,497	68,900	29,963	50,000	79,963
1960	25,704	79,229	32,682	47,000	79,682
1961	25,158	86,663	37,876	51,528	89,404
1962	26,003	97,045	42,224	67,976	110,200
1963	25,859	102,711	48,017	72,776	120,793
1964	26,102	111,386	51,386	61,697	113,083
1965	26,549	121,312	56,199	71,987	128,186
1966	26,551	133,081	61,380	66,380	127,760
1967	27,187	139,676	67,743	55,323	123,066
1968	27,971	150,836	78,572	49,612	128,184
1969	28,460	163,990	81,674	21,958	103,632
1970	28,543	172,005	96,450	28,627	125,077
1971	28,731	200,543	120,244	36,707	156,951
1972	28,850	211,621	133,133	99,460	232,593
1973	28,937	215,580	170,661	51,087	221,748
1974	29,044	217,437	190,380	67,500	257,880
1975	29,300	238,849	220,100	97,400	817,500
1976	29,448	267,762	255,040	85,600	340,640
1977	29,648	262,603	295,173	130,952	426,125
1978	31,100	283,090	341,235	161,442	502,677
1979	72,000	282,435	387,806	118,488	506,294
1980	72,000	300,324	391,148	109,154	500,302
1981	72,021	329,663	459,041	43,367	502,408
1982	72,042	334,448	521,528	95,852	617,380
1983	72,058	335,646	605,279	160,096	765,375
1984	72,074	332,500	616,390	67,690	684,080
1985	72,103	346,190	626,818	111,045	737,863

growing demands, funding for park maintenance, preservation and capital improvements has lagged behind. Cuts to the National Park System budget under the Reagan Administration demonstrate that obtaining increased funding from the government is difficult.³ Perhaps the next administration will be otherwise disposed.

The National Park System, with primary funding from government sources, provides another illustration of Garrett Hardin's "tragedy of the commons" at work.⁴ The nature of a common pool of resources leads to common property attributes in the funding of its operations. Few wish to pay for an entitlement that is provided to all individuals, and the resulting inefficient allocation causes funding shortages for the National Park System and other popular agencies.

Overview Of The Article

This article reviews several problems inherent to the present park system and suggests some possible property rights solutions. A brief history of the National Park System includes a description of the formation of the

TABLE 2
National Park Service
Usage and Funding Ratios

Fiscal Year	Funding Per Acre	Funding Per Visitor	Visitor Per Acre
1955	\$ 1.38	\$ 0.58	2.37
1956	1.96	0.79	2.47
1957	2.79	1.00	2.79
1958	3.12	1.16	2.68
1959	3.26	1.16	2.81
1960	3.10	1.01	3.08
1961	3.55	1.03	3.44
1962	4.24	1.14	3.73
1963	4.67	1.18	3.97
1964	4.33	1.02	4.27
1965	4.83	1.06	4.57
1966	4.81	0.96	5.01
1967	4.53	0.88	5.14
1968	4.58	0.85	5.39
1969	3.64	0.63	5.76
1970	4.38	0.73	6.03
1971	5.46	0.78	6.98
1972	8.06	1.10	7.34
1973	7.66	1.03	7.45
1974	8.88	1.19	7.49
1975	10.84	1.33	8.15
1976	11.57	1.27	9.09
1977	14.37	1.62	8.86
1978	16.16	1.78	9.10
1979	7.03	1.79	3.92
1980	6.95	1.67	4.17
1981	6.98	1.52	4.58
1982	8.57	1.85	4.64
1983	10.62	2.28	4.66
1984	9.47	2.06	4.61
1985	10.23	2.13	4.80

service and the goals behind its founding. An assessment of property rights' claims reveals that Hardin's "tragedy of the commons" is disturbingly appropriate to the use and the funding of the National Park System. A trend line analysis provides a comparison of attendance and funding trends over a 30-year period and demonstrates the inadequacies of the present methods of parks' funding in light of attendance trends.

The Crisis In The National Park System

Early Formation

The importance of setting aside designated space for recreation has long been understood in this country. The first American settlers provided their town with a commons or village green. As communities grew larger, they included parks in their civic planning. As the nation's westward expansion proceeded in earnest during the latter part of the 19th Century, thoughtful people advocated the adoption of conservation practices to ensure the protection of suitable lands and waters for public enjoyment. Although this influence was only slight at the time when the store of such natural resources seemed

inexhaustible, a remarkable early success was scored in 1864 with the establishment of a state park in the Yosemite Valley of California. It has been noted that the national political conservation movement got underway with this development.⁵

In 1832, Hot Springs National Reservation in Arkansas was established as the first national reservation. Although the reservation was not a park in the strict sense of the word since the area did not possess the spectacular or beautiful scenery of other parks, Hot Springs was reserved by the government because of the perceived value of the springs in the treatment of certain ailments.⁶ The first area to be designated as a national park was Yellowstone in 1872. This was done at the urging of Professor F.V. Hayden, Nathaniel P. Langford and Cornelius Hedges, who had explored Yellowstone in response to reports of fantastic natural phenomena (hot pools, geysers and volcanoes) that had been circulated by hunters and trappers who frequented the area. Their report lent credibility to those

legendary tales and helped convince the U.S. Congress to protect the land from development.⁷

In 1890, Congress designated Yosemite as a national park and then added two other California sites (Sequoia and General Grant) to a growing list.⁸ From these beginnings, the park system has grown into a large, complex bureaucracy that now oversees scores of parks, forests and monuments.

Goals And Philosophies

The goals and underlying philosophies of the National Park System were summarized in the enabling legislation which was called the National Parks Act passed on August 25, 1916:

... The service thus established shall promote and regulate the use of the Federal areas known as national parks ... herein after specified by such means and

TABLE 3
National Park Service
Breakdown of Operating and Capital Improvement
Funds on a Per Acre and a Per Visitor Basis

Fiscal Year	Operating Funds Per Visitor	Capital Improvement Funds Per Visitor	Operating Funds Per Acre	Capital Improvement Funds Per Acre
1955	\$0.33	\$0.25	\$0.78	\$0.60
1956	0.34	0.46	0.83	1.13
1957	0.34	0.66	0.94	1.85
1958	0.42	0.74	1.13	1.98
1959	0.43	0.73	1.22	2.04
1960	0.41	0.59	1.27	1.83
1961	0.44	0.59	1.51	2.05
1962	0.44	0.70	1.62	2.61
1963	0.47	0.71	1.86	2.81
1964	0.46	0.55	1.97	2.36
1965	0.46	0.59	2.12	2.71
1966	0.46	0.50	2.31	2.50
1967	0.49	0.40	2.49	2.03
1968	0.52	0.33	2.81	1.77
1969	0.50	0.13	2.87	0.77
1970	0.56	0.17	3.38	1.00
1971	0.60	0.18	4.19	1.28
1972	0.63	0.47	4.61	3.45
1973	0.79	0.24	5.90	1.77
1974	0.88	0.31	6.55	2.32
1975	0.92	0.41	7.51	3.32
1976	0.95	0.32	8.66	2.91
1977	1.12	0.50	9.96	4.42
1978	1.21	0.57	10.97	5.19
1979	1.37	0.42	5.39	1.65
1980	1.30	0.36	5.43	1.52
1981	1.39	0.13	6.37	0.60
1982	1.56	0.29	7.24	1.33
1983	1.80	0.48	8.40	2.22
1984	1.85	0.20	8.55	0.94
1985	1.81	0.32	8.69	1.54

TABLE 4
National Park Service
Trend Line Analysis

Fiscal Year	Trend Line Fund/Acre	Trend Line Fund/Visitor	Trend Line Visitor Per Acre
1955	\$ 1.66	\$0.66	3.36
1956	2.01	0.70	3.48
1957	2.36	0.74	3.60
1958	2.71	0.78	3.72
1959	3.06	0.82	3.84
1960	3.41	0.86	3.96
1961	3.76	0.90	4.08
1962	4.11	0.94	4.20
1963	4.46	0.98	4.32
1964	4.81	1.02	4.44
1965	5.16	1.06	4.56
1966	5.51	1.10	4.68
1967	5.86	1.14	4.80
1968	6.21	1.18	4.92
1969	6.56	1.22	5.04
1970	6.91	1.26	5.16
1971	7.26	1.30	5.28
1972	7.61	1.34	5.40
1973	7.96	1.38	5.52
1974	8.31	1.42	5.64
1975	8.66	1.46	5.76
1976	9.01	1.50	5.88
1977	9.36	1.54	6.00
1978	9.71	1.58	6.12
1979	10.06	1.62	6.24
1980	10.41	1.66	6.36
1981	10.76	1.70	6.48
1982	11.11	1.74	6.60
1983	11.46	1.78	6.72
1984	11.81	1.82	6.84
1985	12.16	1.86	6.96
1986	12.51	1.90	7.08
1987	12.86	1.94	7.20
1988	13.21	1.98	7.32
1989	13.56	2.02	7.44
1990	13.91	2.06	7.56

measures as conform to the fundamental purpose of the said parks . . . which purpose is to conserve the scenery and the natural and historic objects and the wildlife therein and to provide for the enjoyment of the same in such manner and by such means as will leave them unimpaired for the enjoyment of future generations.⁹

The act also created the position of director of the National Park System. This post was initially occupied by Stephen T. Mather on May 16, 1917.

The National Parks Act has often been cited as a major milestone for the conservation movement because it was the first piece of federal legislation which helped ensure that future generations would have rights to use the nation's land. The preservation of resources cannot be assured, however, by simply setting aside land for the future. As is well known, the removal of a resource from development via state ownership *postpones* rather than *solves* the question of the optimal rate of consumption.

The initial interpretation of the National Parks Act was actually quite different from its interpretation by many of today's preservationists. At the time the act was passed, the disappearance of wilderness still was defined as progress by most people. In fact, Mather was more concerned with amusing the public than with preserving park land. Proposed attractions at the time included such things as tramways, resort hotels and scheduled bear feedings.¹⁰ Nonetheless, the 1916 philosophical orientation of the act still is followed today.

The Present State

Unfortunately, the National Park System is presently in a state of decay. Several examples of declining conditions include:

- Shoulders and walks along parts of the Shenandoah National Park's 105-mile Skyline Drive in Virginia are crumbling. Buildings are falling apart. Several camping areas are opening late (and some not at all) because of funding curtailment.¹¹
- Erosion threatens the bathhouses in the Gateway National Recreation Area in New York. Efforts to stop the erosion have not been undertaken due to lack of funding.¹²
- Temporary sandbags fight erosion at Cape Hatteras National Seashore in North Carolina because funding is not available for permanent retaining walls.¹³
- The Quapaw Baths and other Hot Springs spas in Arkansas are closed, not because of a lack of demand but because of the lack of funds to restore them to a safe and sanitary condition.¹⁴
- Air pollution has reduced visibility by up to 30% at the Great Smokey Mountains Park over the past two decades. Sometimes pollution keeps visitors from seeing the other side of the Grand Canyon as well. This condition could be improved if the National Park Service had more influence over developments outside the parks. The funding needed to promote this influence is not available.¹⁵
- It is estimated that the roads at Yellowstone are in

need of \$100 million of repairs over the next 10 years. However, the source of this funding is not yet known.¹⁶

- Pressure to shorten hours at parks, recreation centers and wildlife refuges grows each year. Regular public services such as visitors' centers and nature tours also are subjected to budget cuts on a regular basis.¹⁷
- The demise of the grizzly bear at Yellowstone has been allegedly due to "poor research and the use of incomplete and often conflicting information to make decisions on land use."¹⁸

Although the popular press cites countless examples of decay throughout the park system, these few examples alone suggest that change is needed. Although inadequate funding often is cited as the cause of this decay, it is really a symptom of a more basic problem. The use of national parks as communal property, as theory predicts, also has taken its toll. The National Park Service is a victim of its own bureaucratic system and the ill-defined property rights concepts that are associated with state-owned resources.

The concerns and problems of the park system were summarized by President Richard Nixon on a visit to Grand Teton National Park during the summer of 1971:

The growing popularity of our parks has created a number of serious new problems as millions of Americans have sought the recreation and respite they provide. Traffic congestion and crowded campsites are becoming more common. In many places, natural systems have been overburdened and damaged by the presence of too many people. Wild animals and unique plants have often been crowded out of their traditional habitat. In short, we are beginning to understand that there are limits to the amount of use our parklands can withstand, and that as more and more people seek the great rewards of outdoor life, the experience can be somewhat diminished for them.¹⁹

The problems President Nixon observed are typical of communal property institutions: resources are overused by consumers who have underassessed the marginal costs of the resources in the face of governmental budgetary difficulties and high demands for the resources. The challenge that the bureaucrats face eventually is how to stop the ensuing tragedy. This is the challenge now facing the National Park System.

The Future Outlook

Generally, the park service's goal has been to provide an opportunity for all visitors to visit the parks without any preference given to specific groups of visitors and under conditions that have the widest public acceptance. In the past visitors preferring the solitude of the wilderness and those enjoying the sociability of the campground have supported this policy. Now the sheer number of people using the park system has led to less energetic support of this policy as too many parties on both sides seem to be competing for a shrinking supply of space.²⁰

A factor that has long retarded more positive action has been the coincidental agreement by both polarized groups.²¹ So long as use of the parks by the two groups was compatible, the park service could avoid the uncomfortable role of discriminating against either the "mass recreationists" or the "wilderness purists." In future years restrictions on the number of people who will be able to enter the parks is inevitable, and the determination of how this restriction can be imposed equitably (and efficiently) is one of the most crucial decisions that the park service will face.²²

In 1966, Representative Julia Butler Hansen, chairman of the U.S. House of Representatives' Appropriations Subcommittee which handles the park service budget, stated: "I would recommend that we close those parks with the lowest priority of use."²³ While solutions of this type may help improve the short-term financial conditions of the park system, the additional attendance demands on the remaining facilities inevitably will pose greater problems in the future. In addition, shifting resources from current to future consumption postpones rather than solves the decision.

Private Property And The Funding Of The Parks

Property Rights Within The Parks

It is well known that the way in which property rights are assigned, enforced and transferred affects the allocation of resources. Who controls which resources? Who receives the benefits, and who bears the costs of various actions? How clearly are the property rights specified? How are property rights exchanged, and how are these exchanges enforced? The answers to these and other questions clearly influence the consequences of the market processes at any given time.²⁴ In the same way the definition of property rights in the National Park System plays a major role in the determination of the parks' present condition and future fate.

Limited property rights may be purchased in the parks in a number of ways. Concessions, campsite rentals and entrance fees are three common ways which have been created to allocate these property rights. However, due to a policy of minimal pricing, these devices have not been effective allocative devices.

Concessions are probably the strongest property right claims assigned by the park system. They allow a commercial entity to establish a business organization for a fixed duration and under agreed-upon restrictions concerning business conduct and methods. While the concession periods vary, 30 years is the maximum duration of concession property right claims that are attainable. Investment opportunities may be limited by the finite duration of the concession property right. However, there is incentive to perform in a manner which will be conducive to the renewal of the claims contract.

The administration of campsite rentals does little to ensure utilization of the land for its best use. Campsite rentals are for a fixed duration, usually for a maximum period of two weeks, which discourages responsible use

of the resource. Availability is on a first-come, first-served basis. All campsites are underpriced and at the same level, a policy which ignores the varying levels of demand for various sites and encourages the heaviest use of premier locations.

Entrance fees are usually on a per-car basis, which ignores the fact that large family units or groups generally consume more of park's resources than do smaller groups or individuals. Moreover, the rights granted by the entrance fees are broad but not exclusive. Generally the recipient may consume as much of the park's resources as possible within the park's guidelines.

In summary, the creation of property rights within the national parks are of limited duration and scope. While the policy that dictates their issuance was based on preservation and conservation, this policy fails to protect the parks and thus is counterproductive to the goals of the National Park System.

The National Park System As A Common Pool

At present, the national parks are a common pool; they are open to all visitors without limit. The parks' supply is well defined whereas demand for their amenities continues to grow. As a result, the values that visitors seek in the parks are steadily being eroded. Plainly, we must cease to treat the parks as commons or they will be of no value to anyone.²⁵

In order to mitigate the tragedy of the commons as it applies to the national parks, it would be helpful to isolate those abuses of park resources that are the most threatening. The successful isolation of these abuses permits the identification of potential problems, one issue at a time. It also permits the establishment of objective criteria upon which to ascertain the success of corrective measures. For example, if acidity in the water supply is a problem, a 10% reduction of the acidity level within a one-year period may be an objective measure of success.

The National Park System undertook such a study and reported its findings in the published paper, *State of the Parks—1980*. This paper listed the specific threats that have the potential for causing significant damage to park resources or for seriously degrading important park values or visitor experiences.²⁶ Sources of threat to the national parks are those facilities, vehicles, physical substances, human or animal activities which may cause real or potential infringements on park resources. These sources may be further categorized into internal sources of threat, adjacent land use threats, water-related threats, threats from urban development, mining and associated activities and industrial threats. All of these activities bring into question critical property rights issues.

The paper identified 73 different kinds of threats, which may be aggregated into the following categories:

1. Aesthetic degradation (land development, timbering, etc.)
2. Air pollution (acid rain, hydrocarbon pollutants, etc.)

3. Physical removal of resources (mineral extraction, poaching, etc.)
4. Exotic encroachment (animals, plants, sonic booms, etc.)
5. Visitor physical impacts (campfires, trampling, etc.)
6. Water quality pollution and water quality changes (oil spills, water diversion, etc.)
7. Park operations (utility lines, misuse of biocides, etc.)²⁷

One of the major problems which adversely affects the national parks is overcrowding.

As a rational being, each [park visitor] seeks to maximize his utility. Explicitly or implicitly, he asks, "What is the utility to me of [visiting the park one more time]?" He concludes that the only sensible course for him to pursue is to add [another visit to the national parks attendance tally]. And another . . . Unfortunately this is the same conclusion reached by several of his neighbors. Therein lies the tragedy. Each man is locked in a system that compels him to increase his utility without limit—in a [national park system] that is limited. Ruin of the [parks] is the destination toward which this rationale leads, each man pursuing his own interest in a society that believes in the freedom of the commons. Freedom of the commons brings ruin of the [National Parks] for all.²⁸

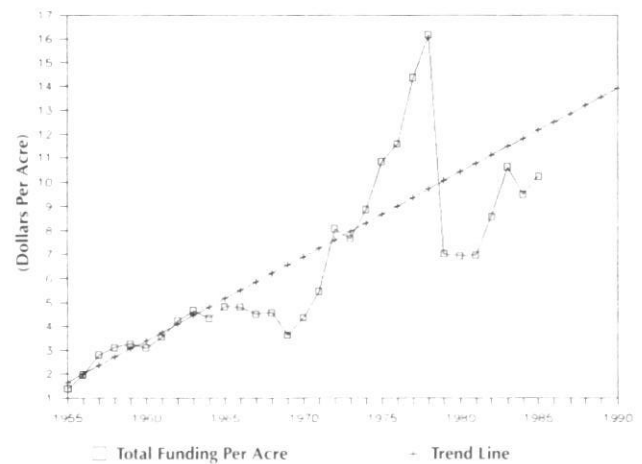
By isolating the overcrowding problem, it can be seen that a lack of individually defined property rights in the parks directly leads to inefficient and excessive use. It may be assumed that despite the large volume of land owned by the national parks, those areas most convenient to public access roads and those possessing the highest degree of natural beauty will be most attractive for visitors. Since no single individual or group can lay claim to exclusive ownership rights of state-owned property with temporary or permanent purchase, it is inevitable that these resources will be overused until they are depleted. The concentration of use of the park lands' most attractive areas is leading to a total erosion of communal park resources, one step at a time.

While it is clear that overcrowding is a problem, it is not clear how to identify methods of rationing. However, an objective means of rationing needs to be defined in order to identify the maximum number of people a park can support.²⁹

Optimizing Carrying Capacity As A Goal

The effects of human overcrowding on recreational areas were recognized very early in the course of development of western civilization. Some of the first regulations of access to European forests were those reserving hunting grounds as an exclusive property right of the nobility. For example, during the reign of Charlemagne (768-814), severe fines were imposed on poachers. This policy guarded the prerogatives of high-born persons but also may have reflected the concern that too many hunters would reduce the quality of the sport.³⁰

FIGURE 1
Funding of the National Parks
Per Acre from 1955 and Projecting to 1990



With the development of the automobile and especially since the end of World War II, outdoor recreation in the United States has increased tremendously, causing many recreational areas to be overcrowded. Managers of overcrowded recreational areas face the problem of defining, understanding and augmenting the carrying capacity of recreation lands. Recreational carrying capacity is the level of use at which quality remains constant.³¹ On the basis of experience, several guidelines have been developed for space requirements of recreationists. Since 1960 the National Park Service has allowed between four and seven campsites per acre. For wilderness areas, the standard of one man-day of use per season on each of three acres has been suggested.³² In light of the increased attendance trends (as reported later in this article), the National Park Service would be wise to determine methods of monitoring carrying capacity limits.

While overcrowding and the consequent overuse of common resources and facilities are viewed as problems within the national parks, overcrowding and overuse actually are symptoms of a more basic problem: the funding methods presently employed within the park system which ensure suboptimal usage of park resources because private property rights are unclear and are not strong enough to deter the overconsumption of the resources.

Private Property Claims In The National Parks

In order to manage the park system, to avoid some of the abuses outlined above and to uphold the high ideals stated by the founders of the park service, a detailed policy is required. Although this charge is one of the explicit activities specified for the National Park Service, it requires funding. The fact that the national parks are communally held but bureaucratically regulated reduces incentives for individual action. Of course, certain groups perceive this situation as an opportunity to achieve gains

consistent with their own political agenda. However, in a world of positive transaction costs, institutional arrangements that weaken property rights claims often give rise to free rider, hold out or other problems of group dynamics.

Despite the problems that presently exist and despite political pressure, this agency has remained independent and non-partisan. Both the Sierra Club, a conservationist group, (and its allies) and the forest products industry, for example, agree that the national forests are not being properly managed. One interpretation of this agreement is that neither of the competing interests feels that the national forests are being managed for them. Thus, if the Forest Service is charged with the responsibility of managing substantial and highly valued resources, and if the agency has great managerial discretion, it is probable that the various interested parties will continue to try to impose their policy preferences upon the decision of the Forest Service.³³

The National Park System is funded by a mixture of market-oriented and government-appropriated programs. As with many government programs, the aim is to *raise revenues* rather than *ration usage*. Of course, as each of these programs is discussed below, raising revenue at the expense of rationing usage is the crux of the problem.

Concessions

Concessions in the parks are licenses that are granted by the government to private organizations or individuals to conduct commercial enterprises within the confines of the parks. Concession owners must agree to provide a percentage of the profits of their activities or make payments at a fixed rate. Usually, the concession license guarantees that few or no competitive ventures will be allowed to operate within that licensee's locale. Of

FIGURE 2
Funding of the National Parks
Per Visitor from 1955 and Projecting to 1990

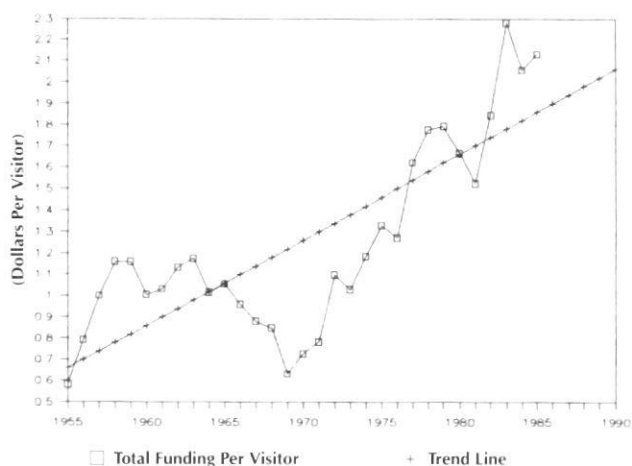
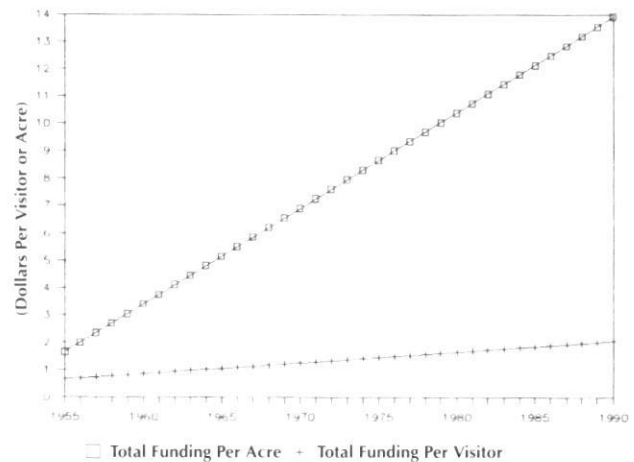


FIGURE 3
Funding of the National Parks
Per Visitor and Per Acre



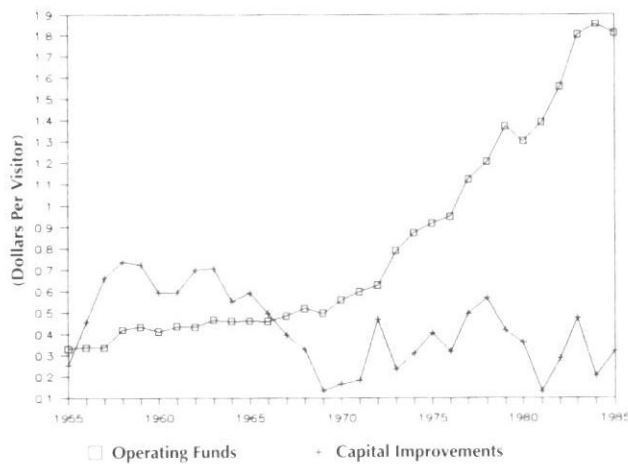
course, the creation of site monopolies is a valuable entitlement only governments can confer.

Concessions have been a part of the National Park System since the creation of Yellowstone. At that time, it was commonly assumed that the new park would be self-supporting (i.e., enough revenue would be generated from concessions to pay the expenses of protecting the land and administering the park). Time has proven this presumption to be incorrect; yet the presumption persisted with the establishment of Yosemite and later parks as well.³⁴

In early Yellowstone history, concessions yielded little or no revenue, net of expenses. Congress later appropriated modest sums and gradually increased funding for roads, visitor protection and park administration on the belief that when the roads and administrative facilities were established, the parks would be self-supporting.³⁵ However, parks have never been self-supporting.

A difficulty with concessions as a means of controlling park usage is that the length of the concession is usually fixed.³⁶ A fixed lease term reduces a business' long-term commitment to a site because, at least in the extreme, a leasehold is a smaller bundle of rights than that of a freehold estate. While 30 years is undoubtedly sufficient time to recoup an investment for a small, service-related concession, it is questionable whether 30 years is sufficient time for a major business enterprise to recoup capital investments in building and maintaining hotels or modern lodges. Limitations on the duration of concession licenses reduce a business' profit potential and may result in a decline in the supply of goods and services provided, particularly when a non-renewable contract is nearing its expiration date. Disincentives to invest or maintain sites in such situations may cause businesses to provide fewer goods and services than may be available in the private sector (i.e., outside park boundaries).

FIGURE 4
Operation and Capital Improvement
Funding Per Visitor



Entrance Fees

The use of meaningful entrance fees represents a potential solution to several of the problems the park system presently faces. First, the demand for park attendance is probably quite price inelastic; thus, park funding problems may be relieved somewhat by imposing higher user fees. In the absence of empirical estimates, one can only guess; however, it seems likely that increased entrance fees will not reduce park attendance. First, park entrance fees represent a very small portion of the total average expenditures that are necessary to travel and visit the parks, and an increase in these fees should not prove to be discriminatory for most visitors. Second, if demand for park attendance did decrease with the implementation of higher fees, the sites would benefit as overcrowding lessened and rationing made the parks more enjoyable for those who utilized them. However, public parks probably require entrance fees that all members of the public can afford. Thus, politically, increasing entrance fees is often regarded as an unpopular policy.

Automobile fees, for example, were originally levied largely for the purpose of paying for park roads and improvements. The first automobile admission fee was imposed at Mount Rainier in 1908 and in the next few years at General Grant (1910), Crater Lake (1911), Glacier (1912), Yosemite (1913), Sequoia (1913), Mesa Verde (1914) and Yellowstone (1915).³⁷

In the early years some park visitors complained about the automobile fees, which actually were fairly high. However, the need for funds also was fairly high. In 1917, as increasing numbers of automobiles entered the parks, National Park Director Mather thought it wise to *reduce* some of the entrance fees.³⁸ In 1926 motor fees again were reduced in several national parks,³⁹ and since 1926 motor fees have not substantially increased in any parks.

Government Appropriations

The use of government appropriations for the national parks represents an important, albeit uncertain, source of funds in the future. Although Congress has supported the park system in the past, allocating operating budgets to the park system and authorizing funds for the acquisition of new park lands, this area of the federal budget is particularly vulnerable to political pressures, often on a regional basis. Moreover, the budgetary process following the passage of the Gramm-Rudman is likely to reduce government appropriations for the National Park Service. The spirit of the Reagan Administration, which consistently supported user fees to directly allocate cost to those who benefit, also may persist.

Taxation

Taxation represents an indirect yet important source of funding for the national parks. Taxes are levied by a number of governmental agencies and are allocated to various governmental groups. Taxes are levied on the income that is generated directly by park concessionaires.⁴⁰ Although it is obvious that the park system is the direct cause of increase in this form of governmental revenue, it is questionable how much revenue from this source is available to the parks.

Private Gifts And Grants

Historically, donations of land, artifacts, services and funds have been very important sources of funding for the park system. A number of civilians have devoted their individual energies to these programs. For example, there are more than a hundred conservation organizations that promote and protect the national parks. Well known advocates include John Muir, who spent his life exploring and preaching about national parks to all who would

FIGURE 5
Operation and Capital Improvement
Funding Per Acre

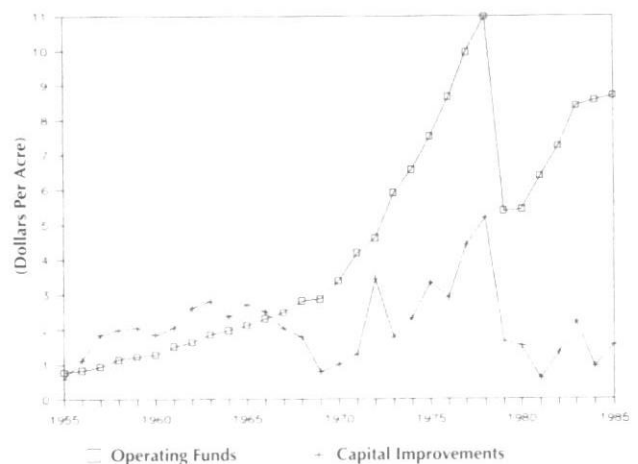
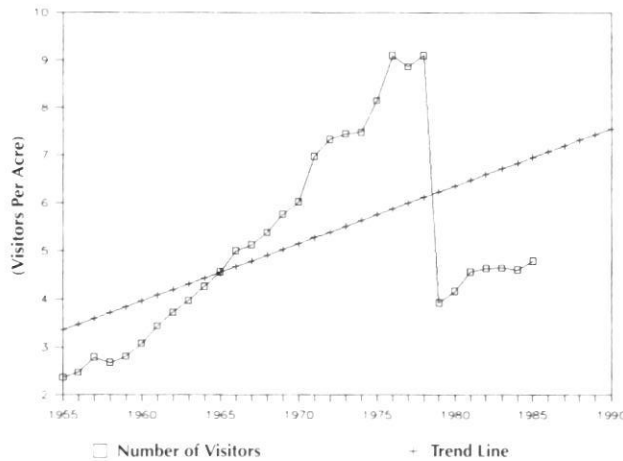


FIGURE 6
Increasing Visitor Trends



listen; Will Steel, who devoted much of his life to the promotion of Crater Lake; George B. Door, who with John D. Rockefeller, Jr., and a few others established Acadia; William Kent and his wife, whose efforts led to the acquisition of the only coastal redwood area in the National Park System; and hundreds of others.⁴¹

The princely gifts and consistent interest and support of John D. Rockefeller, Jr., merit special mention; for without them, the National Park System would be substantially lessened. Rockefeller saw his wealth as a means of serving the most people in the highest and most enduring possible way. Rockefeller's philosophy was not limited to the national parks but extended to scenic areas of all kinds, and his total benefaction for parks of all kinds was probably \$75 million or more.

The obvious benefits of such philanthropy cannot be overstated. Each generation has benefited from the generous legacy of previous generations. However, it is certain that well-maintained and properly managed parks would inspire greater donations than would a corrupt and decaying park system.

While it is clear that several sources of funding are available to the park system, it is equally clear that the park system is in financial straits.

An Analysis Of Funding Trends

This section examines the usage and funding levels of the national parks from 1955 to 1985. Forecasts are made using time series analysis through 1990, and Table 1 through 3 provide the annual data for the analysis. Table 1 reports the total number of federal acres in the park system, visitors to the parks, operating and capital improvement funds available and the total funding available to the park system. Table 2 provides usage and funding ratios: funding per acre, funding per visitor and visitor per acre. Table 3 presents the breakdown of operating and

capital improvement funds per acre and per visitor. The data contained in these tables form the basis of a standard trend line analysis, whose results, calculated for each year in the test period, are presented in Table 4.

Some Observations About The Results

Figure 1 demonstrates the funding per acre from 1955 to 1985 and projects the funding levels through 1990. As can be seen, funding has increased from a low of \$1.38 per acre in 1955 to a high of \$16.16/acre in 1978 but decreased to \$10.23 per acre in 1985. This decrease is due primarily to the addition of acreage to the National Park Service made possible with the passage of the Alaska Land Bill.⁴² Although the time series analysis indicates further increased funding in the future, variances along the trend line should be recognized, and the low levels of current funding should be noted. It is also likely that the recent addition of Alaska park land will force the funding trend line downward in the future.

Figure 2 demonstrates funding levels on a per visitor basis. Funding per visitor has increased from a low of \$0.58 per visitor in 1955 to a high of \$2.28 per visitor in 1983 but decreased to \$2.13 in 1985. Although this 1985 figure represents a 267% increase since 1955, it has not been adjusted for inflation. If a 4% inflation deflator is used, funding per visitor in 1985 would be about the same in real terms as it was in 1955. Of course, this discussion ignores the proportionately greater rise in costs due to larger crowds.

Figure 3 compares the trend lines for funding per acre to that for funding per visitor. It is apparent that funding per acre has risen at a faster rate than funding per visitor. While a policy to increase park funding may be based on federal acreage (due to the large addition granted by the Alaska Land Bill), a more logical argument may be developed for promoting increased funding on the basis of attendance trends. Also, while economies of scale may be achieved up to certain levels, it must be realized that these economies are applicable only within certain limits.

Figures 4 and 5 demonstrate the composition of the total funding per park visitor and park acre for two funding elements: operating funds and capital improvement funds. These results recognize that while greater funds are being made available for the present enjoyment and operation of the parks in the form of operating funds, capital improvement funds have been declining over the 30-year period. The ultimate result of continuing this policy will be the decadence of park resources.

Finally, Figure 6 shows the increasing use to which the existing acreage is being subjected. The time series analysis in this figure forecasts that the use of existing parkland will continue upward, and it emphasizes that existing resources will be strained even more than they are at the present time. This figure also supports the contention that the negative effects of overcrowding presented by the tragedy of the commons may become an unfortunate reality in the National Park System.

Conclusions And Recommendations

The National Park System is in jeopardy. Currently, the park service manages and protects some of the nation's most spectacular and most beautiful natural resources, making these resources available as a common resource to the general public. Because these resources are now being used at an increasingly faster rate, one may conclude that the present level of deterioration will accelerate, leading to the tragic fate awaiting all commons.

As noted by North and Thomas many years ago, "The pressure to change property rights emerges only as a resource becomes increasingly scarce."⁴³ Since change toward privatizing natural resources continues to be politically unpopular, it is imperative that stronger property rights be created within the parks in order to manage them as efficiently as possible. Measures that may be taken include increasing admission fees and usage fees to dissuade casual usage of park resources. Also, the present policy concerning concessions may be modified to encourage greater efficiency. While the existing park system has been successful historically, the current state of insufficient funding and/or improper park management will lead to further deterioration. A restructuring of the park system is mandatory if the parks are expected to exist in the future. This society owes future generations no less.

NOTES

1. As quoted in Tucker, Walter A., *The Crisis in Open Land* (Wheeling, WV: Institute of Park Executives, n.d.): 26-30.

2. One solution to this problem, which has been tried throughout the existence of the National Park Service, is to increase the acreage of the park system. The fact nonetheless remains that certain sites are unique. Such is the nature of real property and the basis for the claim that land is unique among all natural resources.

3. For example, recent budgets have trimmed appropriations from already "grossly inadequate" levels. See Reid, T.R., "New Parks Director Faces Old Mandate," *The Washington Post* (June 14, 1985): A-25. The Reagan Administration has maintained that these cuts will force the National Park System to "trim the fat." Experts such as Destry Jarvis, vice president of the National Parks and Conservation Association, worry that the cuts will be disastrous and continued large cuts will also "whittle [away] . . . the system's backbone." See "Patches Showing Up in National Parks," *U.S. News and World Report* (June 14, 1985) 69-70.

4. Originally Hardin wrote "The Tragedy of the Commons," *Science* (December, 1968). The central ideas and sense of its impact may be found in Hardin, Garrett and Baden, John, *Managing the Commons* (San Francisco: W. H. Freeman and Co., 1977).

5. See Wirth, Conrad L., *Parks, Politics and the People* (Norman, OK: University of Oklahoma Press, 1980): 3-18.

6. *Ibid.*

7. Ise, John, *Our National Park Policy* (Baltimore: John Hopkins Press, 1961): 3-4.

8. Wirth, *op. cit.*

9. *Ibid.*

10. Nash, Roderick. "Path to Preservation," *Wilderness* 48 (Summer 1984): 4-11.

11. *Ibid.*

12. *Ibid.*

13. *Ibid.*

14. *Ibid.*

15. Brown III, Francis C., "Troubled Refuge," *The Wall Street Journal* (November 19, 1985): 1,14.

16. *Ibid.*

17. Dolan, Maura. "Interior Department Budget Knife Cuts Wide, Deep," *The Los Angeles Times* (January 17, 1986): 1,26.

18. "U.S. Tied to Demise of Bears in Yellowstone," *The New York Times* (March 1, 1987): 27.

19. Everhart, William C., *The National Park Service* (New York: Praeger Publications, 1972): 223.

20. *Ibid.*

21. Recall that most property rights issues are non-existent until there is a juxtaposition of claims over some resource. At this point, rights over the asset of interest become important.

22. Everhart, *op. cit.*

23. *Ibid.*

24. Anderson, Terry L. and Hill, P.J., "The Evolution of Property Rights: A Study of the American West," *Journal of Law and Economics* 18 (April 1975): 163-79.

25. See Hardin and Baden, *op. cit.*

26. Connally, Eugenia Horstman. *National Parks in Crisis* (Washington, DC: National Parks and Conservation Association, 1973): pp. 77-81.

27. *Ibid.*

28. This is the well known passage adapted to the National Park System case from Hardin's 1968 piece. See Hardin, *op. cit.*

29. This determination is known as the "carrying capacity."

30. See Wager, J. Alan. *The Carrying Capacity of Wildlands For Recreation*. (Washington, DC: Society of American Foresters, 1964): 4-7.

31. *Ibid.*

32. *Ibid.*

33. Stroup, Richard and Baden, John. "Externality, Property Rights and the Management of Our National Forests," *Journal of Law and Economics* 16 (April 1973): 303-07.

34. See Ise, *op. cit.*

35. *Ibid.*

36. At first the term was ten years, but in 1958 the maximum term was increased to 30 years. See Ise, *op. cit.*

37. Ise, *op. cit.*

38. The fee per car had been \$10.00 for Yellowstone, \$8.00 for Yosemite and \$6.00 for Rainier. These charges were reduced to \$7.50, \$5.00 and \$2.50, respectively.

39. In Yellowstone, the new fee was \$3.00 per car; in Yosemite, \$2.00; in Mount Rainier, \$1.00. Similar reductions were implemented in Glacier, Crater Lake and Sequoia parks as well.

40. There are also minor business taxes available for governments to collect.

41. See Ise, *op. cit.*

42. This legislation added over 41 million acres to the park system in 1979.

43. North, Douglas C. and Thomas, Robert Paul. *The Rise of the Western World*. (London: Cambridge University Press, 1973).

COUNSELORS: PROFESSIONALLY MOTIVATED BUSINESS PEOPLE

Real estate counselors have many faces!

by John R. White, CRE

It is difficult for the general public to distinguish what constitutes truly professional services in the broad field of real estate. The word "professional" has been decidedly over-employed and not infrequently abused by those who presume to be professionals. People sometimes confuse meeting strict professional standards with pursuing professional objectives through a professional attitude.

For example, one may more properly describe the practice of real estate brokerage or real estate management as a business with professional motivations and objectives. Frequently, however, businesses do not demand the educational disciplines characteristic of the lawyer, accountant, priest or minister. I personally have never felt the need to be known as a real estate professional. I feel equally content to be thought of as a businessman possessing professional motives, and conducting myself in a professional manner.

The sale, leasing and mortgage brokers and the property managers must be thought of primarily as engaged in

a business. Very few have met the demanding educational and other requirements nor subjected themselves to the same level of ethical standards as the qualifying professional. Yet, this does not downgrade them in the eyes of the general public. The brokers are proud of their designation as REALTORS; that is, members of the National Association of Realtors.

Two separate real estate activities are perhaps closer to a true professional designation than the practice of brokerage or management. These are real estate appraising and real estate counseling. The appraiser is in the forefront in real estate today as nearly meeting the dictionary definition of a professional in terms of education, examination, internship and experience, continuing education, ethical standards and state licensing.

The accredited real estate counselors in the United States number only about 800 people. They have taxing invitational requirements, but lack the examination and educational standards characteristic of the professional person. Nevertheless, they are highly respected because of their concentration on high ethical standards and depth of experience which qualifies them for membership.

Because the counselor frequently is engaged to negotiate a transaction, the general public is understandably confused about what differences exist between the broker and the counselor. We can compare the exclusive broker or agent with the counselor, since the counselor only will accept engagement as the exclusive representative of the principal in a sale, lease or mortgage transaction. In

other words, counselors don't compare themselves with brokers on an open agency basis where brokers compete simultaneously with each other in a given transaction.

Generally, the counselor never accepts an assignment on a wholly contingent basis. Counselors receive minimum fees from their clients without regard to the outcome of the transaction. If their transaction efforts are successful, they will receive an additional performance fee, which may be similar to the commission the broker would receive. If the counselor fails in the transaction, he retains the minimum fee. Counselors are usually reimbursed for their marketing expenses, including the preparation of a brochure, travel, toll telephone charges and advertising.

The exclusive agent usually works on a wholly contingent basis. That is, he receives payment only if his efforts in attempting to sell, lease or mortgage the property are successful. He usually must pay his own marketing expenses which are an offset against the earned commission. If another broker or salesperson in the office is involved in the transaction, the employing broker must split his commission by pre-agreement.

It is customary for an exclusive agent, by agreement with the client, to be willing to split his commission with brokers in other companies, perhaps on a selective basis but normally on a multiple listing arrangement through the local real estate board. By contrast, the real estate counselor does not normally invade a broker's commission by fee splitting.

The counselor is more likely to

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attempt the transaction himself. He may also, however, have an understanding with his client to offer the property for sale or lease through brokers, with the promise of a customary full commission for a successful transaction. In these instances, the counselor receives an additional fee from the client, over and above the client's commission liability to the selling or leasing broker.

Another distinction between a counselor and an exclusive agent is the manner in which their respective offices are operated. The counselor will normally have a salaried professional staff to whom profits are distributed from a bonus pool at year's end. An atmosphere of team play usually is characteristic. In all probability, a substantial amount of business of the counselor's company is derived from other professional services for fixed fees, such as appraisals, marketability and feasibility studies or general consulting advice.

The typical real estate brokerage normally consists of a number of independent contractors acting as sales persons or brokers. Usually, their revenue is derived solely from commissions. They are paid on a split commission basis, and generally do not receive any fringe benefits for retirement or major medical. They also pay for all their own expenses (except for office services). Generally, brokerage companies do not have appraisal or counseling departments. The only

salaried persons are the proprietors and support staff. The atmosphere tends to be more entrepreneurial than what may be found in a counseling company or a counseling department in a brokerage firm.

How does one choose between an agent and a counselor? Sometimes the complexity of the transaction might influence the employment of a counselor. The depth of the support staff services frequently is a factor. The agent may have a distinct advantage in his depth of knowledge of local real estate market conditions. The counselor may be better equipped to handle a national or international transaction because he tends to conduct business on a regional or national basis as a matter of course. The counselor also has a special relationship with national industrial corporations and life insurance companies.

Quite frequently the brokers may have a distinct conflict of interest in their representation of competitive owners and developers. For example, an agent may have leasing agencies that are directly competitive with a planned project. In this instance, the developer would be well advised to engage a counselor to manage the leasing program by putting the counselor in overall charge of the leasing program and instructing him to deal with brokers directly on an open agency basis with the promise of a full commission at locally prevailing rates. In this way, the developer can

reach the brokers directly without being saddled by an exclusive agency contract.

The late James D. Landauer, the founder of Landauer Associates, commented many years ago, "In the galaxy of real estate services, there is a logical place for the counselor who serves a client on a basis not necessarily related to a wholly contingent commission. On the other hand, many sale situations are better served by brokers and agents. Surely there is a distinct place for both."

It is appropriate to consider a counselor as a business person who possesses strong professional motivations and conducts himself in an ethical, forthright manner. The modern counselor plays a more active role than his predecessors. The early vision of the counselor was that of a sage who over an extended time had participated in ownership and brokerage and who now was dispensing advisory opinions for agreed fees. The modern counselor is an activist who is not only capable of a documented study but also has the capacity to implement recommendations in buying, selling, financing, leasing or rehabilitating. Finally, age alone is no prerequisite to become a counselor. Younger people bring a special flair and verve to the advisory process. Essentially, the counseling function is best expressed as a state of mind—the creation of a special, sometimes fiduciary relationship between the client and the counselor.

THE FRIENDLY ENEMIES

Planners can benefit developers by encouraging controls in real estate.

by Henry Hart Rice, CRE

It is time to rethink the old concept that real estate developers and planners are natural antagonists committed to destroy one another. The fact is that where developers have been unopposed, i.e., in Houston, Denver, New Orleans, they have destroyed themselves. Although the oil boom collapse was a major factor in these cities, the phenomenon of overbuilding has been repeated nationwide where planning has been lenient. The result has been office vacancies hovering around 20 percent. The healthy pockets of investment opportunities exist where planning controls and restrictions have been most severe. Nevertheless, efforts to protect the environment and the public interest have proven expensive for the consumer.

Whenever demand for real estate pushes rents up to where new construction becomes economically feasible, it is a sure bet that developers will fall all over one another trying to get into the action. Land prices will bid up, sub-contractors will have more work than they can handle and the foreseeable result will be overproduction at high prices. The outcome is weak rentals in an overly competitive market.

Restrictive zoning in a mature community plus the scarcity of urban land has kept development within viable limits in New York, San Francisco and Washington. Until very

recently, Boston was another favorable rental market. Boston's vacancy rate which stood at 5.9% in 1988, the third lowest in the nation, is expected to double this year to 11.4% due to the construction of \$4.1 million of new office space. Local developers, including Spaulding & Slye, Ellis & O'Connor and Cabot, Cabot & Forbes, have called on The Boston Redevelopment Authority to tighten up on its regulations. According to one firm,

"Without the Boston Redevelopment Authority, we would have another Houston here. The soundness of Boston's market has been maintained because of barriers set by the BRA."

It is no coincidence that the cities with strong restrictive zoning have remained the strongest markets in the country. Investors in existing properties in these cities have been protected from excessive competition, and developers who successfully threaded their way through the minefields of regulations are virtually assured of success. The four cities—New York, San Francisco, Washington, D.C., Boston—commanded the highest rental rates in the nation.

Theorizing that industry locates near its most essential raw materials, it seems probable that back office operations will move to where people live. This trend for back office operations to move to the suburbs is probably irresistible. During a three year period (1985 through 1987), New Jersey, for example, built 51 million square feet of office space, whereas 17 million square feet was erected in Manhattan. The massive development in New Jersey was possible because zoning controls were widely dispersed, and each community

wanted some commercial tax base. Within Manhattan tight regulations along with residential rent control severely restricted opportunity. The predictable result was that the New York buildings were absorbed at profitable rents, and many of the New Jersey developments remained vacant.

This pattern of development distribution is being repeated across the country. Suburban development outpaces the central business district. Despite strong absorption and steady growth, suburban vacancy consistently exceeds the urban center. Although long range trends favor the suburban markets, the less stringent restrictions on development are encouraging overbuilding. This pattern of growth without profit is extending to many metropolitan areas, with Phoenix as a prime example. The exact opposite is true of Toronto, which also has grown explosively but always in accordance with tight planning controls.

The economics of real estate are the same as in any other business. Prices and profits are set by the interplay of supply and demand. To the extent that supply is restricted, an artificial relative shortage is produced to the advantage of the seller and to the disadvantage of the consumer.

If developers get together and agree to limit production, their action will violate anti-trust laws. When similar limits are imposed by a community, developers and investors should appreciate the protection rather than protest. Perhaps developers and investors in existing structures should organize an annual celebration to restrict zoning and rigidly enforce planning standards.

Henry Hart Rice, CRE, is chairman of the board of James Felt Realty Services, a Grubb & Ellis Company, New York. To his credit is the land assembly for Reston, Virginia, marketing of Parkchester Development, and sale of Parkmerced and Fresh Meadows. A respected public speaker and author, he also is an adjunct professor for the Real Estate Institute of New York University.