Real Estate Issues

VOLUME 2 WINTER 1977 NUMBER 2

Library of Congress card number LC 76-55075

EDITOR'S STATEMENT

John Robert White, CRE, of New York City, one of our best known real estate counselors and an authority on real estate valuation, leads off this edition of Real Estate Issues with a plain and pointed statement on New York's condition and the impact of that condition on office land values. Because this city is a second home to anyone involved with major properties in the country, we think Mr. White's observations will be interesting—and provocative—to a large audience.

Equally outspoken on a very different issue is Stephen Roulac who offers a challenging and authoritative article on the state of real estate analysis and how it needs to be improved. Mr. Roulac has led the way for many of our most advanced real estate counselors and continues to generate ideas and insights at a record rate from his post in California and on his frequent travels.

Turning to public control of property, Frank Gilbert reports on an important recent decision by New York State's highest court that clarifies the extent of the public's right to control landmark properties and lays a foundation for the widespread use of development rights transfers (TDRs). Once again New York has led the way, whether for better or for worse remains to be seen. In a major statement that summarizes key recent zoning decisions, James Cooper, an attorney and economist who combines careers as professor, author, and practitioner, launches a ringing attack on the U.S. Supreme Court for failing to prevent the widespread use of zoning to exclude minorities. We know that many will disagree, and hope that Professor Cooper's well-documented thrusts will provoke appropriate counter-thrusts from our readers.

The vast management experience of Don Sally who, as president of the Community Associations Institute has a unique vantage point from which to comment upon these matters, lends weight to his views on the proper role of tenant and homeowners associations. He offers prudent guidance on what to do and how far to go in respect to tenant efforts at property control. His article is followed by an authoritative statement by Robert Burchell and David Listokin on current requirements for environmental impact statements.

We close with a challenging new approach to housing market analysis from Maury Seldin and Michael Sumichrast, well known to everyone concerned with housing through their activities as writers, teachers, and consultants. Their perspective is both fresh and useful, based as it is upon a breadth of experience probably not matched elsewhere.

Let us know your thoughts and opinions on the matters covered in this issue. This is your forum. We invite you to use it.

Jared Shlaes, CRE
Editor-in-Chief

Real Estate Issues, *Winter 1977*

How Manhattan's Fiscal Problems Have Affected the Office Market **John Robert White, CRE** *Page 1*

Manhattan's office market reached an historic high in 1969-70 but declined precipitiously thereafter as a result of oversupply and demand retrenchment. Corporate relocation intensified, mainly because of the tax burden but also because of the typical urban problems afflicting New York and other major cities. The 1974-75 recession and the revelation of New York City's fiscal mismanagement in 1975 dealt a cruel double blow to the economy and to the office market. Looking back, the author finds that fiscal instability and overspending were the principal reasons for the demise of the office market. Recovery is now evident as the city adopts measures designed to insure a break-even budget and as the national real estate recovery continues. The cutback in demand for office space may have resulted primarily from extraordinarily high taxes, but the advantages of agglomeration nevertheless are clear: there is no substitution for a commercial hub. However, for cities as New York to compete more effectively, land values should be reconstituted as a smaller component of development costs.

Real Estate Investment Analysis and Valuation: Economic Analysis, Disclosure, and Risk **Stephen E. Roulac** *Page 8*

The author asserts that a major refocus of emphasis in the investment analysis and appraisal process must take place if improved investment results and, therefore, investor confidence in real estate is to be achieved. Specifically, he claims that too many investments are premised upon deficient economic analysis, characterized more by a superficial presentation of a "best case" optimistic outcome—and advocacy assertion unsupported by analysis or disclosure of substantiating evidence—than by the preferred approach that embraces a commitment to investor-oriented disclosure of probable investment results. Reasons for the deficient economic analysis are listed, including the fact that too many participants in the real estate sector have a false impression of their abilities as investment economists and may decline to commit sufficient resources for a useful analysis. The author develops his approach, a material departure from traditional practice, and promises the likelihood of superior economic analysis.

The Grand Central Case: The Preservation of Individual Historic Landmarks **Frank B. Gilbert** *Page 26*

In June, New York State's highest court, the Court of Appeals, upheld the landmark status of Grand Central Terminal and sustained the denial of permission to build a 55-story office tower on the site. The unanimous opinion upheld the New York City landmarks preservation law and commented favorably on the transfer of development rights as a way to give an owner a reasonable return on his property. Under the decision, an owner's constitutional rights would be satisfied when he received a reasonable return on his landmark building. In addition, the opinion by Chief Judge Charles Breitel recognized the tangible contributions by the government to the present value of this railroad station and its site and said that the owner "is not absolutely entitled to receive a return on so much of the property's value as was created by social investment." The author calls attention to the increased interest in historic preservation as demonstrated by the 500 municipal ordinances for the identification and protection of historic property.

Metropolitan Growth, Suburban Enclaves, and the Yick Wo Laundry— Will they be the Roots of Disorder in America? **James R. Cooper** *Page 31*

The author believes that attempts to bar dispersion of lower-income classes to our suburbs will run afoul of the *Yick Wo* principles. He sees the fight to open suburbs as profoundly affecting democratic principles and contends that the U.S. Supreme Court, in turning to local referendums, is risking "massive private discrimination." He warns against majoritariansim and says that real estate practitioners can play statesmen's roles in this crucial struggle.

Real Estate Issues

The Professional Journal of the
American Society of Real Estate Counselors

How Manhattan's Fiscal Problems Have Affected the Office Market

by John Robert White, CRE

THE PRIOR BOOM

The five-year period from 1966 through 1970 witnessed the most intensive, hyperactive office market boom in Manhattan's history. Manhattan's office market was profoundly influenced by the strong national inflation that commenced in the mid-1960s, primarily because of the Johnson administration's unwillingness to finance the Vietnamese War on a more current, conservative basis. In retrospect, the boom was an impressive performance. Absorption of space was at an abnormally high level. Some 28 million square feet were rented between 1966 and 1970, an average of 7.6 million square feet annually, while only 32 million square feet were being completed. Rents rose 50% to the $12-$14 per square foot level. Vacancies were virtually non-existent. Land values in prime locations such as Park Avenue more than doubled from $300 per square foot to $700 a square foot.

Corporate relocations to the suburbs and elsewhere were lightly regarded and frequently dismissed. The Borden Company, for example, moved its corporate headquarters to Columbus, Ohio. Its Manhattan building was then sold to Condé Nast for $100 per square foot, reportedly the highest price ever paid for a 40-year-old office building. What matter that Pepsico, Continental Oil, American Can, Johns Manville, General Telephone & Electronic, and others had left or planned to leave in this same five years? Internal growth was considered to be so strong that Manhattan could not be affected. Indeed, the office market paid little heed to the rather shallow recession of 1969-70 even though industrial and other blue collar and service employment declined sharply at the time, presaging a deterioration in local economic conditions. Planning and construction of new office buildings continued in the face of warning signals.

John Robert White, CRE, MAI, is president and chief executive officer of Landauer Associates, Inc., the New York-based national real estate consulting firm. A Harvard graduate, he also holds an M.B.A. degree in real estate from New York University, where he was formerly an adjunct associate professor. Mr. White was president of the American Society of Real Estate Counselors in 1969 and served the American Institute of Real Estate Appraisers for five years as chairman of the board and editor-in-chief of *The Appraisal Journal*.

RISING CONCERN OVER CITY SPENDING

In retrospect, the widly inflationary boom of the late 1960s masked some disturbing economic and political facts. During this time, New York was sowing the seeds of its own near destruction. Starting with the transit strike on the very first day of the Lindsay administration, the city thereafter appeared to capitulate to strong union demands for wage increases and improved fringe benefits by permitting raises possibly beyond its financial capacity. After all, with assessed valuations in Manhattan increasing $2.4 billion in those five years, why should the city be unduly concerned with its ability to afford these increases?

The city's position was further complicated by the costs associated with the in-migration over many years of culturally and educationally-deprived blacks and hispanics. This forced the essential expansion of programs in welfare, education, and job training. There were also significant related increases in police, fire, sanitation, and other service costs. Taxpayer and business groups became increasingly restless and concerned over what they felt were excessive and poorly-structured debt issues to finance these costs. Debatable accounting practices further undermined the confidence of the business community in the city. If prosperity had continued unabated, it might have been possible to carry this financial burden. Events rapidly proved otherwise. While the office market was seemingly riding out the recession of 1969-70, non-white collar job losses were severe. As it subsequently turned out, New York never fully recovered from the 1969-70 recessionary effects. Coupled with a sharp ensuing retrenchment in office demand and a staggering oversupply, the city moved closer to its own denouement.

A SERIOUS REAL ESTATE DECLINE

The decline in the real estate market in late 1970 and 1971 was in its own way as unforeseen as the prior five-year boom. It was experienced in diverse ways. Corporate relocation planning intensified. Other companies accommodated their office growth needs simply by decentralizing on a regional and divisional basis. Demand for all practical purposes nearly vanished. The burden of ever-increasing taxes of a wide-ranging nature was the principal motivation in the corporate abandonment of Manhattan. It appeared that crime, congestion, educational problems, deficient commuting, and pollution in themselves were not sufficiently strong reasons for commerce to leave New York City in large numbers. These problems were common to all the older major eastern and midwestern cities and were certainly not peculiar to New York. By 1975, only 1,453,000 square feet of new space was rented, a drop of 65.7% from the 1966-70 five-year average. An unfortunate complication that further weakened the market was the 42 million square feet of space completed in the five-year period after 1971.

Real estate market indicators told the classical story of demand retrenchment and oversupply. Rents in prime buildings plummeted from the $12 level to $10 or less. Vacancies reached 33 million square feet in 1974, representing a 14% vacancy rate. Assemblage activity ceased, except to complete assemblag-

es long since previously started. Building plans were shelved. Assembled plots were broken up. Sales activity declined precipitously. Mortgagees quietly re-evaluated their willingness to make mortgage loans on Manhattan property. The once proud, bellwether commercial real estate market of the world was at almost a standstill in 1974-75.

THE FATE OF LAND VALUES

Land values really could only be hypothesized or inferred since there was no direct market evidence in the form of land sales made for the purpose of constructing new office buildings. One factor was clear. It was impossible from 1971 through 1976 to find any signs of land value by using so-called land residual capitalization techniques. Although direct building costs had declined under the pressure of high unemployment in the building trades, indirect or "soft" costs, principally construction loan interest went to new highs.

A combination of high interest, a low level of obtainable rent, high if not excessive building costs, excessive real estate taxes, and inflationary operating expenses theoretically conspired to deprive land of any value whatsoever. Judgment became a major factor. Some degree of eventual recovery had to be anticipated. It was felt that land had fallen between 50 and 60% in the six years of real estate depression that followed the 1966-70 boom. Fortunately, Manhattan land was in such strong hands that there was no complete demoralization or actual collapse of the land market. Owners, mainly institutional or developmental, doggedly stayed with their investments and hoped for a cyclical recovery.

Land of course is a residual product. It invariably suffered the consequences of demand cutbacks, loss of confidence, oversupply of space and erosion of the city's economic base. For example, in early 1974 Landauer Associates, Inc. represented the fee owner in a ground lease arbitration for the land underlying the Chrysler Building. The basis for settlement was a land value of $335 a square foot. In 1977, we again represented the fee owner in a ground lease arbitration for the land under 757 Third Avenue, a tall office tower at East 48th Street. The basis for settlement was $140 a square foot. While this location was not as good as the Chrysler Building site, it was nevertheless a very low land value. By way of comparison, at least four comparable sites within six blocks along Third Avenue had been assembled by 1971 in the $300 to $400 per square foot range.

To return to our narrative, the recession of 1974-75 and the widespread public revelation in 1975 of New York's near bankruptcy dealt a cruel double blow to the office market, to land values, and to the city's fortunes. Job losses continued to mount after 1970 until they reached a high near 600,000 by January, 1977. The city's financial crisis further eroded the confidence of the business community. Passage of emergency legislation insuring greater financial control, debt re-structuring and operating economies, supplemented by state and federal loans, averted the bankruptcy but doubts and fears about the city persisted throughout 1975. It was impossible to see any short-term improvement in our predicament.

TURNING OF THE TIDE

The gradual national recovery from the 1974-75 recession subtly influenced the stirrings of a real estate recovery for Manhattan, beginning in 1976. First, the relocation trend abated sharply; the remaining Fortune 500 companies had compelling reasons to stay in New York. Strong internal growth and mergers were gradually creating newly eligible Fortune 500 companies. The corporate advanced services sector, the wide ranging support services represented by banking, law, accounting, architecture, real estate, public relations, advertising, and other services, was already three times the size of the basic corporate office sector in number of personnel and was growing rapidly in response to national calls for its services. Vacancies in Manhattan by 1976 declined by 10 million to 23 million square feet, or 10% of the total inventory. Rents in prime locations were rising modestly. Suddenly it became apparent that there were no large blocks of space available for very large tenants, except in the historically troubled 1166 Avenue of the Americas building.

Development activity is about to resume as investors react positively to the recovery signs. For example, Harry Helmsley is scheduled to start construction on the Palace Hotel and residential condominium this fall. The Fisher Brothers-Prudential joint venture is seriously examing the start of an office building west of the Racquet and Tennis Club off Park Avenue. Citicorp has been successful in obtaining $16 per square foot rents in their new 50-story office tower on Lexington Avenue. It is evident that six years of recession are over. The upturn has commenced.

WHAT ABOUT THE CITY'S FORTUNES?

New York's fiscal problems are beginning to come under strong control; a break-even budget has become a realistic prospect despite yet-to-be solved questions about substantial overassessment, widespread tax delinquencies, debt restructuring and wage increase pressure. Perhaps the most significant and encouraging event has been the closer alignment of the business community with the city. The skills and competence of business management have been used by the city to reorganize its accounting and computer operations. The city has also recognized the importance of retaining industry and commerce by passing various tax abatement statutes designed to induce industry and people to remain. It has also pledged to reduce or eliminate the notorious stock transfer and tenant occupancy taxes which had become symbols of the city's inability to plan and implement a reasonable fiscal program. The present administration has even promised if elected to refrain from increasing the real estate tax rate for four years!

Employment is stabilizing for the first time in seven years. This has been accomplished in the face of severe declines in government employment necessitated by operating economies. Internal employment expansion is beginning to exceed the loss in jobs arising from the decentralization process. Manhattan's population is also expected to stabilize. Youth particularly welcome the challenges of the city. The major problem of attracting families with children unfortunately remains.

The traditional mix of office tenancy is also changing. For example, five years ago, there were 21 foreign banks licensed in New York. Today there are 117. It is widely recognized that New York is replacing London as the premiere international banking center. The foreign multi-national corporations invariably have offices in New York and are increasing them at a rapid rate. Currently, over 10% of the space in the Pan Am building is leased to foreign tenants. Heretofore little understood is the fact that corporate relocatees to the suburbs or elsewhere continued to depend on New York companies for their banking, legal, real estate, accounting, engineering, advertising and other services, thus minimizing the shock impact of office decentralization.

The biggest factor is and will continue to be the restoration of confidence in the political process by the business community. Strong cities uniformly are characterized by a close and respectful relationship between the business and political leadership—witness Chicago, Atlanta, Houston, and Dallas. There is every reason to believe that a closer bond is being forged; it has been amply evident in the mayor's recent key appointments to high positions, in the willingness of business executives to serve, in the state's more extensive involvement in the city's affairs, and in the achievement of a prudent operating budget.

WHAT ABOUT THE FUTURE FOR LAND?

Although we have been unable to draw any precise mathematical correlation, events of the past seven years conclusively indicated that New York City's fiscal mismanagement contributed heavily to but was by no means the sole reason for the decline in Manhattan real estate land values. Overspending is a pervasive force that finds expression in many ways. Certainly, to the extent that the city lived beyond its means, it has resulted in unnecessarily harsh and regressive taxes, ranging from real estate taxes approaching 30% of gross revenues to city income taxes, occupancy taxes, stock transfer taxes, industrial equipment taxes, franchise taxes, and others. Many in the business community made the judgment that these taxes could no longer be tolerated and that sound alternatives to New York existed where life-styles could be improved while after-tax income could be increased. A mood of despair and disillusionment with the city prevailed from 1970 through 1975. No amount of jaw-boning by the city's Economic Development Administration could deter many companies from leaving. Many decided the deterioration in the city's affairs was irreversible and that relocation was the sensible solution rather than to stand and fight for prudent fiscal policies.

In the forefront was the abandonment of the city by those companies who sought sylvan suburban retreats while still relying heavily if not exclusively on critical business support services available only in the city, and on the city's cultural, educational, and amusement facilities. Problems typical of all major urban cities such as crime, pollution, education deficiencies, congestion, and high living costs also strongly motivated companies and families to move. Employers complained about the difficulty of inducing rising young executives with families to relocate to New York. With increased leisure time the phrase "life-style" caught on to express the desire of many to live in a smaller,

less complicated, and less intensively populated environment, remote from the seamy aspects of urban living found in street crime, drugs, poverty, and prostitution.

Purely as an informed judgment and entirely without pretense as a precisely articulated answer, it appears that overspending not only was the root cause of office relocation but probably was more than 50% responsible for the loss of the large executive headquarters companies. It must in all fairness be pointed out that the federal government failed to assume enough of the extraordinary welfare and other costs characteristic of New York. Relocation had been occurring since the early 1950s when General Foods moved to White Plains, New York, and Time and Life and General Electric purchased large tracts in Westchester County in anticipation of doing so. Thus, there were obviously other forces at work to influence decisions to leave New York. Even in earlier times, however, the question of what the business leadership considered to be excessive taxes played some role in shaping corporate relocation decisions. What probably happened is that taxes assumed constantly higher importance as the major reason as the years went by.

At the peak in 1970, assemblage land costs of $400-$500 per square foot were commonplace. Individual key parcels were sold by the Landauer firm for as much as $700 to $1,000 per square foot in order to round out assemblages. It is really difficult to foresee a return to these price levels, at least not for an extended period of time. After all, it took 40 years (from 1930 to 1970) for land prices to begin to recover from the stunning effects of the decade-long depression of the 1930s. Despite increased inflationary pressures, land prices expressed in nominal or so-called inflated dollars will tend to remain lower and lag behind the recovery in rents and occupancy.

This is not to say that nominal land prices will not increase moderately in the next several years. Invariably, they will respond to market forces and an increased level of activity. However, the wild prices paid to obtain possession from tenants with leases and the excessive prices for key parcels will not be quickly seen again. Assuming constant rather than inflated dollars, it is entirely possible that there will be no real increase in land prices within the foreseeable future. In fact, a decline in constant prices is equally likely. Excessive land costs would serve only to drive office space users out of New York because of the higher rents that would have to be charged. In order to continue its progress towards recovery, New York must remain competitive with the suburbs, if not with other sections of the country.

THE FUTURE FOR NEW YORK

New York in the 1980s will have a smaller employment base than the 1969 peak. A significant reduction is foreseen in the total inventory of office space from a high of 230 million square feet down to a low of 200-210 million square feet. Much of this reduction will be accomplished by conversion of marginally located office buildings to residential and other uses or by demolition. An innate stability should characterize the 1980s; internal office growth and in-migration together will be equal to or slightly exceed a sharply diminished but always-occurring office and industrial decentralization.

There is nothing catastrophic about the prospects of continuing decentralization. Modern production technology and distribution requirements compel many manufacturers to relocate to outlying areas. There is no denying that all major cities have lost part of their office dominance as well. Improvements in telecommunications, interstate highways, and other technologies have deprived major cities of a part of their raison d'etre, that is, the need to cluster together for ease of personal communication. Personal interaction and relationships are simply not as important as in the past. The agglomeration phenomenon no longer underpins the major cities.

Yet there is convincing evidence that a good proportion of headquarters companies and, more importantly, the advanced corporate service companies that support them, still prefer to remain in the central city where the advantages of agglomeration still remain, to say nothing of the advantages of and convenience to cultural activities and sports events, private clubs, restaurants, and friends.

Under these mixed circumstances in which there have been expressed significantly different views of the viability of central city areas, land values logically have undergone a recapitalization to significantly lower levels. If wise market heads prevail, city land values will be reconstituted as a smaller component of development costs. This will enable the major cities such as New York to compete more effectively with the suburbs and with smaller cities for the favor of office space users.

Real Estate Investment Analysis and Valuation: Economic Analysis, Disclosure, and Risk

by Stephen E. Roulac

"How can one measure the good without knowing the bad?" (Kurt Seligman, *Magic, Supernaturalism and Religion*, Pantheon Books, 1948, p. 150)

Disappointing investment results should prompt those involved to examine how their bad decisions were made. Such an examination leads almost inescapably to deficiencies in the economic analysis behind the decisions:

1) Too little economic analysis was done.
2) That which was done was misfocused.
3) The presentation of the economic analysis was inadequate.

Much of what passes for "economic analysis" is actually a superficial presentation of a "best case" optimistic outcome, an advocate's assertion not supported by adequate evidence. Much more is grossly misfocused.

There are a number of reasons for this. The methodologies relied on by many for measuring investment performance are primitive. Their techniques for communicating financial data do not provide useful information because existing general prohibitions against projections deny the investment community the information fundamental to decision-making. Very few of those providing real estate economic analysis services have a sufficient breadth of background and expertise, combined with the multiperson, multidisciplinary organizational structure essential to superior economic analysis. Finally, many real estate participants have a false impression of their abilities as investment economists. As a consequence, they decline to commit sufficient resources to perform useful analysis of probable investment results, and some do not bother to utilize any analytic services at all.

This article is intended to underscore and examine the need for better economic analysis and the specific qualities of the analysis required. It begins with consideration of investment economics and risk-return relationships.

Stephen E. Roulac is president of Questor Associates, a real estate investment banking and consulting firm headquartered in Menlo Park, California. A widely known author and lecturer, he is a member of the faculty of the school of business administration, University of California at Berkeley, and a Ph.D. candidate at Stanford Graduate School of Business.

This is followed by a discussion of measures of investment performance, especially as regards the interdependency of the appraisal and investment analysis processes. The importance of the economic concept of core theory to valuation, the variability of the outcomes of future economic events, and the reality of variable values and returns are then explored. The importance of future-oriented financial information is introduced with the focus of the examination directed first to the "state," or perhaps more accurately, "non-state" of the art of economic analysis and then to a review of certain deficiencies in the analysis and disclosure of economic information. Finally, the issue of the cost-effectiveness of economic analysis is addressed and the preferred content, emphasis, and environment of economic analysis are presented.

The approach advocated here represents a material departure from traditional practice. The preferred approach to economic analysis for real estate investment decisions emphasizes full life-cycle forecasts based on detailed market analysis; a probabilistic presentation of anticipated investment results; utilization of advanced economic and econometric models; and risk measures based both on realized investment experience and on a macro-economic/environmental analysis of future investment market conditions. This method embraces a commitment to investor-oriented disclosure of probable investment results and specifically encompasses an explicit presentation of the data, assumptions, and models.

INVESTMENT ECONOMICS

An analogy often used in introductory economic texts to make clear the distinction between consumption and investment is the classic dilemma faced by the farmer: does he consume his current crop of corn or plant it to grow future crops? An investment involves the deferral of benefit today in anticipation of a greater benefit at a later date. It must be recognized that economic events occur over a time continuum; when a particular event occurs determines its significance and magnitude in today's terms. The means by which the timing implications of economic events are taken into consideration is present value analysis.

Crucial to the understanding of investment economics is a clear statement of what an investment is. As John Maynard Keynes observed, it is important to think of an investment as a series of flows: a contractual obligation to make one or more contributions and a contractual claim on one or more pay-offs.[1] While the obligations are known, at least at the base level, and are seldom avoidable, the future outputs are less known. While certain contractual arrangements promise fixed and non-variable investment benefits, it is more often the case that a major portion of anticipated investment benefits is risky (variable) if not uncertain (not identifiable). The more uncertain the incidence of these future pay-offs—their amount, duration, and timing—the more uncertain the investment and the greater return the investor will require to participate.

Over four decades ago, Keynes recognized that the focus on the current yield from an investment was misplaced. Investment results are realized in the future and the focus of analysis must be on the future. As Keynes put it:

> "The most important confusion concerning the meaning and significance of the marginal efficiency of capital has ensued in the failure to see that it depends on the *prospective* yield of capital, and not merely on its current yield."[2]

Unfortunately, both lay and professional investors often confuse an assessment of current operations with an evaluation of investment quality. Insight into investment return can only be obtained by considering all economic flows over the full investment life cycle. Keynes noted that the return from an investment is equal to the marginal efficiency of capital, which he in turn defined as:

> "That rate of discount which would make the present value of a series of annuities given by the returns expected from the capital-asset during its life just equal to the supply price."[3]

Similarly, John Burr Williams defined the value of an investment as the present worth of the future stream of benefits it is expected to provide. Williams emphasized the importance of estimating future payments, and also the necessity of adjusting for expected changes in the purchasing power of money.

Investors face a multitude of opportunities for investments. Given this wide array of investment opportunities from which to elect, there must be an investment criterion. Generally, investors seek to maximize their "utility," which in an investment context is currently thought to be best measured by the preferred combination of risk and return characteristics.[4]

The concept of the variability of investment outcomes is fundamental to resource allocation. This concept underlies the pathbreaking research by Harris Markowitz on portfolio theory.[5] Where an investor knows with full confidence what the outcome of an investment will be, he can place a certain value on that investment. Where the possibility exists that an investment's outcome may be variable rather than fixed, most investors individually, and therefore investors as a class for purposes of analysis, demand a premium for participating in a situation where they perceive they may receive less than the "safe" rate of return involving no risk.[6] A significant investment risk is the possibility of not attaining the required (or desired) pattern of returns.[7] Where the future investment results are not known, investors will seek an additional premium for this uncertainty to offset the premium they seek for the variability of possible outcomes.[8]

MEASURING INVESTMENT PERFORMANCE

Economic realism is fundamental to the efficient working of real estate markets. The problems experienced on a recurring basis are the result of unrealistic investments. Too often, the deals were over-priced, over-leveraged, over-tax-gimmicked, over-gouged. While regulators have sought to respond to these problems by requiring an appraisal as part of the registration process,[9] by imposing limitations on the use of leverage in public programs where the

properties are unspecified,[10] by requiring legal opinions on the tax asumptions,[11] and by imposing limitations on sponsor compensation,[12] these efforts all address characteristics rather than the essence of the issue. Ultimately, the investor is concerned with risk and rate of return considerations which are best measured by investment analysis and investment valuation. Presently, these considerations, which are fundamental to economic realism, are assigned a lower priority than considerations which may not materially influence the investment results.

Although the subject of rate of return analysis is often viewed as separate and distinct from appraisal valuation, such a distinction is unsound. Both valuation and investment analysis involve similar analytic processes in that each is concerned with developing a current measure of future economic events surrounding a specific investment situation. A rate of return analysis reflects a relationship between the initial acquisition cost of an asset and anticipated future investment outcomes. The income capitalization appraisal derives a value reflecting the worth of anticipated future investment outcomes to an investor seeking a designated return. Both rate of return and valuation are concerned with future investment outcomes. In valuation, the initial price is the unknown; with investment analysis, the return is unknown. The two processes are interdependent; similar considerations influence both valuation and investment analysis; common analytic concepts underlie both processes.

Unfortunately, the investment community, appraisers, and securities regulators do not fully appreciate the interdependence of valuation and investment analysis. At the same time that appraisals are required for a securities registration, severe restrictions, and even flat prohibitions, are imposed on the use of investment analysis in the offering documents.[13] The perception of separation between appraisal and investment analysis reflects and contributes to the primitive "state of the art" of these disciplines. It may in part result from a poor understanding of both microeconomics and valuation concepts.

CORE THEORY AND VALUATION

While the economic theory underlying value and price is addressed in the appraisal textbooks, it has been virtually ignored in terms of rigorous analytical study.[14] Generally, the accepted appraisal theory, that which underlies current appraisal practice, is highly deficient.[15] Without delving into these deficiencies in detail, it can be observed that the focus of "market value"[16] on a single point estimate, i.e., one specific number, is attributable to an adaptation of economic theory concerned primarily with distribution and allocation rather than price and value.[17] Thus, the classical economists David Ricardo and John Stuart Mill have had an excessive, unwarranted, and unfortunate influence on appraisal theory.[18] Most simply, the appraisal profession adopted the wrong approach, a consequence not all that surprising in view of the fact that "appraisal theory" has essentially been practitioner-generated rather than based on a disciplined effort to develop an economic explanation of the process and its objectives.[19]

Although it is clear that in the perfectly functioning theoretical market, as Gerard Debreu implies, price equals value,[20] this ideal is not achieved in practice, particularly where capital investments are considered. More useful to the question at hand is the theory of the core as developed and discussed by Eugen von Bohm-Bawerk,[21] John von Neumann, and Oscar Morgenstern,[22] Duncan Luce and Howard Raiffa,[23] and Lester Telser.[24] Most simply, core theory stipulates that competitive forces cause transactions to take place within a range of prices, consisting of an interval rather than a single point price as argued by the classicists.

In the majority of instances, the real estate market functions as the reverse of the classic auction market in that the seller starts with an asking price and reduces it until a buyer is willing to pay the desired amount and a transaction results. Thus, sellers operate within a range defined by their initial "asking" price and a "floor" of what they are willing to accept. Similarly, buyers operate within a range defined by their initial "bid" price and a "ceiling" of what they are willing to pay. In practice, the Boulware approach to labor negotiations[25] seldom applies in real estate markets. Each party tends to work within a range bounded by an "initial" price to start the negotiation process on the one hand and by a "final" price on the other hand. A transaction can occur where a buyer's "final" price is at least equal to the seller's "final" price.

The necessary overlapping of buyer and seller prices can be shown by considering a seller who asks $1,000,000 for a property while being willing to accept $900,000 and a buyer who bids $850,000 while being willing to pay $950,000. There is a $50,000 overlap and a transaction can take place within this range. As with core theory, it can not be said with precision where within the range the transaction price will be. This depends on several factors including the bargaining abilities and motivation of the involved parties as well as which buyers enter into the negotiation process. The nature of investment markets is such, especially in the real property context, that not all potential buyers participate in all negotiations. Consequently, which buyers do participate will influence the price at which the transaction may occur.

Although in practice it is possible to identify a collection of "final" prices that approaches a relatively smooth demand function, the bid prices are much more varied. While there is certainly some relationship between bid and final price, the amount by which the "final" price exceeds the bid varies. The prospective buyer participates in the negotiation process if, after his initial bid, the seller determines it is possible that their respective final prices may overlap. The prospective buyer makes a bid after a determination, based on an assessment of the seller's asking price as well as other considerations, that it is possible their final prices may overlap. As noted in the discussion of core theory, a transaction will occur within a range, reflecting the common overlap of the seller's ask-final price range and the buyer's bid-final price range.

VARIABILITY OF FUTURE OUTCOMES

Financial return above the "risk free" rate by definition involves variability and the accompanying possibility that performance may be below expecta-

tions or below the "risk free" rate. The marketplace is defined by and reflects variable and changing economic behavior. If outcomes were certain, there would be no need to await the occurrence of events before accounting for them.

The ultimate focus of management decision-making is on a flow of economic outcomes—a series of "profits" or a stream of benefits over time. Each economic outcome is the result of the interaction of multiple variables and can effectively be thought of as the result of the interactions of other economic events or decisions. A change in any component decision or event means the composite outcome will be altered. Given the interdependence of multiple factors, each individually subject to variability, it is inevitable the primary focus of analysis will be variable as well.

The inherent variability of future outcomes is reflected in different perceptions by market participants in buying, selling, and leasing space. Differences in perceptions about futures are fundamental to the efficient functioning of markets. Indeed, James Graaskamp has incisively observed that financing generally, and real estate financing specifically, ultimately turns on the credibility of the assumptions of respective parties to a transaction with the differences between assumptions and their realization being risk.[26]

Variances in forecast reliability are attributable to differences in models, data deficiencies, and differences in forecaster judgment. Forecasts involve different combinations of statistical method, historical data, numbers of variables, and equations, and judgment. Because there are a multitude of different forecasting techniques and forecasters, evaluating them is difficult and complex.[27]

Too little appreciated is the role of regulatory change in creating or destroying economic values. As a case in point, extending the limit for fishing to 200 miles has been a great stimulus to a dying industry in the United States, has encouraged investments in new boats,[28] and ultimately will influence the values of properties in communities heavily dependent upon fishing as a prime component of the local economic base.

Regulatory change alters property rights, as reflected either by revisions in the claims on the property's economic productivity or in the allowable uses, which in turn influence the property's productivity. Where attenuation of property rights exists, the subject property by definition is less valuable than if non-attenuated.[29] Because there is always the possibility of regulatory change attenuating property rights, investors will demand a premium for this risk. The different perceptions of various market participants influence the necessary risk premium and further contribute to the variability of future outcomes.

VARIABLE VALUES AND RETURNS

As Bohm-Bawerk noted, "In the last analysis, the value of all goods is bound up with man and his purposes."[30] Indeed, there exists no substantive and uniformly accepted definition of "fair market value."[31] Certainly a contributing factor to this situation has been the general disinclination of

the accounting fraternity to address this issue forthrightly,[32] reflecting no doubt the traditional conservative orientation toward historical cost.[33]

Attempts to separate "value" from economic motives are unlikely to produce meaningful information.[34] Investors commit capital to properties on the basis of an expectation of earning a return on that capital,[35] consistent with the universally-accepted theorem that the present value of an investment is equal to the sum of its discounted anticipated future benefits.[36] The observation by May on this point is particularly apropos:

> "What the investor or speculator is interested in is the value of the business as a whole, and that is dependent mainly on what it will produce in the future and is not determinable by any purely accounting process."[37]

Indeed, Henry Babcock suggests that the market value of an investment property can only be derived by investment analysis, otherwise the property is a "marketable noninvestment property" or a "service property."[38]

In approaching the valuation process it is important to recognize the essential multi-faceted nature of real estate investment. To this end one is well to think of each investment property as a business unto itself involving capital assets, supplies and materials, and working capital; and requiring marketing and promotion, maintenance, repair, and managerial supervision.

The complexity of the investment process as well as its sensitivity to alternative interpretations must be recognized. Investing in real estate requires numerous judgments of many items that can have a range of outcomes, and this leads to substantial dispersion of results for a common venture reviewed by different analysts, each employing his own assumptions. An investment analysis is meaningful only in the context of a specific statement of the information and relevant assumptions on which it is based.

FINANCIAL REPORTING OBJECTIVES

Deliberations about valuation theory and the preferred approach to developing an opinion of value are inseparable from considerations of how that value opinion is to be used and communicated to the financial community. The disclosure of valuation analysis should be considered in terms of the needs of consumers of financial information.

In the context of financial reporting, the concept of the "going concern" is central to accounting theory:

> "It is the task of accounting to make the most truthful and significant measures possible of the continuous flow of business activity."[39]

However, given a "continuous flow of business activity," accounting theoreticians observe:

> ". . . the ultimate outcome of the activities lies in the future. But decisions cannot await the ultimate outcome; management, investors, government, all of the interested parties, need 'test readings' from time to time in order to gauge the progress made. By means of accounting we seek to provide these test readings by a periodic matching of the costs and revenues that have flowed past 'the meter in an interval of time.' "[40]

Accounting, then, faces the difficult task of accurately reporting at a single point in time the status of a "continuous flow of business activity." Indeed, a major study on generally accepted accounting principles included in a list of ten basic concepts the concept that "timeliness in financial reporting requires estimates."[41]

The accounting fraternity is not unaware that the financial community is more interested in a company's future prospects than its past performance:

> "Almost all external users of financial information reported by a profit-oriented firm are involved in efforts to predict the earnings of the firm for some future period."[42]

Further, an important recent study reported that: "The basic objective of the financial statement is to provide information useful for making economic decisions . . . the user's needs should be paramount in guiding the preparation of financial statements . . . all economic decisions look to the future . . . an objective of financial statements is to provide users with information for predicting, comparing, and evaluating enterprise earnings power."[43]

Because investment decisions are made on the basis of information about that future, the objectives of financial reporting, and therefore the communication of valuation and investment analysis, should be on disclosing relevant information on the enterprise's probable future investment performance.

STATE—OR "NON-STATE"—OF THE ART

The current "state of the art" of analysis of real estate investments leaves much to be desired. Such analysis as is done is too often characterized by questionable assumptions, incorrect data, conceptually illegitimate models, dubious motives, perverse ethics, and fraudulent representations. Indeed, the authors of one article cautioned that of all the parties to a deal, only the lender did any meaningful analysis and his was for a purpose different from that of the investors.[44] Investment analysis as applied to real estate investments suffers from questionable assumptions as to key elements of anticipated investment benefits, unsophisticated and misleading methodology, and unrealistic expectations as regards a reasonable level of investment return.

Real estate participants generally, and particularly those in new development projects, have long been noted for placing emphasis on considerations other than economic feasibility in the determination of whether to commit capital to a project. As *The Economist* observed: "The American property development system works on faith, hope and tax losses."[45]

Feasibility studies are often ignored: "'Tax shelter' buyers prompt some developers to go ahead without feasibility studies because they can sell the projects before construction."[46] Or if required, an accommodating "analyst" is found: "The market feasibility boys were having a field day. You could always find one who would agree with your opinion that the proposed deal was outstanding."[47]

Because many real estate participants, even in the face of problems, rely more on optimism than objective analysis,[48] it is not surprising that the "state of the art" of investment analysis is as behind the times as it is.

The appraisal process is regularly a source of much controversy, both on a "popular" and a professional level. Appraisers are accused of conspiring to violate fair housing laws[49] and of assisting and falsifying tax returns.[50] They are described as "surely the most maligned segment of the real estate industry"; only half of the respondents to a recent survey of pension administrators believe that an appraisal is a valid means of establishing real estate values.[51]

The investment community lacks confidence in the reliability of appraisals,[52] as indicated by the Money Market Directories, Inc.'s survey of the value relationship pension administrators believe would prevail when real properties are sold. By more than a two to one margin, pension administrators indicated they thought properties would likely sell below rather than equal to or above appraised value.[53]

The problem is further exacerbated where appraisers are confronted by "problem properties" or "distressed markets" and seek to use "normal" or "standard market" assumptions rather than looking to the actual market conditions. This tendency has raised the question as to whether many appraisers possess the basic ability needed to undertake a valuation based on actual market analysis as opposed to hypothetical and theoretical assumptions.[54] On this point, it should be noted that the problem is by no means unique to the United States. *The Economist* recently questioned:

> "How long will the bankers and auditors be prepared to suspend their disbelief in an art which consists of extrapolating tenuous trends in a marginal market over the massive property now clogging up the system."

Indeed, these problems have led the Securities and Exchange Commission (SEC) to require appraisals based on actual market conditions and showing a realistic investment return, a rational and reasoned approach but one which has been poorly received by the banking fraternity because of the necessity of currently recognizing the financial reality of questionable investments by requiring immediate correction for inflated values.[55]

Regulatory authorities have continually expressed concern about the reliability of appraisals, particularly in the real estate securities context.[56] The regulatory disdain of the appraisal process is not surprising, particularly in light of the role of appraisals and the earlier problems associated with real estate securities. During the real estate securities boom of the 1920s, for example, such unprofessional practices as appraisals contingent on valuation opinions equal to or exceeding designated levels proliferated. One underwriter relied on its own appraisals for more than half of its 430 mortgage bond offerings. Because the size of the appraisal influences the size of the bond issue, the amount of bonds available for sale, and the magnitude of commissions, the practice of inflating "inhouse appraisals" was a primary reason for the subsequent problems."[57]

DEFICIENCIES IN ANALYSIS AND DISCLOSURE OF ECONOMIC INFORMATION

Investors' misperceptions of risk-reward relationships have persisted from the earliest days and are commented upon by such economists as Adam Smith, who observed:

> "The overweening conceit which the greater part of men have of their own abilities is an ancient evil remarked by the philosophers and moralists of all ages. Their absurd presumption in their own good fortune has been less taken notice of. It is, however, if possible, still more universal. There is no man living who, when in tolerable health and spirits, has not some share of it. The chance of gain is by every man more or less over-valued, and the chance of loss is by most men under-valued, and by scarce any man, who is in tolerable health and spirits, valued more than it is worth . . ."[58]

and Keynes who stated:

> ". . . it is probable that the actual average results of investments, even during periods of progress and prosperity, have disappointed the hopes which prompted them. Business men play a mixed game of skill and chance, the average results of which to the players are not known by those who take a hand. If human nature felt no temptation to take a chance, no satisfaction (profit apart) in constructing a factory, a railway, a mine or a farm, there might not be much investment merely as a result of cold calculation."[59]

For those familiar with the real estate sector's lack of historical perspective, the lead to the recent *Business Week* cover story feature is not surprising:

> "A short 18 months ago, U.S. real estate men were talking little else but disasters—distressed properties, foreclosures, forced sales, losses. The industry had just gone through its worst crunch in 40 years. . . . Today, the talk—and it is heard everywhere—is all about big deals, properties bought and sold, new projects just launched or about to be launched, and especially the unprecedented flood of investment dollars chasing U.S. real estate.
>
> "Today prime U.S. real estate is probably the most sought-after investment target in the industrial world.
>
> "U.S. real estate has achieved this enviable position because investors, domestic and foreign, are convinced that it can only appreciate in value."[60]

There are many reasons why economic analysis and the resulting decisions are deficient. Often the data are unreliable[61] or the models unrealistic. As Roger Kennedy, financial vice-president of the Ford Foundation, observes,

> ". . . it is not strange that we so often confront the forecaster as reductionist. We have masters of single-factor predicting who tell us that most complex of phenomena, the complex of complexes, emotions and artifice, our economy, is governed by one trend, 'nothing but' money supply, 'nothing but' the immediate past, 'nothing but' the ineluctable repetition of the business cycle."[62]

Misunderstandings as to basic economic issues are contributors to undesirable economic decisions.

The majority of appraisers look solely to the tangible real property to the exclusion of legal, behavioral, managerial, financial, tax, and related considerations that influence ultimate investment appeal.[63] While many appraisers qualify their valuation reports with an observation, "For an in-

vestment property, the income capitalization appraisal technique is preferred and should be given special emphasis in situations where the purchaser is buying primarily for investment motives," such qualification is redundant if not ludicrous. Real property does not exist exempt from the political, legal, and capital market systems. No party can own a property without an investment objective, for even if the property were acquired at no cost through some type of windfall, the value of that property becomes its investment, with an associated opportunity cost equivalent to what could be earned with those funds placed in the most attractive alternative use.

Appraisers sometimes demonstrate considerable confusion about the primary focus of their assignments and consequently it is not surprising that their valuation opinions, in light of subsequent events, are wide of the mark. In *Utech v. City of Milwaukee* an appraiser valued a property taken in eminent domain according to its potential use and then added to that figure the value of an existing residential structure, which happened to be some 20% of the property's value at its "highest and best use," on the grounds that developers typically pay a 20% premium to acquire desired sites.[64] The transparency of this methodology is readily apparent. If developers typically pay a premium price above a certain figure for a desirable property, then the price they will pay is in fact the property's value.

All too frequently the analysis is implicit rather than explicit. The implicit approach to analysis, particularly when at an aggregate as opposed to a "line-by-line level," is fraught with potential for miscalculation. It is most often the case that the deterministic approach takes a "most probable" figure for each of the relevant variables and then derives a final figure which is a composite of the individual items. While selection of "most probable" numbers certainly has advantages over using less likely numbers, by itself it does not eliminate error. The cumulative interactions of "most probable" figures can cause an end result with a material variance from the expected value figure derived by a probabilistic approach.[65]

Many investment analysts rely on primitive measures of return on investment.[66] When one relies on unsophisticated profitability measures, an investment's apparent return often can be at material variance from the economic reality.[67] As a case in point, one "analysis" of a proposed investment showed returns ranging as high as 46.9% when in fact utilizing generally accepted concepts of economic analysis, but taking as "given" assumptions of future economic events which were at least favorable if not optimistic, the investor would do well to break even on an after tax basis.[68] Many participants in real estate ventures are for various reasons reluctant to face the economic realities of projects in which they are involved. Even when the participants do affirmatively attempt to understand the underlying economics, their conclusions are often inaccurate.[69]

The deficiencies in economic analysis are contributed to and exacerbated by financial disclosure practices and guidelines. There are irreconcilable differences between investor needs and traditional accounting methods.[70]

Traditionally, the SEC has opposed the use of projections[71] although this policy has been somewhat modified recently.[72] The offering document is the product of the securities regulatory process and, presumably, is a primary source of information for investment decision making. But too often it contains all information except that which is needed to evaluate whether or not the proposed offering is an attractive investment. The information provided is difficult first to find and then to interpret. As one court observed:

> "In at least some instances, what has developed in lieu of the open disclosure envisioned by the Congress is a literary art form calculated to communicate as little of the essential information as possible while exuding an air of total candor."[73]

COST EFFECTIVENESS OF ECONOMIC ANALYSIS

The economic analysis of real estate decisions is a difficult and complicated undertaking. All too often, the budget is totally inadequate for the urgency of the task. Not surprisingly, a limited budget will frequently lead to limited analysis. The first area of "economizing" is often market analysis.[74] Indeed, virtually without exception, sponsors and investors budget nominal sums for work that properly should require fees comparable to those charged by professionals involved in the legal, architectural, and mortgage banking functions.[75]

A source of tension as regards the economic analyst's role is the desire of a number of sponsors to insure "safe" appraisals, i.e., appraised value exceeding acquisition price. Very frequently, sponsors are unwilling to allow a sufficient budget to undertake a meaningful valuation analysis. Where the appraisal fee is only $750 to $1,500, as is frequently the case, it is impossible for the appraiser to do substantive field research and detailed analysis. Many appraisers respond to such constraints by relying on data from their files and other unverified information whose reliability is suspect. Then, such analysis that is done is simplistic, if not naive. In the face of budget constraints, however, it is no wonder that detailed forecasts and more powerful models are ignored.

On balance, sponsors commissioning such "studies," and to a lesser degree appraisers accepting such assignments, seem to be operating with a strange, if not perverted, sense of priorities as regards the cost effectiveness of economic decision making. The total cost of a competent valuation analysis exceeds the usual budget for a "financial public relations" appraisal by only a few thousand dollars, certainly an immaterial amount in the context of a million-dollar-plus property. Most simply, the additional information provided by a competent valuation analysis will pay for its extra cost many times over. In light of the substantial losses incurred by real estate investors over the years, an investment in competent valuation analysis promises very high returns.[75] It must of course be recognized that a disturbing number of sponsors have no interest in the appraiser's input to the decision process beyond his endorsement of a decision already made. On this point it should be pointed out that many sponsors like to cite as evidence of their negotiations and acquisitions

ability their record of buying properties consistently at substantial discount from "fair market value" when in fact this more accurately reflects their talent in selecting appraisers.

Perhaps only in real estate is the concentration of economic resources in enterprise management, direction and implementation so misplaced. While good implementation activity is of course a necessary condition for investment success, by no means is it a sufficient condition. The expertise the financial economist brings to the real estate investment decision "adds value" by virtue of risk control, concept refinement, market targeting, finance packaging, ultimate investment objective-setting, in an amount at least in the same ball park as other involved professionals. Those market participants who pay low-budget fees will get low-budget advice; if they cannot understand the necessity of investing substantial resources to make a substantial decision, they are beyond help and deserve all the misfortune that befalls them.

AGENDA FOR THE FUTURE

Because the general quality of real estate economic analysis leaves much to be desired, the potential payoff for superior analysis is high. An accelerating pace of change, escalating regulatory complexity, and increasing uncertainty of economic outcomes makes distinctive investment valuation of even greater worth. The needs of the new real estate capitalists—the prominent financial institutions—require economic analysis consistent with the seriousness of their fiduciary responsibilities.

Appraisals and investment analyses based on one-year statements, simplistic methodologies, unsubstantiated data, and non-disclosed assumptions create a severe risk of legal claims and litigation on the grounds that prudence and due diligence were not adhered to in the investment decision process. Unfortunately, too many economic analyses are a potential source of legal liability for both those performing them and those placing reliance upon them.

Better investment results, particularly through the reduction of risks, will be achieved through better analysis. Potential liability will be largely reduced, and the functioning of real estate markets, the efficiency of resource allocation, and the stability of the economy will all be improved.

Economic analysis leading to an investment decision, if it is to be a superior decision, must be based on a multidisciplinary approach. The integration of disciplines beyond a narrow definition of economics is required. The early description of this branch of social science, political economy, is relevant. As Kennedy observes:

> "The most important determinants of economics are political. Consequently, we must not ask economics, a numerate activity, to cope with non-numeric factors. The brain and the psyche do not function like computers—synapses are not chips. Forecasting requires that an economist use skills and perceptions he garners in foraging beyond the bounds of his profession."[7]

While there is no question that effective economic analysis requires unrelent-

ing investigation, rigorous analysis, a sense of economic history, breadth of perspective, an advanced knowledge of microeconomic theory, insight into the changing demographic patterns and relationships, sensitivity to evolving legal standards, and shrewd political savvy, ultimately the process involves originating viable data and identifying crucial factors and their linkage relationships.[78]

There exists a sharp rift between the requisite organizational approach to implement multidisciplinary analysis and the practices of most real estate economic analysts. While a select few individual practitioners are capable of exemplary work, the business is overly-populated by sole practitioners and small firms too narrow in their approach, with few substantial firms bringing together multiple disciplines and perspectives. Significantly, real estate economic analysis is too much characterized by a craft as distinguished from an industrial approach. Such an orientation is not surprising because the technology of real estate economic analysis would likely have parallels to the technology of creating real estate properties. Buckminster Fuller has observed that the building sector has been the last of man's activities to embrace an industrial approach, using tools which "cannot be produced by any one man," as opposed to a craft approach, involving tools that can "be spontaneously fashioned and adopted by any one individual studying nakedly in the wilderness."[79]

Those analysts who operate alone have a limited capital base, both in terms of equipment to utilize modern analytical technology and also of investment in their own knowledge to implement such technology, and consequently are at a severe disadvantage. The preferred approach requires an organization whose decision-makers have broad general talent and the ability to integrate the contributions of specialists in the various disciplines to reach a superior investment decision.

Unfortunately, the trend of education and professional practice is towards increasing specialization. As Kennedy observed:

> ". . . everything now points to worse and worse forecasting. All the crabbed forces dominating the faculties of American colleges and universities, the parochialism of our disciplines, the dessicating emphasis upon statistics, the adversion to history, psychology, and sociology, are conspiring to prepare numerate illiterates. Graduate students, diminished rather than enlarged by this process, cannot be trusted to predict anything more complicated than the pace of a print-out."[80]

While a full discussion of what superior real estate economic analysis ought to encompass is beyond the scope of this writing, certain broad statements can be advanced. The analysis should start with consideration of broad environmental issues that impinge upon the decision at hand. Once macroeconomic analysis has been completed, attention can be directed to developing specific forecasts, built up on a line by line basis, of probable future economic results. The appropriate economic models are then selected as well as the measures of risk and return to evaluate investment quality. Here, the importance of knowledge of realized investment results together with reasonable anticipations for future investments results is crucial.

As highlighted in earlier sections of this article, economic analysis based on a deterministic rather than a probablistic approach is destined to be relatively unreliable. The decision-maker is interested not only in the expected value outcome but also the range and associated probabilities of possible outcomes. Fundamental to assessment of the economic analysis is full disclosure of the underlying assumptions and methods by which the various data inputs were derived, the models that were used, and the points where judgments were made.

There is evidence that modern approaches to decision-making are gaining growing acceptance.[81] Significantly, a computer model employing econometric techniques and probability analysis was utilized in planning a recent expedition for climbing Mount Everest.[82] When an investor faces a financial Mount Everest, the size of the stake inevitably clouds his judgment.[83] Here, a third party analyst can make a particularly important contribution by bringing both objectivity and superior analytic talent.

Research into decision-making suggests that decision makers consistently underestimate the benefits of collecting and assimilating new information.[84] Real estate investment experience in this century is characterized by extreme miscalculations and is unarguably the most persuasive reason for a greater commitment of resources to economic analysis for decision-making purposes. For most in the business such a commitment will represent the highest return on investment expenditure they can possibly make.

REFERENCES

1. "When a man buys an investment or capital-asset, he purchases a right to the series or prospective returns, which he expects to obtain from selling its output, after deducting the running expenses of obtaining that output, during the life of the asset." (John Maynard Keynes, *The General Theory of Employment, Interest, and Money*, 1935, p. 135.)
2. *Ibid.*
3. Keynes, supra note 1. According to Keynes, the *supply price* of the capital-asset is not the market price at which an asset of the type in question can actually be purchased on the market but the price which would just induce a manufacturer to produce an additional unit of such asset, i.e. what is sometimes called its *replacement* cost.
4. Much of the theory relevant to achieving this optimization objective is discussed in John von Neumann and Oscar Morgenstern, *Theory of Games and Economic Behavior* (1944).
5. "Uncertainty is a salient feature of security investment. Economic forces are not understood well enough to be beyond doubt or error. Even if the consequences of economic conditions were understood perfectly, noneconomic influences can change the market, or the success of a particular security." (Harry Markowitz, *Portfolio Selection*, Yale University Press, 1959, p. 4.)
6. John Hirshliefler, "Risk, the Discount Rate, and Investment Decisions," *American Economic Review* (May 1961), p. 112.
7. Alexander Robichek, "Risk and the Value of Securities," *Journal of Financial and Quantitative Analysis* (December 1969), p. 513.
8. "In formal terms, at risk involves a situation about which the various possible outcomes and their respective probabilities of occurrence are *known to the decision-maker at the time he makes the decision*. Uncertainty, on the other hand, involves a situation about which the probabilities of the possible outcomes are *not* known." (Charles Ellis, *Institutional Investing*, Dow Jones-Irwin, 1971, p. 144-5.)
9. "All real property acquisitions must be supported by a competent, independent appraiser." Sec. C, "Conflicts of Interest and Investment Restriction" and Sec. M, "Requirement for Real Property Appraisal," from Midwest Securities Commissioners Association, *Statement of Policy Regarding Real Estate Programs* (February 28, 1973) cited by Stephen E. Roulac, *Real Estate Securities Regulations Source book* (Practising Law Institute, 1975), p. 488.

10. While there are no formal guidelines on the use of debt in non-specified property programs "the leveraging to be employed shall be fully set forth in the statement of investment policy." (Sec. VI, C #3, Midwest rules [*ibid.*] p. 489.) As a practical matter few if any offerings have cleared registration without a limit on maximum borrowings of 400% of invested capital, which is equivalent to an 80% loan to value ratio.
11. See Sec. VIII, C 15, of Midwest rules, p. 497, supra note 9.
12. See Sec. IV, "Fees-Compensation-Expenses" of Midwest rules, p. 483-485, supra note 9.
13. While projections generally are "permitted but not required" on the state level (Sec. VIII, D of Midwest rules, p. 499, supra note 9) they generally have been discouraged at the federal level by the SEC.
14. A study of 1300 articles published in *The Appraisal Journal* over the 1932-1961 period discovered only 48 on theory, as opposed to application; with 44 of these appearing between 1932 and 1938, and only 4 in the subsequent 23 years. See Warner, "Creativity in the Appraisal Process," *The Appraisal Journal* (July 1963), p. 316.
15. Stewart, "An Economist Looks at Appraisal Theory," *The Journal of the Canadian Institute of Realtors* (March 1964), reprinted in *The Real Estate Appraiser* (July 1966). For a critical discussion of certain of these issues see Paul F. Wendt, "The Development of Appraisal Theory," Ch. 2, *Real Estate Appraisal—Review and Outlook* (1974).
16. It should be noted that there appears to be some prospects that this term will supplant "*fair* market value." "Market value" is the preferred term in Byrl Boyce, *The Appraisal of Real Estate* (Ballinger Publishing Company, 1975) jointly sponsored by the American Institute of Real Estate Appraisers and the Society of Real Estate Appraisers.
17. Stewart, supra note 15.
18. *Ibid.*
19. Paul F. Wendt, "Recent Developments in Appraisal Theory," *The Appraisal Journal* (October 1969), p. 485.
20. "If an attainable state of an economy is an optimum, there is a price system relative to which that state is at equilibrium." (Gerard Debreu, *Theory of Value*, Yale University Press, 1959, p. 90.)
21. Eugen von Bohm-Bawerk, *Capital and Interest*. 1959 English translation of 1921 4th ed. Vol I first published in 1884 by Hunke and Sennholz.
22. Von Neumann and Morgenstern, supra note 4.
23. Duncan Luce and Howard Raiffa, *Games and Decisions* (1957).
24. Lester Telser, *Competition, Collusion and Game Theory* (1972).
25. General Electric in its labor negotiations pursued a "final best offer" strategy, known as "Boulwarism," refusing to revise a proposal unless new information is presented that justifies a revision. See Boulware, *The Truth About Boulwarism* (1969).
26. James A. Graaskamp, "An Approach to Real Estate Finance Education by Analogy to Risk Management Principles," *Real Estate Issues* (Summer 1977), p. 53.
27. For a discussion of the issues involved in and the results of an evaluation of national econometric models see Stephen K. McNees, "An Evaluation of Economic Forecasts," *New England Economic Review* (November/December 1975).
28. Neil Ulman, "After Years of Decline, U.S. Fishing Industry is Beginning to Boom," *The Wall Street Journal* (July 25, 1977), p. 1.
29. "The term attenuation is used to signify the degree of restriction on the owner's right to exclusive use of a thing." (Pejovich, "Toward a General Theory of Property Rights," *The Economics of Property Rights*, eds. Eirik Furbotn and Svetozeor Pejovich, 1974, p. 344.)
30. Bohm-Bawerk, *Positive Theory of Capital*, vol. II, p. 121.
31. Braitman, "The Eye of the Beholder: A Fresh Look at Fair Market Value," *Taxes—The Tax Magazine* (May 1974), p. 269.
32. "Accountants have been loath to become involved in accounting for value." (Lee, *Income and Value Measurement—Theory and Practice*, 1975, p. 11.)
33. The recent interest in "current value accounting" will undoubtedly focus new attention on the value question, although it should be noted that the primary thrust of the current value accounting methods is on restating the "values" for those assets where market quotations exist, rather than on developing more accurate statements of value for asset categories that have relatively "thin" markets or are more commonly thought of as illiquid in a trading sense.
34. "Any attempt to transmute value into utility value, intrinsic value, real value, or speculative value involves the study of philosophy and metaphysics in the realm of idealism and materialism." (Zangerle, *Principles of Real Estate Appraising*, 1924, p. 23.)
35. "The sole motivation for the purchase of income real estate is expectation of profit." (L. W. Ellwood, *Ellwood Tables*, 1970, p. VI, pt. 2.)
36. *Idem.*, "Value as a Present Worth of All Rights to Future Benefits Arising from Ownership," p. 1.
37. May, "The Influence of Accounting on the Development of an Economy," 61 *J. Accountancy* 11 (1936), p. 20.
38. Henry Babcock, *Appraisal Principles and Practices* (Irwin, 1968), p. 119.

39. W. Paton and A. Littleton, *An Introduction to Corporate Accounting Standards* (1940), p. 11.
40. *Ibid.*
41. P. Grady, *Inventory of Generally Accepted Accounting Principles for Business Enterprises* (1965), p. 24.
42. American Accounting Association, *A Statement of Basic Accounting Theory* (1966), p. 23.
43. American Institute of Certified Public Accountants, *Objectives of Financial Statements—Report of the Study Group on the Objectives of Financial Statements*, (October 1973), pp. 13-45 passim.
44. Samuel Hayes and Leonard Harlan, "Caveat Emptor in Real Estate Equities," *Harvard Business Review* (March-April 1972), p. 92.
45. "The Pie-In-The-Skyscrapers," *The Economist* (March 25, 1973), p. 14.
46. "Research, Tax Shelters Assailed," *Apartment Construction News* (September 1973), p. 88.
47. Max Resnick, "Broken Promises Back Many Distressed Real Properties," *Apartment Construction News* (July 1975), p. 43.
48. "The patient is sick and running a fever. He can't read the thermometer objectively. He doesn't know that there is anything wrong. And that is understandable. A typical builder/entrepreneur is an optimist." *(Ibid.)*
49. "U.S. Accuses Realty Groups of Racism," *San Francisco Chronicle* (April 17, 1976) pp. 1, 44.
50. "Nixon Lawyer and Appraiser Indicted by U.S.," *The Wall Street Journal* (February 20, 1975), p. 6.
51. Money Market Directories, Inc., *Survey of Real Estate Investing by Pension Fund Administrators* (1975).
52. "Pension officers question whether an appraisal value can be taken as a market value." (Barbara Patocka, "Pension Funds Blaze Real Estate Trail," *Institutional Investor*, June 1974, p. 79.) "Appraisals have historically not met the test of prices generated by the market." (Zell, "Pension Fund Perils in Real Estate," *Real Estate Review*, Winter 1975, p. 62.)
53. Money Market Directories, Inc. supra note 51.
54. In a critique of the appraisal process, one commentator noted that "Most appraisers simply do not have a sufficiently broad understanding of the real estate market." (Alvin Arnold, "How Valuable is the Independent Appraiser?" *The Mortgage and Real Estate Executives Report*, October 15, 1975, p. 2.)
55. "SEC Advises Banks to Check Asset Values and Swaps with REITs," *The Wall Street Journal* (February 19, 1976), p. 2.
56. "It should be noted here that 'real estate appraisers' are not held in the highest esteem by some people in the securities industry . . ." (Frederick Chippendale, *What the Real Estate Appraiser Should Know About Real Estate Securities*, 1974, p. 5.) On this point, the following observation based on comments made at a Practising Law Institute seminar, "Public and Private Offering of Tax-sheltered Investments," held in Los Angeles in early January, 1973, are particularly apropos: "Several times during the course of the two-day conference the participants indicated a high degree of respect for the reliability of appraisals made by oil and gas appraisers. Concurrently, they all expressed very low opinions of real estate appraisers, both as to reliability and the professionalism of the appraisals . They also left no doubt that we are going to have continuing regulatory problems with real estate securities unless the entire real estate appraisal field is substantially upgraded . . . the speakers at this seminar included representatives of the SEC, both Washington and Los Angeles, the NASD, and lawyers and CPAs who practice before the SEC." (Private communication to the author from Harris E. Lawless, January 1973.)
57. Aron, *The Mortgage Problem* (1934), p. 35.
58. Adam Smith, *The Wealth of Nations* (1776), p. 95.
59. Keynes, supra note 1, p. 150.
60. "The New Money Target: Profitable Real Estate," *Business Week* (August 1, 1977), pp. 52, 53.
61. K. Larry Hastie, "One Businessman's View of Capital Budgeting," *Financial Management* (Winter 1974), p. 36.
62. Roger G. Kennedy, "A Forecast About Forecasting," *Decision* (Fall 1976), p. 8.
63. One effective distinction is drawn by Howard H. Stevenson, associate professor of the Harvard Business School, who has developed a conceptual framework for looking at real estate issues that breaks the evaluation process down into a series of questions classed in three categories having to do with the deal, people, and property.
64. *Utech v. City of Milwaukee*, 9 Wis. 2d 352.
65. In one such analysis, the "most probable" deterministic approach derived an operating income figure of $72,000, as contrasted to the expected value for the operating income as calculated by a probabilistic analysis of $66,000. See Roulac, supra note 4, pp. 451-60.
66. A study conducted for the Department of Housing and Urban Development by Touche Ross & Co. *(Study on Tax Considerations in Multi-Family Housing Investment*, 1972) reported that the vast majority of investors surveyed preferred the "average annual return" and other unsophisticated profitability measures over the "discounted rate of return."

67. For a discussion of errors in investment decision making, see Fleischer, *Capital Allocation Theory: The Study of Investment Decisions* (1969), p. 51.
68. A copy of the suspect "analysis" and a revised evaluation according to preferred methods of economic analysis are included in Stephen E. Roulac, "Real Estate Syndication Digest-Principles and Applications," *Real Estate Syndication Digest* (1972), p. 156.
69. Jared Shlaes, "Landmark Issues in American Cities," *Real Estate Issues* (Fall 1976), p. 29.
70. Donald Rappaport and James O. Stepp, "The Unreal World of Real Estate Accounting," *Price-Waterhouse & Co. Review* (Winter 1972-73).
71. "The SEC does not permit the inclusion of anything resembling a forecast in prospectuses filed with it under the Securities Act. If such information material is intentionally or through oversight included in a registration statement as originally filed, the SEC staff will insist that it be removed when the registration is amended." (Louis H. Rappaport, *SEC Accounting Practices and Procedure*, New York, Ronald Press, 1966, pp. 25-26.)
72. "Public Proceedings in the Matter of Estimates, Forecasts, or Projects of Economic Performance and Related Subjects," Securities Exchange Act release no. 9844, November 1, 1972, *Securities and Exchange Commission News Digest* (February 2, 1973, issue no. 73-23).
73. *Feit v. Leasco Data Processing Equipment Corporation*, 332 F. Supp. 544, 565 (E.D.N.Y. 1971).
74. John E. Bohling, "Market Analysis: A Better Tool for Better Loan Appraisals," *The Appraisal Journal* (January 1977), p. 25.
75. *Ibid.*
76. John Robert White, "Real Estate Appraisals: How They Pay Off for Investors," *The Appraisal Journal* (January 1977), p. 49.
77. Kennedy, supra note 62, p. 9.
78. An insightful perspective into the economic analysis process is contained in an observation by Charles F. Roos, "Survey of Economic Forecasting Techniques," *Econometrica* (October 1955), reproduced in Edward Rams, *Rams' Real Estate Appraising Handbook* (Prentice-Hall, 1975), p. 7. In his book, Rams presents an eclectic and highly useful compendium of applied models for urban economic analysis.
79. Buckminster Fuller, *Ideas and Integrities* (1963), p. 37.
80. Kennedy, supra note 62, p. 12.
81. J. William Petty and Oswald D. Bowlin, "The Financial Manager and Quantitative Decision Models," *Financial Management* (Winter 1976), p. 32.
82. An intriguing and illuminating illustration of the use of quantitative methods in computer models is presented in Chris Bonington, "Logistics," app. 2, *Everest the Hard Way* (Random House, 1976), p. 200.
83. Christopher Jencks, "Decisions, Decisions," *The New York Times Book Review* (July 3, 1977), p. 4.
84. Irving L. Janis and Leon Mann, *Decision-Making—A Psychological Analysis of Conflict, Choice, and Commitment* (The Free Press, 1977).

The Grand Central Case: The Preservation of Individual Historic Landmarks

by Frank B. Gilbert

A major court decision in June, 1977 about Grand Central Terminal has strengthened the position of persons working to preserve a city's historic buildings, especially those located on valuable land. In a unanimous opinion, New York State's highest court, the Court of Appeals, said that the owner of an individual landmark structure may be regulated in the use of his property and that a reasonable return on it will satisfy constitutional requirements. In addition, the opinion by Chief Judge Charles Breitel recognized the tangible contributions by the government to the present value of the landmark and its site and said that the owner "is not absolutely entitled to receive a return on so much of the property's value as was created by social investment."

Penn Central Transportation Company v. The City of New York (case number 273, decided June 23, 1977), involves a proposal to construct a 2,000,000 square foot office building on the site of Grand Central at Park Avenue and 42nd Street, just south of the Pan Am Building. In its decision the court upheld the New York City landmarks preservation law and the landmark status of Grand Central. It sustained the denial of permission to build the 55-story office tower and commented favorably on the transfer of development rights as a way to give an owner a reasonable return on his property.

Coming at this time, the decision will encourage efforts to find some alternative to the demolition of landmarks and buildings in historic districts, when sites are assembled for new construction. Today there are 500 local ordinances whose purposes are the identification and protection of historic buildings and areas, in 1965 there were less than 100 such laws. Matching the effort by municipal governments, federal tax laws now encourage the rehabilitation of commercial buildings that are certified historic structures (section 2124 of the Tax Reform Act of 1976).

Frank B. Gilbert, landmarks and preservation law counsel for the National Trust for Historic Preservation, participated in amicus curiae briefs in favor of the preservation of Grand Central Terminal during the litigation described in his article. From 1965 to 1974 he was secretary and then executive director of the New York City Landmarks Preservation Commission; in those years much of his time was spent on the Grand Central proceedings. He received his J. D. degree from Harvard Law School.

Public appreciation of older buildings has increased in recent years, and the Court of Appeals opinion reflects an acceptance of intervention to prevent demolitions that would have been inevitable a few years ago: "In times of easy affluence, preservation of historic landmarks through use of the eminent domain power might be desirable, or even required. But when a less expensive alternative is available, especially when a city is in financial distress, it should not be forced to choose between witnessing the demolition of its glorious past and mortgaging its hopes for the future." The court concludes that New York City landmarks preservation law "represents an effort to take a middle way."

BACKGROUND OF THE CASE

It has been ten years since plans for a skyscraper at Grand Central were first announced. In 1967 at the height of the office building boom in Manhattan, the premerger New York Central said that it would negotiate with a builder for the redevelopment of the railroad station site. In 1968 an English developer, Morris Saady, was selected, and his company, UGP Properties, picked Marcel Breuer as its architect for the project. Because Grand Central is a designated New York City landmark, any change to its exterior required the approval of the New York City Landmarks Preservation Commission.

After some preliminary proceedings in 1968, Breuer and the developer eventually presented for consideration alternative designs—one would have placed the office tower on top of the terminal and its Beaux Arts facade by means of massive cantilevers, while the second proposal would have destroyed the exterior of the landmark so that the outside of the new building would have a completely modern appearance. The two designs contained the train facilities which continued on the site, and both attempted to preserve much of the station's main concourse, an interior feature of the building over which the landmarks commission had no jurisdiction.

From the start the Grand Central office building was a controversial project. One interesting element of the discussion was the feeling of inevitability about the loss of the terminal in its present form. Nothing could be done, and perhaps a good new building by Breuer was all that could be hoped for, because the landmark was located on such a valuable site. After extensive public hearings the New York landmarks commission in August, 1969 turned down the developer's and the railroad's application for a certificate of appropriateness, giving its reasons in a 14-page opinion.

In the period after this decision, other parts of the city government worked with the railroad and the developer on possible projects that would have transferred the allowable floor space from the Grand Central site to proposed new construction on adjacent property owned by Penn Central. Preliminary architectural drawings were prepared for a large new office building on the site of the Biltmore Hotel. The provisions in the city's zoning ordinance were expanded to facilitate a transfer of development rights, but the weakening of the market for office space apparently kept any new buildings from being started.

DECISION BY THE COURT OF APPEALS

In 1972 the developer and the railroad activated their pending suit to overturn the rejection of their plans by the landmarks commission. The Court of Appeals decision is the third one in this litigation; it follows a trial court decision for the developer and the railroad that was reversed on appeal by the Appellate Division of the Supreme Court (377 N.Y.S. 2d 20, 1975). In analyzing the problem before it, the Court of Appeals spoke in broad terms about "determining the scope of governmental power" to save "irreplaceable landmarks deemed to be of inestimable social or cultural significance." Since historic preservation laws are enacted as an exercise of the government's police power, payments to owners are not provided for in these statutes. Thousands of buildings are now covered by these laws, and so the use of eminent domain will rarely be the way to save a threatened historic property.

Writing for the court, Judge Breitel distinguishes this case from a zoning regulation because "the purposes are different." He also treats it differently from the regulation of a historic district where owners "benefit, to some extent, from the furtherance of a general community plan." The opinion then gives significant support to laws protecting individual historic landmarks:

> "Discriminatory zoning is condemned because there is no acceptable reason for singling out one particular parcel for different and less favorable treatment. When landmark regulation is involved, there is such a reason: the cultural, architectural, historical, or social significance attached to the affected parcel. Even when regulation is designed to achieve such an acceptable purpose, however, the landowner must be allowed a reasonable return or equivalent private use of his property."

Owners of landmark buildings have often opposed regulation of their property with arguments about large new structures they might want to develop there. According to the Court of Appeals, the test for the regulation of a landmark building and its site is whether it is capable "in its economic context of producing a reasonable return, even if its development is limited." The court also says:

> "Plaintiffs contend that the Terminal currently operates at a loss. Even if that be true, it is not of critical importance. What is significant, instead, is whether the property, managed efficiently, is capable of producing a reasonable return. If the courts were forced to look to the property as it is, rather than as it could be, any inadequacy of managers of property could frustrate any land use restrictions."

Turning to the question of what value the regulators must consider, the opinion goes beyond previous analyses in cases about landmarks:

> "Of primary significance, however, is that society as an organized entity, especially through its government, rather than as a mere conglomerate of individuals, has created much of the value of the terminal property. . . . Absent this heavy public governmental investment in the Terminal, the railroads, and connecting transportation, it is indisputable that the Terminal property would be worth but a fraction of its current economic value. Plaintiffs may not now frustrate legitimate and important social objectives by complaining, in essence, that government regulation deprives them of a return on so much of the investment made not by private interests but by the people of the city and state through their government.

Instead, to prevail, plaintiffs must establish that there was no possibility of earning a reasonable return on the privately contributed ingredient of the property's value."

The court goes on to say that it will be "exceedingly difficult but imperative, nevertheless, to sort out the merged ingredients and to assess the rights and responsibilities of owner and society." To help with this problem, the court invites further submissions of briefs by the parties at the trial court level.

THE TRANSFER OF DEVELOPMENT RIGHTS

In the opinion Judge Breitel calls attention to the land and buildings owned by the railroad in the Grand Central area because they "would lose considerable value and deprive plaintiffs of much income, were the Terminal not in operation. Some of this income must, realistically, be imputed to the Terminal." In addition, these adjacent properties make viable the zoning provisions permitting the transfer of unused floor area from a landmark site to a new building proposed for construction.

Discussing problems about a possible transfer of development rights, the court says that long-term leases or existing buildings on receiving parcels do not make development rights worthless. It points out that when "the improvements have lost their utility, a larger building could be constructed." The opinion describes as "significant" the "permitted splitting of the development rights among several receiving parcels, to allow optimal use of the rights."

Summarizing its views on this point, the court concludes:

"Development rights, once transferred, may not be equivalent in value to development rights on the original site. But that, alone, does not mean that the substitution of rights amounts to a deprivation of property without due process of law. Land use regulation often diminishes the value of the property to the landowner. Constitutional standards, however, are offended only when that diminution leaves the owner with no reasonable use of the property. The situation with transferable development rights is analogous. If the substitute rights received provide reasonable compensation for a landowner forced to relinquish development rights on a landmark site, there has been no deprivation of due process."

THE IMPORTANCE OF THE DECISION

The opinion then notes that in this situation: "The compensation need not be the 'just' compensation required in eminent domain, for there has been no attempt to take property." The court continues its analysis and adopts another position that is important to the preservation of landmarks. The designation of Grand Central as a landmark and its subsequent regulation by a city commission "permitted productive use of the Terminal site as it had been used for more than half a century, as a railroad terminal. In addition, the development rights were made transferable to numerous sites. . . . Since this regulation and substitution was reasonable, no due process violation resulted." The court goes on to say that the landmarks law is a reasonable land use regulation. To stop the application of the law to them, the developer and

the railroad have the burden of demonstrating affirmatively that the regulation has eliminated "all reasonable return" on their property. On the facts of this case, the court holds that they "have failed to meet that burden."

At the end of the opinion, the court recognizes that its decision is not supported "by ample precedent or wholly developed principles." It adds: "The last word has not only not been spoken; it has hardly been envisaged." The railroad and the developer may ask the U. S. Supreme Court to review the case. The Supreme Court has discretion whether or not to hear this appeal.

At this point the Court of Appeals has provided an additional legal foundation for growing preservation activities around the country. Its support for the preservation of a major commercial landmark matches the feelings of many private individuals. With the necessary support from municipal governments, more communities will now have a fair opportunity to preserve their city's historic landmarks.

Metropolitan Growth, Suburban Enclaves, and the Yick Wo Laundry—Will they be the Roots of Disorder in America?

by James R. Cooper

In January of 1977 for eight consecutive nights record numbers of Americans—130 million of our people—viewed a TV program based on Alex Haley's *Roots*. Scholars have already begun to analyze this phenomenon. Dr. Gilbert Parks, staff psychiatrist at Topeka State Hospital, Kansas said, " 'Roots' epitomized every American's fight for personal freedom and prosperity. That was its appeal . . . Even though the show highlighted one particular family's struggle for freedom, it was a story of everyone's fight—not only for freedom, but for freedom and a higher standard of living."

This article is about a nationwide fight which is ongoing. It is quiet, but deadly serious: quiet because true to American tradition it is being fought in our courts; serious because its uncertain outcome will profoundly affect our republic's democratic system for better or for worse. The fight is to open the metropolitan suburbs to the lower-income classes.

Americans have discovered and rediscovered that riot in the streets solves nothing, arouses fear in those who hold power, and only delays resolution of conflict. In the 1970s we have lived in a time of relative domestic tranquility as the urban poor and those below middle-income test the usefulness of the legislative process and judicial review as means for redress of their asserted wrongs. These underdogs cannot be ignored any more than this nation could ignore labor's demands that management be brought to the conference table for collective bargaining.

James R. Cooper is a professor of real estate and urban affairs at Georgia State University, Atlanta and has been a faculty member of the Wharton School of the University of Pennsylvania, and the universities of Illinois, Wisconsin and Pittsburgh. Dr. Cooper has published numerous articles and is the author of *Real Estate Investment Analysis*. He is a member of the bar of the United States Supreme Court.

As in the past, whenever social injustice occurs in the United States, diverse groups find themselves working with former opponents as we seek the way toward conflict resolution. Today, the Urban League, regional homebuilders' associations, Realtors, the NAACP, blue ribbon metropolitan leadership councils, and large-scale developers find themselves working in concert to solve a national problem which our suburbs are trying to evade. It is certain that our population will grow by no less than 41 million persons by the year 2000, and may grow by 50 million. Current demographic trends indicate that birth control methods are being used more effectively by the upper-income classes. Thus a much higher percentage of our new population will be either born poor or be the elderly who have become poor due to inflation.

The places where our lower-income classes will live is a matter of critical importance. Providing housing for families with incomes below the national median has been a chronically difficult problem for decades. Ever since Senator Robert Taft sponsored a National Housing and Slum Clearance Act in 1949, the U.S. Congress has stated that decent housing for every American in a good living environment is a bi-partisan national goal. Now, after a period of neglect (1972-1976), it appears we are about to embark on another national effort to confront the problems of decent housing at convenient locations for our metropolitan area housing-deficit families.[1]

In our last noble effort, the National Housing Act of 1968, we were forewarned that the housing programs for low and low moderate-income families would require six million acres of new land on the fringes of our metropolitan areas and that social and political barriers stood in the way. One of the many reasons the programs created by the Act (Sec. 235 and Sec. 236) foundered was the lack of suitable sites, especially on the urban fringes. We now seem to be tending toward forms of subsidy (e.g. housing allowances) which will prefer the use of the existing stock and encourage dispersal of the lower-income classes by way of providing them with housing vouchers which will enable the "deficit families" to find their own location under open equal opportunity housing regulations.

A central theme of this article is to show that though our state courts are doing what they can to solve the conflicts arising from the effort of our suburbs to prevent low and low moderate-income housing from being erected in their midst, the results are not only diverse but even contradictory. Meanwhile, the U.S. Supreme Court under the leadership of Burger, Powell, Rehnquist, and Stewart are not only doing all they can to avoid these land use disputes, but worse may be leading many people into using the law as a regressive means to prevent the nation from achieving the bi-partisan goal of a decent home for every American family.

This article points out ways in which laymen could have a beneficial impact on the way the public interest is exercised to shape public policy in the area of land use. It will present economic and social facts intended to belie some of the myths which are now motivating suburban people and which have been a part of the established law.

BREAKDOWN OF THE STABLE NEIGHBORHOOD

MYTH: Neighborhood homogeneity will continue to be the primary way Americans stabilize life styles and property values.

It is apparent that there are significant forces now at work which are bringing traditional attributes of neighborhood homogeneity to an end. *First*, the U.S. Census recently reported that 20% of couples in the age 40-55 bracket are not married but are living together. The high rate of divorce has not only increased the number of people who remarry, it has also brought to our society an increasing number of people who appear to prefer cohabitation to remarriage even though it is easier to obtain a divorce than before. These couples are discreetly infiltrating all kinds of neighborhoods but especially the suburban areas because they tend to be more affluent than the average. *Second*, the Harvard-MIT Urban Studies Center has documented that the 1970s have brought about a sharp increase in the headship rate of nonmarried households. In effect, young and old people are organizing themselves into housekeeping units without cohabiting in the modern sense of the word, which implies sexual relationships. In the case of the elderly on fixed incomes, this is probably, in part, due to the pressure of declining purchasing power because of our tacit national policy on inflation. In the case of the young, it is a way of gaining freedom and privacy to carry out their life style which may be substantially different from their older relatives. More recently, households of non-marrieds are being formed to spread the impact of soaring utility costs. The inflationary effect of salaries and wages is also a factor for some occupational classes. As declining family sizes begin to affect the housing market, we can expect the 4-6 bedroom houses in single-family detached neighborhoods in our suburban areas to be converted to duplexes if the law allows (more often it prohibits); and if not, then their use will be converted to informal congregate living. The patriotic duty of energy conservation may even enable these new kinds of households to claim ethical justification for conduct which was suspect if not abhorrent only a few decades ago.

In the *Village of Belle Terre v. Boraas*[2] six students at SUNY Stoneybrook on Long Island rented a house in the village from its owners in apparent violation of the village's zoning ordinance. The village has 700 people on a total land area of less than one square mile. It has restricted land use to one-family dwellings, excluding lodging houses, boarding houses, fraternity houses, and multiple-dwelling houses. The word "family" has statutory definition in the ordinance. In summary it is defined as a single housekeeping unit containing one or more persons related by blood, adoption, or marriage, but also includes households of one or two persons who maintain a home.

Thus, the village ordinance did permit an unrelated couple or an "odd couple" to live together or cohabit. The plaintiff owners argued that if two unmarried people can constitute a "family," there is no reason why three or four may not, for purposes of complying with the ordinance. The village of Belle Terre's ordinance was found constitutional, upholding their peculiar definition of a "family." In an opinion which is hardly a model of clarity, Justice Douglas wrote for a 7-2 majority. The students' landlord had attempted to make some

very significant challenges to the village ordinance: that it interfered with a person's right to travel, to migrate, and to settle within the state; that the ordinance expressed the social preference of the residents for groups that will be congenial to them; that social homogeneity is not a legitimate interest of government; that the restrictive use interferes with the newcomers' rights of privacy. The opinion imperiously waved these issues aside by saying,

> ". . . we find none of these reasons in the record before us. It (the ordinance) is not aimed at transients . . . It involves no fundamental right guaranteed by the Constitution.
>
> "A quiet place where yards are wide, people few, and motor vehicles restricted are legitimate guidelines in a land use project addressed to family needs . . . it is ample to lay out zones where family values, youth values, and the blessings of quiet seclusion, and clean air make the area a sanctuary for people."

The court's avoidance of the question of fundamental rights is disappointing. At a time of swiftly rising construction costs, pressures on municipal tax bases, and energy shortages, this paean of praise to the single-family detached dwelling on a large lot (where yards are wide) doesn't speak well for the court's wisdom on prescience.

Justice Marshall stood alone in his willingness to discuss whether or not the students' fundamental rights were affected by the ordinance. Marshall claimed the ordinance unnecessarily burdened the students' First Amendment rights of freedom of association and the constitutional right to privacy. He felt that these constitutional rights should extend not only to political rights but also to those which pertain to conduct or to social and economic benefits such as the selection of one's living companions. He felt the right to establish a home was part of the liberty guaranteed by the 14th Amendment. He closed by commenting that our Constitution, in his opinion, secures to the individual freedom of choosing how one would satisfy his intellectual and emotional needs within the privacy of the home:

> "The instant ordinance discriminates on the basis of just such a personal lifestyle choice as to household companions. It permits any number of persons related by blood or marriage, be it two or twenty, to live in a single household, but it limits to two the number of unrelated persons bound by profession, love, friendship, religion, political affiliation, or mere economics who can occupy a single home . . . The town has, in effect, acted to fence out those individuals whose choice of lifestyle differs from that of its current residents."

Some states, when faced with ordinances similar to Belle Terre, have held that the ordinance was unauthorized by the state zoning enabling act[3] or that the similar ordinance was violative of the state constitution.[4] It would seem that, since the U.S. Supreme Court has eschewed the question of diversity of lifestyle raised by Belle Terre, an attorney might advise a developer that the constitutionality of such a local ordinance barring group housing is a matter for the specific state jurisdiction until the Supreme Court faces the question in a proper test, advice which wouldn't be particularly helpful.

The *third* force that is changing our traditional view of a stable neighborhood as one which is relatively homogeneous, is the imminent mixing of economic classes. The lower economic classes will surely insist on access to more and more of the metropolitan area which the suburbs have prevented to date.

DISPERSING THE POOR TO THE SUBURBS

The strangely convoluted opinion of the U.S. Supreme Court in *Gautreaux v. the Chicago Housing Authority and HUD* points the way to HUD and housing authority involvement in the dispersal of poor blacks to the suburbs of our metropolitan areas. As Americans in the North, the South, and other parts of the nation have shown hostility to the continued use of school-busing as a method of racial integration, they have thus unwittingly opened the way to leased housing and housing allowances as the more feasible alternative way to alleviate the effects of segregation. Whatever method is chosen, efforts must be made to educate the public.

The first problem is to overcome the peculiar propensity of the media to foster an image of the urban poor as a stereotype promiscuous black welfare mother of two, or more, with a shadowy male figure in the background. It is, and has been for years a totally misleading picture. Two-thirds of the urban poor are white. As Wellesley Professor of Economics Carolyn Shaw Bell stated in a recent letter to *Business Week*,

> ". . . Poor white familes outnumber blacks by more than two to one. Among poor families headed by women, more black mothers (22%) work and earn income than do white mothers (6%). It follows that the bulk of aid to dependent children recipients are white. In 1974, 2.8 million white families received public assistance compared to 1.5 black families. *Business Week's* "typical family" on the cover is the wrong color."[5]

As a professor who teaches housing economics, every term I find the students quite surprised to find the true incidence of poverty as set forth in Anthony Downs' CED pamphlet *The Urban Poor*.[6] The most ominous statistic is that about 44% of the urban poor are children under the age of 18, and that they constitute a steadily growing proportion of all those under age 18. Obviously, we are being hard pressed by fact for a solution to the problem of the ill-housed who live in the poverty enclaves.

ELIMINATING POVERTY ENCLAVES—A TOP PRIORITY

The poverty enclaves are at the same time made up of unusually high percentages of substandard, aged, deteriorated housing, as one would expect of older neglected inner-city neighborhoods. There are actually large numbers of stable middle-class families in these poverty neighborhoods with typical middle-class aspirations who are quelled into despair by the street atmosphere." In Edward Banfield's words, ". . . for those working and middle-class slum dwellers, life in the slums is a daily battle to preserve life, sanity, and self-respect."[7] It comes as no surprise that the upward-striving members of the poverty enclave will seek a change of neighborhood at the first oppor-

tunity. Nor should it be a surprise that under conditions of race discrimination prevailing up until the late 1960s this led to expansion only of the fringes of the poverty enclaves. Decentralization has been a very selective phenomenon limited largely to better educated, more affluent whites and to the more skilled with better paying jobs. Thus the shibboleth, "the white noose of the suburbs," tells only one-third of the story, for it has also been an exclusion of the white poor and lower middle-classes of all ethnic types.

The distance of this separation between income classes has grown from a few blocks the other side of the tracks in 1900, to many miles at the outward end of an expressway. We have now become aware that the vitality of our nation's cities depends on our capacity to cope with the locus of the home, family cycles, personal ambitions, in effect the myriad goals and aspirations of all the individuals who make up our urban society today and, perhaps more importantly, the children who will be our citizens in the next generation. Until now we have given very low priority to the condition of our inner cities in our budgeting allocations. Expenditures for one kind of war weapon often exceed all our community development grants. We hunt enemies abroad while unrest and insecurity breed at home.

A CASE OF UNEQUAL ACCESS

MYTH: All Americans have equal protection before the law and the privileges of immunities of American citizenship; thus, we all have the right and opportunity to have open housing without discrimination based on race, color, creed, national origin, sex, or age.

The economic costs of litigation effectively bar access to the courts for the vast majority of our middle and lower-class Americans. Thus aggrieved parties experience social injustice (refusal to lease, to issue building permits, to grant variances in zoning, etc.) without having a peaceful way to redress the wrong done. In a totalitarian state this would be a generally accepted way of life. The grievance festers more in our nation because we are taught we do have equal access to the law. The experience of Dorothy Gautreaux and others who were black tenants and applicants for public housing in Chicago is instructive.

In 1966 *Gautreaux*, and others, charged both HUD and the Chicago Housing Authority with intentionally maintaining existing patterns of residential separation of races by tenant assignment and site selection procedures. After three years the federal district court, in 1969, found with Gautreaux and issued an injunction against CHA restraining the unconstitutional practices and ordered CHA to remedy the past effects by providing that future sites would be in the "General Housing Area" (less than 30% non-white) of the city of Chicago. After many hearings the case reached the U.S. Circuit Court of Appeals, for the second time, in June of 1974. It appears that the "white man's burden" of the 19th century has been replaced by the "black man's burden" of the 20th century. The costs of these delays, the use of thousands of man-hours of high quality legal talent, are measured only in part by money, but certainly the Gautreaux litigation costs must be comparable to the hun-

dreds of thousands of dollars expended on anti-trust cases. Those who finance the defense of every citizen's political and civil rights must do so out of their own pocket or, possibly, by seeking donations. This may sound like hot rhetoric. Let the words of Justice Clark, sitting on the case, speak for themselves:[8]

". . . anyone reading the various opinions of the District Court and of this Court quickly discovers a callousness on the part of CHA and HUD towards the rights of blacks, underprivileged citizens of Chicago, that is beyond comprehension.

". . . Given the eight-year tortuous course of this case . . . we believe the relief granted (compelling CHA to find sites for 1500 units in the 'general housing' area of the city of Chicago) is much too little and much too late in the proceedings.

". . . we are obliged to conclude that on the record here it is necessary and equitable that any remedial plan to be effective must be on a suburban or metropolitan basis . . ."[9]

After eight years (1966-1974) of litigation it would appear that Gautreaux was to have open housing. But HUD, under Carla Hills, had yet another appeal. Two more years elapsed before the U.S. Supreme Court made the questionable claim it had affirmed in Justice Clark's 7th Circuit Court of Appeals opinion. The CHA had not appealed the Clark decision. Justice Stewart delivered the opinion:

"HUD has been judicially found to have violated the Fifth Amendment and the Civil Rights Act of 1964 in connection with the selection of sites for public housing in the city of Chicago.

". . . the relevant geographic area for purposes of HUD's housing options is the Chicago housing market, not the Chicago city limits. That HUD recognizes this reality is evident in its administration of a federal housing assistance program through 'housing market areas' . . . encompassing 'the geographic area "within which all dwelling units . . ." are in competition with one another as alternatives for the users of housing.' (See Department of HUD 'Techniques of Housing Market Analysis')

"HUD has discretion regarding the selection of housing proposals.

"The Housing and Community Development Act of 1974 significantly enlarged HUD's role. Under Sec. 8 lower-income housing programs HUD may contract directly with private owners to make leased housing available and HUD has acknowledged that local government approval is no longer explicitly required as a condition of the program's applicability to the locality.

"In most cases the 1974 Act grants the local government the right to comment on the application."

It is at this point in the opinion that Stewart uses his forensic skill to appear to affirm the Clark opinion but at the same time to deal a crippling blow to a metropolitan solution to construction of such housing in suburban areas.

Returning to Stewart's opinion for the court:

". . . the local governmental units retain the right to comment on specific assistance proposals, to reject certain proposals that are inconsistent with their approved housing assistance plan and *to require that zoning and other land use restrictions be adhered to by builders.*" (italics supplied)

STATE ZONING SOVEREIGNTY

To the uninitiated it would appear we have now established a new national policy requiring HUD to recognize the reality of metropolitan area-wide housing markets in carrying out the federal housing assistance plans, without abridging local home rule. In reality we are more likely to have a crazy-quilt of contradictory policy controlled by local actions which will be inconsistent with any uniformity of federal policy. This is because the Burger court has empowered each state to go its own way in developing doctrine in this area of land use control.

Thus in a state such as New York, which has an enabling act that permits the villages of Belle Terre to be an "island unto themselves," they could "zone-out" such a builder so long as it was not a response to the builder's proposal. In other words, the court certainly doesn't permit "Black Jack" zoning (that is, after the fact) but it has honored a plan for single-family detached housing which excludes multi-family, commercial, industrial, and other uses necessary for orderly metropolitan growth.

In Illinois the courts have substantially restricted the "assumption of validity" of the local governing body's zoning action which was enunciated by the U.S. Supreme Court in the 1926 case, *Euclid v. Ambler Realty Co.* The courts of Illinois will seriously consider a challenge to present zoning (e.g. from single-family residential to multi-family) if the existing zoning results in a substantially lower land value than the proposed classification.[10] Illinois courts have also been unsympathetic to large-lot zoning, a preoccupation of upper-middle-class suburbs.[11] They have invalidated three-acre minimum zoning for single family, ruling that it made development uneconomical and thus infeasible. In another case the Illinois courts invalidated zoning restrictions against multiple dwellings where the regulations allowed for only single-family to two-family use. They ruled in favor of the multi-family use which would allow for more housing at more varied prices to a wider segment of the market.[12]

ARLINGTON HEIGHTS: "A VILLAGE BEAUTIFUL" BEATS POOR LEGAL TACTICS

It could be argued that *Metropolitan Housing Development Corporation v. Village of Arlington Heights*[13] is a case of "bad facts make bad law," in that MHDC did not succeed in requiring Arlington Heights to change a single-family classification to multi-family in spite of the fact that it appears, on its face, to go against the line of Illinois cases cited and had "the incidental effect of discrimination." A review of the facts in the case shows that Arlington Heights had already zoned 60 tracts for the R-5 multi-family use sought and some of it was available to the plaintiffs. As Judge McMillen stated, "the weight of the evidence proves that the Village of Arlington Heights was motivated by a legitimate desire to protect property values and the integrity of the village's zoning plan." The "home-rule" prerogatives seem to have prevailed, but since we know that Illinois courts do support highest and best use economic analysis which could show the local community has improperly

zoned the land below its value, it should not be a matter of great concern. It appears more likely that the federal court was the wrong forum for getting at the question of rezoning the land to multi-family which, after all, is the result sought. Thus, we see that a major state, Illinois has gone a different way than New York and its "home-rule" protection of the "village beautiful with ample lots, blessings of family values, etc."

It appears reasonable to say that though the court seems to have given hope to metropolitan planning in *Gautreaux*, their reluctance to vitiate "home-rule" has done little to resolve the political conflict between those on the one hand who wish to enable a metropolitan area to grow as one urban economy, and on the other hand their adversaries, who feel that the rights and powers of the many political enclaves which have balkanized our metrocities should prevail. The Burger court's majority appears to be sleep-walking its way back to a bygone year when the court simply avoided what it labeled "political questions" as not justiciable on the ground that the legislature was the proper place to resolve such questions under our separation of powers system. Thus for decades, in the early twentieth century, cases challenging the malapportionment of voting power (by the failur to re-district) were held non-justiciable as late as 1946 by the U.S. Supreme Court.

The social injustice of the rural control of our state legislatures was having deleterious effects on our cities because such legislatures had little interest in urban problems. After 16 more years of inaction on the part of the states, a new court headed by Warren took action. *Baker v. Carr*[14] ruled that apportionment-districting-elections restrictions were indeed justiciable on their merits. The power had shifted; the advantages had gone to the suburban rings and not to the "older inner city." Though probably unintentional, the fragmentation of the metropolitan areas was strengthened by *Baker v. Carr*. The entry into the political thicket by the court has had its risks. In any event, it would be unwise to think that the Burger court's apparent retreat from "political questions" is an indication they are any less willing to experiment with their vast powers.

THE BURGER COURT EXPERIMENTS WITH STATE'S RIGHTS AND MAJORITARIANISM

The Burger court is engaged in another social engineering experiment. They are seeking to return power to the states and their local instrumentalities. An underlying theme of this article is that in order to accomplish this "states rights-majoritarian" objective the Burger court is placing new limits on "equal protection before the law" and the "privileges and immunities of the citizens." They do so under the guise of limiting the court's legislative activity, under the separation of powers concept, and under the cloak of "dual supremacy" and their resulting deferral to states' rights.

It seems the majority on the Supreme Court would prefer the bygone years when less than a half-dozen zoning cases had reached the high court in our first 175 years. The attitude seems to be that the states' courts should be able to handle these problems. In order for this to be a reasonable possibility the

state courts must feel free to apply the principles of judicial review to the legislative actions of municipalities enacting land use controls. Yet, since 1926 in the most famous of zoning cases, *Euclid v. Ambler Realty Co.*,[15] the U.S. Supreme Court has held to the doctrine of "presumptive validity." Under this rule of law, landowners, developers, Realtors, citizens, etc. were given the burden of proving that the ordinance was a violation of the police powers, so the tendency since *Euclid* has been for courts to feel constrained to hold the municipal zoning action a valid exercise of the state's police power under the enabling act. It takes a courageous court to take the action of the Oregon Supreme Court in the case of *Fasano v. Board of County Commissioners of Washington County.*[16] This case involved a challenge to the approval by the county commissioners of a zone change from single-family residential to "planned residential" which would allow mobile home parks. Nationwide, mobile homes now constitute 85% of the new single-family housing units selling for less than $25,000. The Oregon Supreme Court rejected the "presumption of validity" and ruled that the zoning board (county commissioners) had acted in a judicial manner rather than in the performance of their legislative function. The court established some important principles of judicial review which have drawn national attention:

1) The power to zone is conditioned on the comprehensive plan; therefore, any change in zoning must be shown to be in accord with the comprehensive plan. In making such a showing, it must be proved that:
   a) There is a public need for the change;
   b) Such a need is served by changing the zone of the particular property in question rather than other available property.
2) The burden of proof is on the party seeking the change, since it involves an exercise of judicial authority. The greater the change the more clearly it must be shown that it is in accordance with the comprehensive plan, that there is such a need for change, and that such need will best be met by the change.

Thus the court sought to extend the greater due process safeguards accorded to judicial proceedings, in spite of the fact it could result in delaying developments and would increase development costs through front-end litigation costs and imputed interest costs resulting from the delay. It is interesting to note that the court said,

> ". . . having weighed the dangers of making desirable changes more difficult against the dangers of the almost irresistible pressures that can be asserted by private economic interests on local government, we believe that the latter dangers are to be more feared."

Our nation's experience with the uses and abuses of the local use of the police power over the past one hundred years does suggest that we should proceed with caution and hesitate to give favorable judgment to acts of our local governments.

YICK WO AND THE LOCAL FOLKS

In 1886 some Chinese laundrymen revealed to us that the "local folks" do work in ingenious ways their discrimination to perform. In the famous case of *Yick Wo v. Hopkins,*[17] a statute provided that laundries in wooden buildings

(as distinguished from brick or stone) could not be carried on without a license. The classification itself appeared impartial and reasonable, but *in application* the licensing authority consistently refused licenses to Chinese applicants while granting licenses to non-Chinese applicants. Such an application of the statute (in the court's words), ". . . with an evil eye and unequal hand . . ." was held violative of the equal protection clause of our 14th Amendment. Note, however, the repetition of the difficulty of facing high economic costs of litigation. "A discriminatory purpose on the part of the building inspectors will *not* be presumed. The party challenging the application (or administration) must plead and prove clear and intentional discrimination."

It is possible that we have "old wine in new bottles." Urban officials who are pressing for urban growth management plans such as Petaluma, Ramapo, and Boulder may have discovered an apparently new way to exclude certain classes of persons who would be unwelcome in the area according to the lights of those who have the "gatekeeper function." It appears certain we will face tests of these new "growth management plans" which are constitutional, on their face, but are possibly being *administered* in a discriminatory manner.

LOCAL RULES CAUSE UNCERTAINTY AND DEVELOPMENT RISK

It should be obvious that we appear to be heading into a period where much uncertainty is being added to the already risky business of urban land development. Current conditions in the housing and land development industry are such that some see a depressed industry for many years. However, it would be a mistake to assume that real estate development will return to its former preeminence when and if its problems are solved. Recent developments in various widely separated urban areas such as Ramapo, Petaluma, and Boulder have had the cumulative effect of extending the lead time for a relatively simple, conventionally financed project from a few months to two or more years, with a commensurate increase in holding costs and in financial exposure during the planning period. The vesting of the zoning power in even the smallest municipality has resulted in widespread "shopping" by land developers. Now the adherents to the no-growth philosophy have upped the ante, and in some cases simply withdrawn their land from the bidding process, thus placing greater pressure on other land within their metropolitan areas. They do so through the use of highly sophisticated talents to maneuver and resist the normal patterns of growth of the metropolitan area of which they are part and parcel.

Though developers have been aggressive in attempting to satisfy market needs in communities reluctant to cooperate, the growing sophistication of these communities in using legal strategems to erect legal barriers to growth may stultify growth in metropolitan areas where it is most needed (those smaller than, say, Philadelphia). The skill with which these communities may be thwarting the normal migration patterns of a growing metropolitan area are

perhaps best characterized by the developer's experience in *National Land and Investment Co. v. Kohn.*[18] In that case the highest court of Pennsylvania struck down a four-acre minimum lot requirement in an undeveloped area as an invalid zoning without reasonable relation to the general welfare. Yet, when the developer returned to Easttown (the city with four-acre restriction) to offer a plan for development, he was informed that the new minimum was 3.9 acres and the community was ready to litigate again. Planning for the front-end costs of such vexatious litigation and adding the holding costs of the vacant land pending the end of such litigation is not economically feasible. Yet, these developers are not simply profit-motivated, they are trying to fulfill an actual need as our population grows in our standard metropolitan statistical areas (SMSAs).

Boulder, Colorado—City of the Future?

This city is famous for its repeated attempts to enact an ordinance which would prohibit population growth. As a proponent of the "no growth is good" philosophy it continues to find ways to inhibit growth through the use of the judicial, legislative, and administrative process. A case in point is *Lawrence B. Robinson, et al. v. City of Boulder.*[19] In June 1965 the city promulgated a "Program for Boulder's Planned Development" which directed the administrators of the city to use the city's water and sewer services to provide for orderly development of the city's fringe area. The city does not have the present capacity to serve all of the "service area" within its area of franchise. The city had the right to provide the water and sewage service to the land owned by Robinson, a developer. Robinson made application to the city requesting that the city extend water and sewage service, but Robinson was denied it. The request of Robinson was denied because the land development proposal was deemed to be not in compliance with Boulder's Interim Growth Policy. Development of Robinson's land was not planned, by public administrators, until the year 1990. Unfortunately, Boulder's Interim Growth Policy was *not* a model of free and open disclosure. In the words of the City of Boulder Growth Study Commission, November 1973:

> "The city of Boulder's current growth and development policies seem to be scattered in several places: part in the Boulder Valley comprehensive plan, part in planning procedures and regulations, part in ordinances, and *part in the minds of various city and county officials.* The effects of the combined policies and other forces at work are exclusionary, despite the city's willingness to assume its allocated share of the Denver region's low-income housing. A court test of the policies could easily rest on their exclusionary effects, rather than their unexpressed intent, however enlightened from a planning viewpoint."

The court held that in an area of established service (the neighborhood Gun Barrel Hill) the city has a duty to serve all persons within the area.

Thus Robinson, *a developer who apparently could afford the costs of litigation*, was able to obtain social justice in the face of Boulder's abuse of their utility franchise powers. The court took up some constitutional issues which aren't discussed here. It also found that the city's denial of service, until after

the year 1990, constitutes an unreasonable restriction on the use of the subject property and violates the due process clauses of the United States and Colorado Constitutions.

It is important to this article to emphasize that the nature of our adversary legal system is such that though Robinson got his permit approved it is possible there are other applicants to the Boulder water and sewage system who may be denied. This is because in spite of the clearly stated opinion of the court, Boulder has the power to force each specific case to litigate to establish their individual rights. This is the main thrust of the *Yick Wo v. Hopkins* case, mentioned previously. It is unconstitutional to administer regulations in such a way as to ignore the rule of law. Yet our adversary system of justice requires the aggrieved to have the wherewithal to pay the price of access to the courts. The system is in need of innovation.

City of Petaluma, California—Planning the Future?

The city of Petaluma's growth control policy sets forth certain fundamental policies among which are that the city adopt the following:

1) Petaluma Environmental Design Plan
2) Residential Development Evaluation system
3) Petaluma Housing Element
4) Official Statement of Development Policy

It is not possible within the space limitations of this article to provide sufficient detail of this elaborate plan. Without unduly speculating on the powers of discretion it should be clear that the possibility that the Petaluma plan's administration may be functioning as a gatekeeper for excluding "inharmonious" neighbors while welcoming with open arms fast-food operations and inharmonious industry, causes one to question whether there is a proper motive behind the limitation on residential use. Over time, communities such as Petaluma will probably build the record for another *Yick Wo* case by their haphazard management of the industrial and commercial sector, or by repeated denial of welfare motivated builders who want to construct low or low moderate-income housing.

The Town of Ramapo, New York—Legerdermain Replaces Candor

The most sophisticated controlled growth technique that has emerged is sequential development controls or development timing (SDCDT). This system adds the dimension of time to the spatial controls associated with zoning.

Some critics of this carefully drafted ordinance have contended it is fiscal zoning dressed in environmental clothing. Certainly, it is a masterpiece of forensic land planning.

The key element is that the point system created by the ordinance devolves upon the administrator's ministerial functions which could be an unconstitutional delegation of authority. It appears that they may have the power to

actually decide land use over time. Further, the entire plan is hinged on an 18-year capital improvements program. What is to prevent a slowdown or stoppage in the capital improvements program during this 18 years, or the switching around of the priority of capital improvements in ways that adversely affect certain developers while benefiting others? What is to prevent the creation and use of a capital improvements program which is so vague and general in its description as to make it possible for the administrators to do whatever they wish to do without public disclosure?

As a person who drafted capital improvements programs for a six-year period, aware of the capricious and political way we switched priorities from year to year to meet the wishes of changing elected officials, I am suspicious of the "realism" of this "scientific" sequential development control system. Perhaps the words of the Court of Appeals of New York have a prophetic tone, for I feel the American *process* of judicial review in regard to these sophisticated growth management plans is not completed. The Court of Appeals of New York said, in its Town of Ramapo decision:[20]

> ". . . What we will not countenance, then, *under any guise* is community efforts at immunization or exclusion . . . while even the best of plans may not always be realized, *in the absence of proof to the contrary* we must assume the Town will put its best effort forward in implementing the physical and fiscal timetable outlined under the plans.

Obviously, if they are *not* putting their best efforts forward then towns like Ramapo, Petaluma, and Boulder will find the administration of their managed growth plans won't wash clean in the *Yick Wo* laundry.

The problem is that this is not 1886; as Alvin Toffler has so eloquently set forth in his treatise, *Future Shock,* the pace of change is much faster today and it implodes upon us. It is quite possible that our modern electronic media, which spread the news so fast, will also sharpen the impatience of our lower and lower-middle classes. A not too fanciful flight of imagination causes this writer to see a scenario which could shake my firm beliefs in the ideals of our democratic representative republic. This scenario arises out of another trend of the Burger court which has some disquieting possibilities.

REFERENDUMS—THE THREAT OF RAMPANT PLURALISM?

The focus of our attention is the increased interest which the Burger court has shown in the popular referendum. Burger and his fellow "majoritarians" seem to believe in the benefits of direct governance far more than did our founding fathers. James Madison, one of the authors of the U.S. Constitution, warned against the devastating effect, especially in democracies, of inflaming mankind with mutual and ruinous animosity over matters of religious beliefs, political and civil rights, and political philosophy.[21] Because of this natural political readiness to love and to hate, Madison sought to mute and moderate these age-old kinds of political behavior by setting up a representative democratic republic in which coalitions of a "multiplicity of interests" would vie with each other to form the dynamic majority. Thus the

United States founded a novel system on the basis of a tranquil, modern politics of interest groups as distinct from a politics of class struggle. It is a grand plan which has worked surprisingly well. The durability of the American experiment during this century of ideological despotisms, wars, and demagogic leaders, is a testament to Madison's prudence. It is suggested that the Burger court is tampering with this foundation in their approach to the referendum.

Referendum in San Jose—James v. Valtierra[22]

In the early 1970s citizens of San Jose, California, and San Mateo County, localities where housing authorities could *not* apply for federal funds to provide low-rent housing, poverty citizens sought to test the constitutionality of a public referendum which had defeated the intentions of elected and appointed officials to apply for such aid to house urban "poor housing deficit families."

Since 1950, California has had a constitutional amendment (Article XXXIV) which requires a mandatory referendum for *all* low-income public housing projects. The article provides that no low-income housing project should be developed, constructed, or acquired in any manner by a state public body until the project is approved by a majority of those voting at the specific community's election. The citizen plaintiffs argued that the mandatory nature of the Article XXXIV referendum constituted unconstitutional discrimination because it hampers persons such as the plaintiffs who were eligible and desiring (needing?) public housing from achieving their objective, while no such roadblock faces other groups seeking to influence other public decisions to their advantage.

The majority of the court found the California Article XXXIV mandatory referendum constitutional. The article requires referendum approval for any low-rent public housing project, not only for the projects which will be occupied by a racial minority. According to the court, the record here would not support any claim that a *law seemingly neutral on its face* is in fact aimed at a racial minority.

Marshall in strongly worded dissent found that the mandatory referendum applied solely to people of low income, for XXXIV reads:

> ". . . any development composed of urban or rural dwellings, apartments or other living accommodations *for persons of low income*, financed in whole or in part by the federal government . . ."

Persons of low income are defined as:

> ". . . persons or families who lack the amount of income which is necessary . . . to enable the person, without financial assistance, to live in decent, safe, and sanitary dwellings, without overcrowding."

Article XXXIV of the California Constitution explicitly singles out low-income persons to bear its risk of losing the vote. *Publicly assisted housing developments to accommodate the aged, veterans, state employees, persons of moderate income, or any other class of citizens other than the poor,* need *not* be approved by referendum.

In a previous decision, *Douglas v. California*,[23] the court had stated, "The states, of course, are prohibited by the Equal Protection Clause from discriminating between 'rich' and 'poor' *as such* in the formulation and application of their laws."[24]

It is obvious that Marshall's dissent made clear that the court chose to subject Article XXXIV to no scrutiny whatsoever. Rather than overrule or explicitly limit the cases of the earlier court, which Marshall calls to our attention, the Burger court chose to avoid arousing the communication media by ignoring this tacit but major change in direction of our nation.

Thus the California suburbs may, if they wish, vote to exclude the domestics, sanitary workers, street sweepers, busboys, dishwashers, and other working poor that are essential to the efficient working of a metropolitan area.

Another Case for Majoritarianism: The Eastlake Referendum—Zoning Changes by the People

The Burger court has recently extended its adventure into what it sees as "popular democracy." In the *City of Eastlake v. Forest City Enterprises* (1976)[25] Chief Justice Burger delivered the 6-3 majority opinion. He was joined by Stewart, White, Rehnquist, Blackmun, and Marshall.

In this case the plaintiff acquired an eight-acre parcel of real estate in Eastlake zoned "light industrial" at the time of purchase. Meanwhile, the Eastlake city charter was amended to provide that any changes in land use agreed to by city council required a 55% approval by referendum.

Forest City Enterprises then picked up the burden of litigation costs and sought a judgment declaring the city charter provision an invalid and unconstitutional delegation of legislative power to the people. *While awaiting adjudication of the question*, Eastlake citizens voted to reject the proposed zoning change. The lower courts sustained the city charter provision. The expenses of litigation mounted as Forest City sought the opinion of the Ohio Supreme Court. Ohio's highest court ruled that the enactment of zoning and rezoning provisions is a legislative function (see *contra* the *Fasano* rule!) and that a popular referendum lacks standards to guide the voters *thus permitting the police power to be exercised in a standardless, arbitrary, and capricious manner*. In rendering the opinion the Ohio court relied on *Seattle Trust v. Roberge*.[26] The Burger court distinguished this case. In effect, a neighborhood has no reserved power to make legislative decisions but the people can, and in Ohio have, *reserved* to themselves the power to deal directly with matters which might otherwise be assigned to the legislature. The Burger court then lapsed into sonority, which the dissent felt obfuscated the primary issue:

> "The reservation of such power is the basis for the town meeting, a tradition which continues to this day in some states as both a practical and symbolic part of our democratic processes. The referendum, similarly, is a means for direct political participation, allowing the people the final decision, amounting to a veto power over enactments of representative bodies. The practice is designed to 'give citizens a voice on questions of public policy.'"

It should not surprise the reader that Burger then cited *James v. Valtierra*, the San Jose public housing referendum case. On the above basis the court held that the 14th Amendment had not been violated and overruled the Ohio Supreme Court.

Justice Stevens, joined by Brennan in dissent, supported the *Fasano* view that rezoning is an exercise of judicial authority and its propriety is subject to an altogether different test than the legislative act (see the *Fasano* discussion supra). Thus the majority of the Burger court has failed to hold that the rezoning decision is quasi-judicial in nature. They have totally ignored the rulings of a number of states. Due process procedures of judicial review are constitutional safeguards of our individual rights. The city of Eastlake avoided them by this "reservation of power to the people" according to the Burger majority.

In this modern world of rapid technological change we need the safe-guards against "majority rule" which Madison and our other founding fathers built into our representative republic. The actions of elected legislators and judges are subject to public review and scrutiny which guards against ignorance, fear, and prejudice. In the past, zoning laws made tallow-rendering plants and junk yards "prohibited uses" because of their potential to creat a nuisance. Modern technology, site design, and landscaping have made these essential urban uses tolerable to the point they can now be regulated rather than prohibited.

Today, genetic engineering presents us with the possibility of great benefits and threatens us with fearful catastrophe through the possibility of escape of redesigned bacteria which could be lethal. Cambridge, Massachusetts, demonstrated that an elected city council can deal with the very real problem of permitting a regulated genetic engineering laboratory in one local community. The Burger court's dabbling in land use referendums has made it possible for "the people" to prohibit uses such as genetic engineering (tallow-rendering plants and junk yards) in any local community with the sort of broad powers which exist in some of our states' enabling acts.

The next comment is a suggestion which arises out of intuitive reaction to the developing trend indicated by *Valtierra* and *Eastlake*. These cases have caused me to fear the ghost of *Reitman v. Mulkey*,[27] a popular referendum case which the Warren court laid to rest in 1967.

Reitman's "Private" Right to Racial Discrimination

In *Reitman*, Justice White wrote the opinion for a 5-4 majority consisting of himself, Fortas, Brennan, and Warren, with Douglas concurring. The dissent was written by Harlan, with the concurrence of Black, Clark, and Stewart. This case concerned the question of whether or not Article I-26 of the California Constitution (commonly known as Proposition 14), an initiative amendment, was a denial of "equal protection before the laws" within the 14th Amendment of the U.S. Constitution. This peoples' referendum, if constitutional, would have effectively repealed acts of the California legislature designed to prohibit discrimination in housing. As the California Supreme Court stated when it ruled Proposition 14 unconstitutional:

". . . its immediate design and intent was to overturn state laws that bore on the right of private sellers and lessors to discriminate (the Unruh and Rumford Acts) and 'to forestall future state action that might circumscribe this right. . . . It would establish a purported constitutional right to privately discriminate on grounds which admittedly would be unavailable under the 14th Amendment should state action be involved.'"

The U.S. Supreme Court upheld the California high court on the following reasoning:

"Section 26 (Proposition 14) was said to have changed the situation from one in which discrimination was restricted 'to one wherein it is *encouraged* within the meaning of cited decisions. In effect the new constitutional amendment was legislative action (albeit by the people) which authorized private discrimination' and made the state 'at least a partner in the instant act of discrimination . . .'"

The main reason for resurrecting this case is the dissent in which Justice Stewart concurred. The dissenting opinion said,

"(We) are . . . at a loss to understand how this . . . change in California's Constitution can be a violation of the 14th Amendment; thus rendering void a (private person's) refusal to rent to the (black plaintiffs) because of their race. The Equal Protection Clause which forbids the State to use its authority to foster discrimination based on such factors as race (citations omitted) does not undertake to control purely personal prejudices and predilections, and individuals acting on their own are left free to discriminate on racial grounds if they are so minded.

". . . The denial of equal protection emerges only from the conclusion reached by the Court that the implementation of a new policy of *governmental neutrality* embodied in the new constitutional provision, and replacing a former policy of anti-discrimination, has the effect of lending *encouragement* to those who wish to discriminate . . .

". . . When legislation in this field (discrimination) is unsuccessful there should be wide opportunities for legislative amendment, *as well as for change through such processes as the popular initiative and referendum.* This decision, (we) fear, inhibits flexibility." (italics supplied)

Keeping in mind that the Burger court upheld the popular referendum in the *Valtierra* case, in part because the *law was seemingly neutral on its face*, we can see that, the composition of the court having changed, there is broader support today for the views which were expressed by Stewart and Harlan in dissent.

It appears quite possible that if a state such as California were to pass a constitutional amendment today by popular referendum, such as Proposition 14, repealing all the anti-discrimination statutes relating to housing, the Burger court would find the legislative action of the people simply a retreat to neutrality.

This position is given even more credibility when one is aware that in 1971 the case of *Palmer v. Thompson*[28] declared that the court of Nixon appointees found there was *no official encouragement* of discrimination through the legislative act of closing the public swimming pools in a Mississippi town; and that

inasmuch as both black and white citizens were deprived of use of the pools there was no unlawful discrimination. Justices White, Brennan, and Marshall dissented, arguing that this was state action which penalized Negroes for asserting their rights.

HUMAN RIGHTS—THE NEED FOR STATESMANSHIP

It is hoped the day never comes that we go full circle on *Reitman v. Mulkey*. This nation has learned much since the passage of the Civil Rights Act of 1968 and the death of Martin Luther King, Jr. Both *Jones v. Mayer* and the 1968 act have had elevating influence on the Codes of Ethics of the various Realtor organizations.

It is public knowledge that Realtors were one of the prime moving forces behind the passage of Proposition 14 in California. Certainly, the language of the amendment is seductive in its appeal to the ancient concept of the fee simple absolute and the right of a man to do as he wants with his property. But, in a day of rising Black Africa, at a time when a developing third world is in a position to do us great harm (OPEC, Jamaica bauxite, etc.), when serious racial strife is rending South Africa apart, and when the Helsinki Accord on Basic Human Rights is used by U.S.A. in diplomacy, I am confident that Realtors would see the great public service involved in lending opposition to a revival of the "right to private discrimination." Otherwise, we as a nation would not really stand for human rights in the world's eye.

NEW JERSEY POINTS THE RIGHT WAY

Though this writer has made it obvious that he feels we are ill-advised to leave land use regulations in the hands of the U.S. Supreme Court, I still have hope that we will straighten out the confusion caused by the court in recent years.

I believe New Jersey is leading the way with its opinions which are called, for convenience, the *Mt. Laurel Cases*. Unfortunately, to date they apply only to the state of New Jersey.[29]

In a lengthy opinion both expanding and modifying its Mt. Laurel rule the New Jersey Supreme Court in January 1977 ruled that another "developing municipality's" zoning ordinance was invalid because it was exclusionary. The court remanded the case to the trial court with directions that the court should demarcate specific boundaries of a pertinent region (the housing market), and fix a specific number of low and lower-moderate income housing units as the "fair share" of the regional housing needs to be made possible by ordering a change in the "developing municipality's" ordinance.

The court adopted a standard of "least cost" unsubsidized housing, zoning for which would be necessary in these "developing municipalities." These municipalities must encourage the production of multi-bedroom units on small lots. The court specified revisions of these various ordinances in the developing communities: 1) allocate substantial areas for single-family dwellings on very small lots; 2) substantially enlarge areas available for multi-family dwellings; 3) substantially enlarge medium-size lots; 4) reduce the area

occupied by large lots; 5) modify restrictions in PUDs which generate costs to discourage the production of apartments with two or more bedrooms; 6) modify PUD regulations to eliminate undue costs; 7) modify PUD regulations to eliminate excessive road and utility costs; 8) generally eliminate and reduce undue cost-generating restrictions in those zones allocated for "least cost" housing. The court also noted that these "developing municipalities" must provide a "cushion" in land reserved for "least cost" housing to assure results in terms of actual production. The wisdom of these regulations is more apparent to Realtors than to lawyers.

This extraordinary opinion by the New Jersey Supreme Court demonstrates a very sophisticated knowledge of housing economics, something that is not common knowledge, as many REITs and banks can now attest. The Mt. Laurel Case opinion itself as written by Justice Hall should go down in history as one of those rare occasions when the law found a man who understood economics.

> "The record thoroughly substantiates the findings of the court that over the years Mount Laurel has acted affirmatively to control development and to attract a selective type of growth . . . There cannot be the slightest doubt that the reason for this course of conduct has been to keep down local taxes on *property* (Mount Laurel is not a high tax municipality) and that the policy was carried out without regard for non-fiscal considerations with respect to people, either within or without its boundaries. . . . Large families who cannot afford to buy large houses and must live in cheaper rental accommodations are definitely not wanted so we find drastic bedroom restrictions for, or complete prohibition of, multi-family or other feasible housing for those of lesser income.
>
> "This pattern of land use regulation has been adopted for the same purpose in developing municipality after developing municipality. One incongruous result is the picture of developing municipalities rendering it impossible for lower paid employees of industries they have eagerly sought and welcomed with open arms (and, in Mount Laurel's case, even some of its own lower paid municipal employees) to live in the community where they work.
>
> "Core cities were originally the location of most commerce and industry. Many of those facilities furnished employment for the unskilled and semi-skilled. These employees lived relatively near their work, so sections of cities always have housed the majority of people of low and moderate income, generally in old and deteriorating housing.
>
> "The situation has become exactly the opposite since the end of World War II. Much industry and retail business, and even the professions, have left the city; Camden is a typical example. The testimonial and documentary evidence in this case as to what has happened to that city is depressing indeed. For various reasons, it lost thousands of jobs between 1950 and 1970, including more than half of its manufacturing jobs (a reduction from 43,267 to 20,671, while all jobs in the entire area labor market increased from 94,507 to 197,037). A large segment of retail business faded away with the erection of large suburban shopping centers. The economically better situated city residents helped fill up the miles of sprawling new housing developments, not fully served by public transit. In a society which came to depend more and more on expensive individual motor vehicles, transportation for all purposes, low-income employees very frequently could not afford to reach outlying places of suitable employment and they

certainly could not afford the permissible housing near such locations. This category of city dwellers desperately needs much better housing and living conditions than is available to them now, both in a rehabilitated city and in outlying municipalities. They make up, along with the other classes of persons earlier mentioned who also cannot afford the only generally permitted housing in the developing municipalities, the acknowledged great demand for low and moderate-income housing.

"The legal question before us, as earlier indicated, is whether a developing municipality like Mount Laurel may validly, by a system of land use regulation, make it physically and economically impossible to provide low and moderate-income housing in the municipality for the various categories of persons who need and want it and thereby, as Mount Laurel has, exclude such people from living within its confines because of the limited extent of their income and resources. Necessarily implicated are the broader questions of the right of such municipalities to limit the kinds of available housing and of any obligation to make possible a variety and choice of types of living accommodations.

"We conclude that every such municipality must, by its land use regulations, presumptively make realistically possible an appropriate variety and choice of housing. More specifically, presumptively, it cannot foreclose the opportunity of the classes of people mentioned for low and moderate-income housing and in its regulations must affirmatively afford that opportunity at least to the extent of the municipality's fair share of the present and prospective regional need therefor. These obligations must be met unless the particular municipality can sustain the heavy burden of demonstrating peculiar circumstances which dictate that it should not be required so to do.

"We reach this conclusion under state law and so do not find it necessary to consider federal constitutional grounds urged by plaintiffs."

His able statement of the growth of our urban problems after World War II and the salient reasons why the Mt. Laurels of America must be called to task is actually a call to action for the entire country.

Leaders of the real estate industry could do a great service for the country by seeking the national adoption of legislation which would carry the obligations of the developing municipality to every metropolitan area in our several states. This could be attempted at the federal level through congressional land use policy acts such as the Air and Water Quality Control Acts under the commerce power or by way of pressing for the adoption of a properly drafted uniform state law such as was done with the Uniform Commercial Code. As a real estate professor, trained in the law, my final word is "don't leave it to the lawyers;" few of them understand urban economics and the economics of land use and development as well as real estate professionals. The problems of how land "ought" to be used in an open society will never end; they shouldn't because the conflicts are a necessary product of our diverse personalities. But we must remember that zoning is for orderly land use, not for denying the future.

REFERENCES

1. Housing-deficit families are defined as those families and households who live in dwelling units which are so deteriorated as to be rated physically inadequate, so overcrowded as to be unacceptable by community standards, or so financially burdensome as to have an adverse affect on nutrition, health, or employment, i.e., by depriving the occupants of money for transportation to work.
2. 94 Sup. Ct. 1536 (1974).
3. *City of Des Plaines v. Trottner*, 216 N.E. 2d 116 (1966).
4. See generally, *Kirsch Holding Co. v. Borough of Manasquan*, 59 N.S. 241, 281 A. 2d 513 (1971); "Comment: All in the Family, Legal Problems of Communes," 7 *Harv. Civ. Rights—Civ. Lib. L. Rev.* 393 (1972).
5. "Readers Report," *Business Week*, February 14, 1977, p. 7. (It is fortunate the article was not in the *Reader's Digest* which permits no letters to the editor to correct its errors.)
6. Anthony Downs, *The Urban Poor*, rev., CED Pamphlet No. 26 (New York, New York: 1971).
7. Edward Banfield, *Unheavenly City Revisited* (Boston: Little Brown, 1973).
8. *Gautreaux et al. v. Chicago Housing Authority and HUD*, 503 F. 2d 903 (1974).
9. *Hills (HUD) v. Gautreaux*, 96 Sec. 1538 (1976).
10. *Cosmopolitan National Bank of Chicago v. Village of Mt. Prospect*, 177 N.E. 2d 365 (1961) and *Seith v. Wheaton*, 232 N.E. 2d 173 (1967).
11. *Du Page County v. Halkier*, N.E. 2d 635 (1953); *LaSalle National Bank v. City of Highland Park*, 189 N.E. 2d 302 (1963).
12. *LaSalle National Bank v. Village of Skokie*, 186 N.E. 2d 46 (1962); see also *Kaweien v. Village of Dolton*, 234 N.E. 2d 137 (1968).
13. *MHDC v. Village of Arlington Heights*, 373 F. Supp. 208 (1974).
14. *Baker v. Carr*, 369 U.S. 186 (1962).
15. *Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1962).
16. *Fasano v. Board of County Commissioners, Washington County*, 507 P. 2d 23 (1973).
17. *Yick Wo v. Hopkins*, 118 U.S. 356 (1886).
18. *National Land and Investment Co. v. Kohn*, 419 Pa. 504, 215 A. 2d 597 (1965).
19. *Laurence B. Robinson et al. v. City of Boulder*, No. 72-2033-1, May 20, 1974.
20. *Ruth Golden et al. v. Planning Board of the Town of Ramapo* and *Rockland County Builders Association v. John McAlevey*, 30 N.Y. 2d 359 (1972).
21. Martin Diamond, "The American Idea of Man," *"The Americans* (Lexington, Mass.: Lexington Books, 1976) pp. 1-23; see also James Madison, *Federalist* 51.
22. *James v. Valtierra*, 91 Sup. Ct. 1331 (1971).
23. *Douglas v. California*, 83 Sup. Ct. 814 (1963).
24. *McDonald v. Board of Election Commissioners*, 89 Sup. Ct. 140 (1969); *Harper v. Virginia Baord of Elections*, 89 Sup. Ct. 1079 (1966) and Douglas *supra*.
25. *City of Eastlake v. Forest City Enterprises*, No. 74-1563, June 21, 1976; see also 324 N.E. 2d 740.
26. *Washington, Seattle Title and Trust Co. v. Roberge*, 278 U.S. 116.
27. *Reitman v. Mulkey*, 87 Sup. Ct. 1627 (1967); see also *Mulkey v. Reitman*, 413 P. 2d 825.
28. *Palmer v. Thompson*, 403 U.S. 217 (1971).
29. There are a number of citations possible. These should suffice: *So. Burlington Cty. NAACP v. Mt. Laurel* 67 N.J. 151 cert. den 423 U.S. 803 (1975) and Oakwood at *Madison v. Twp. of Madison* (Now Old Bridge) A-80/81 Sept. 1975, opinion Jan. 26, 1977. See also Jerome G. Rose and Melvin R. Levin, "What is a Developing Municipality?" *Real Estate Law Journal* (Spring 1976).

Limits of Democratic Participation in Property Management

by William D. Sally

Some degree of participation by residents in the management of multi-family housing is now a fact of life. Such participation is most evident in the community associations which govern condominiums and similar multi-owner properties, but it is also found in many residential rental properties.

How far should resident participation extend? In community associations, should residents be involved in every decision or at least consulted before the governing board of directors acts? And in rental housing should the owner, developer, or managing agent seek tenant consensus before enacting policies?

Just as a pure democracy has its practical limitations, so does resident participation in housing management. Too much is time-consuming, costly, and often leads to standoffs and hard feelings. It amounts to an abrogation of an owner's rights to his property.

This discussion will consider the limits of resident participation—first in the case of condominium property, then for rental housing.

CONDOMINIUM HOUSING

Promoted as a carefree way of living, condominiums are also marketed to the public as a democratic community way of life. Owners automatically belong to the community association which operates the property. The number of associations has grown phenomenally, from 500 in 1962 to some 22,000 in 1977.

To acquaint these groups with their role, scores of booklets and manuals have been published. Two of the most recent and comprehensive, issued by the Urban Land Institute (ULI) and the Community Associations Institute, Washington, D.C., are *Creating a Community Association: The Developer's Role in Condominium Homeowners Associations* (1976) and *Financial Management of Condominiums and Homeowners Associations* (1975).

William D. Sally, CPM, is vice president and general manager of the property management division of Baird & Warner, Inc., Chicago, and a trustee of Baird & Warner Realty and Mortgage Investors, a REIT. A licensed real estate and insurance broker, Sally is past chairman of the Property Management Council of the Chicago Real Estate Board, charter member of the Management Advisory Council of the National Housing Partnerships, Washington, D.C., and president of the Community Associations Institute, Washington, D.C.

Community Association Role

The task of governing the condominium or community association is given to the board of directors, whose action or inaction determines the scope and character of resident participation. The legal powers of these bodies are by now well established; the most recent discussion of their powers can be found in volume six of *Real Estate Transactions,* written by Patrick J. Rohan, professor of law at St. John's University Law School, and published in 1977 by Matthew Bender & Co., Albany, New York.

In 1973, many community associations were not fulfilling their functions satisfactorily, according to a ULI report entitled *Townhouses and Condominiums: Residents' Likes and Dislikes.* Surveying 49 projects in the Washington, D.C., area and California, ULI found that only 39% of residents rated the organization and operation of their condominium or homeowners association as "good"; a "fair" rating was given by 42%, and 19% called them "poor."

Among the conclusions reached by ULI was that "there is great dissatisfaction with the way associations are run and their lack of accomplishment. In fact, some residents are so dissatisfied they move out to get away."

Limits to Resident Participation

Personal observation and the comments of colleagues lead this writer to conclude that community associations are often lacking in performance because they tend to overinvolve residents in decision-making.

As a result of promotional campaigns extolling condominium and association living as a democratic way of life, many condominium owners believe they will be involved in all condominium decisions, a notion that many associations do not discourage. Owners expecting to be consulted may be upset or irate if they are not. They may bridle at unpopular decisions, and become gadflies and obstructionists.

Although most boards are empowered to act without consulting residents at large, many board members feel that the concept of the community associations requires resident participation. But too much participation can lead to the board's abdication of its responsibilities.

In the practical sense, resident participation is limited by two factors. First, the majority of condominium owners are content to live privately and "let George do it." As long as they are pleased with their own unit, discover no upsetting problems affecting the common areas, such as poor maintenance or lax enforcement of rules, and enjoy reasonable assessments, they are seldom heard from. Among those who are unhappy with the state of affairs, some may prefer to sell and move, rather than attempt to affect changes.

Second, the declaration and bylaws are usually quite practical in establishing the board's decision-making procedures as well as resident voting. Most declaration drafters are well aware of the perils of 100% democracy, and their documents usually leave matters to the will of the majority, typically 51%. Declarations and bylaws may be amended, but we know of none that require a unanimous vote before action can be taken.

Given these several and often opposing forces—the board's legal responsibilities, the desire to involve residents, and the practical limitations of widespread participation—what can the board do to act responsibly without turning every board gathering into a town meeting?

Communications

Communications comprise the first step—meetings, special notices, and newsletters to inform owners of the association's activities. Lack of communication breeds misinformation and rumors. Board members must realize that their business is the association's business, which every member is entitled to know. Boards that ignore this principle may find themselves confronted with dissident groups who can thwart the association's operations by various means, including lawsuits.

Committees

Appointment of a reasonable number of appropriate committees—concerning, for example, maintenance, budget, architectural, and social concerns—is the next step. Residents should be named to these groups—which provide good training grounds for future board members—on the basis of interest and ability.

Two warnings are appropriate: 1) Committees should be primarily advisory. The board cannot safely delegate its policy-making functions to committees of residents. On the other hand, committee formation is meaningless and committee members are insulted if the board will not listen to and act on their advice; 2) the number of committees should be kept to a practical minimum, and not inflated simply to get more owners into the act. For example, laundry room, swimming pool, and playground committees are often useless groups; their purpose is limited, and membership can lead to a sense of frustration.

Provinces of the Board

As the third step, the board must be firm in recognizing and acting on matters which are clearly within its province, realizing that community consensus is not always necessary. If the board wants a community vote on everything, it should declare a pure democracy and go out of business.

The following are tasks which the board—as representatives of the community—should handle by itself:

1) Establish the budget.
2) Hire and fire operating and maintenance personnel (unless this is done by the managing agent).
3) Select vendors, accountants, and attorneys.
4) Pick the insurance carrier.
5) Determine the landscaping motif.
6) Arrange for decorating and furnishing of common areas.
7) Arrange for building repairs.
8) Call in the exterminator.
9) Set refuse pick-up times.

10) Regulate parking.
11) Limit children's use of elevators.
12) Decide how hospitality rooms are to be reserved.
13) Make rules for bicycles and buggy parking.
14) Handle deliveries.
15) Regulate front door parking times.

The board should not vacillate in its responsibilities. How effectively it acts depends on its strength or weakness. A strong board that functions responsibly can make a major contribution to the association. A weak board that postpones action or acts indecisively is promoting owner disaffection.

Consensus Issues

The fourth and final step requires the board's alertness on issues requiring a consensus, or at least an expression of opinion by the owners at large. These issues typically concern matters affecting the pocketbook or behavior of the owners in a significant way, and may, in fact, involve a change in factors which led them to buy the condominium in the first place.

Examples of such issues are the following:

1) *A change in pet rules.* This can be an explosive issue, considering the very strong feelings harbored by pet-lovers and pet-haters alike.
2) *Unit maintenance.* Normally community associations do not care for the inside of an owner's home, but some owners are accustomed to this kind of service and expect it in a condominium. Providing such amenities means an increase in cost to everyone. Do the owners want it?
3) *Major changes in service, such as security.* When the property is marketed, the budget may provide for only one shift of doorman service, for instance, but the developer may pay for the other two himself. Now that the association is on its own, do the owners want to pay extra for 24-hour doorman service?
4) *Switching the management.* The directors may consider do-it-yourself management rather than paying for a professional management company, or vice versa. Which do the owners prefer?
5) *Incurring a large debt to expand or remodel a common element.* Do the owners want to bear the expense, for instance, of enlarging the swimming pool or building another one?
6) *Increasing the number of directors on the board by amending the declaration.* This may be necessary if the present board is too small, with too few members attending to form a quorum.

These are just some of the questions that a wise board will take to the owners. Beyond such matters, the board will do well to act decisively and quickly in carrying out its duties. To do otherwise is to neglect the well-being of the association and invite dissatisfied residents to form groups that will challenge the board. The result can be wide-scale unhappiness with the association way of life and a degradation of property values.

RENTAL HOUSING

In condominium, cooperative, and other types of community association housing, the concept of democratic participation in property management

has some validity because the residents are owners. But in rental housing, this is not the case. What rights do renters have to participate in management?

The traditional approach allows the owner of the property to do whatever he wishes with it. If the residents (tenants) don't like it, they can move out.

However, conditions have changed. Today if the tenants are dissatisfied, they can form tenant unions, organize rent strikes, sue the owner, and undertake similar actions to prove that their views must be considered. In addition to merely being "considered," some tenants want to be actively *involved*. They want to guide the landlord as he decides how to paint the halls, make bicycle parking rules, and deal with late rent.

Tenants Rights Movement

These and other demands are part of the tenants rights movement which began in the mid-1960s. In September 1969, the Urban Research Corporation of Chicago issued a report of 89 tenant group activities in 50 cities. The paper covered tenants in low-income and public housing, as well as those in middle and upper-income areas. Grievances are summarized in the following table:

	Middle and Upper Income	Low Income	Public Housing
Poor maintenance	8%	44%	12%
Rent	16%	9%	9%
Lack of tenant control	8%	1%	9%
Inadequate security	2%	3%	6%

According to an article in the *New York Times* (December 6, 1976), the middle class that was rising up angry in 1969 is still at it: "While tenant activism and rent strikes were largely slum-area phenomena a decade ago, today they are a conspicuous part of the city's middle-class life as well." In New York, the largest and most militant tenant organization—the Metropolitan Council on Housing—regularly sponsors conferences on tenant activity.

Landlord-Tenant Code

One result of the wild-to-mild flurry of tenant activism has been an attempt to formulate a landlord-tenant code. The American Bar Foundation developed a tentative model Residential Landlord-Tenant Code under the direction of professor Julian H. Levi at the University of Chicago Law School. Originally written in 1969 in an attempt to outline obligations of both parties, the code has undergone several revisions over the years and has yet to be formally acted upon.

Role of Federal Government

Perhaps the greatest impetus for tenant participation in management has come from the federal government, which has made clear just how far it ex-

pects owners to yield to tenants, at least as far as federally-assisted housing is concerned. In its Suggested Housing Management Agreement, the Department of Housing and Urban Development (HUD) states:

> "The Agent will establish and follow an employment policy which affords residents of the Project maximum opportunities for employment in the management and operation of the Project . . . ." Later, the Agreement says: "The Agency will encourage and assist residents of the Project in forming and maintaining representative organizations to promote their common interests . . . ."

In other words, owners are obligated to organize the tenants and involve them in the management of the project. Nothing could be plainer.

HUD has even published a small brochure titled *"Why Tenant Organizations—A Role for Residents of Rental Housing"* (September 1972). Aimed at self-help type roles, the brochure suggests that tenant organizations can help control vandalism, aid in security problems, and "make HUD-assisted housing a better place to live." Many of the accomplishments cited fall into the category of cooperative business ventures, and HUD concludes that these tenant groups can make for better communities.

Co-Op City Experience

But *can* tenant organizations and tenant participation in management indeed improve communities? More than likely, such participation will create more problems than it solves.

For those who see nothing mysterious about property management, and believe that any intelligent person can master the trade, the experience of Co-Op City, a 15,000 unit apartment complex in the North Bronx section of New York City, may be instructive.

Technically, the development is a cooperative, but since tenants can only sell their shares back to the corporation they have no effective equity interest. The project is subsidized under New York State's Mitchell-Lama program, with tenants paying below-market rents.

According to the *Wall Street Journal* (July 1, 1977), when the housing authority raised rents to cover a $12 million yearly deficit, the tenants went on strike. After 13 months, the state negotiated a settlement, through which the tenants took over the project. They were given six months to end the deficit by economizing while keeping rents at the old level.

The tenants couldn't do it. They stopped making debt service payments to the mortgage holder, and the project is on the verge of a default crisis. The city's answer is an $18 million appropriation to help out.

Whether or not this comes to pass, the point is that tenant management could work no miracles. Perhaps in this case the problem was so great that nothing but a complete restructuring of the development—including a rent raise—would do the trick. But when tenants are oblivious to the facts of economic life—including the necessity for a rent increase—their efforts are doomed.

The unfortunate fact is that many tenants believe that rent raises aren't necessary and that tenant management can save the day. Co-Op City shows otherwise.

Tenant Limitations

What is it that makes tenant organizations unsuited for participation in management? Consider first the HUD requirement that tenants be hired to run the property. HUD acknowledges that ability is important, but it requires the manager to train residents who are not otherwise qualified. This puts an added burden on the owner, and means that the other residents may not be getting the best possible service.

There are other reasons why tenant involvement in the operation of the property is not a good idea. Tenants who work in management, whether as clerks, rental agents, or maintenance personnel, may pick up information that leads to rumors detrimental to the property. They may feel that the development is theirs and may, in effect, give the store away by doing favors to other residents. Firing them for incompetence may be a further problem. They may have supporters who want them reinstated, or they may engage in sabotage as way of retaliation. How do you deal with such a person—refuse to renew the lease? That can lead to further trouble.

Hiring tenants to run the management end involves many of the same problems inherent in nepotism and conflict-of-interest situations. If the owner has any choice, he will draw a distinct line between his employees and his tenants.

The HUD requirement for fostering tenant organizations leads to other perils, especially when such groups feel they must be consulted in the management of the property. Tenant groups seldom know about the financial condition of a property, and make demands which are not related to reality. Even if the tenants were exposed to the property's financial data, chances are slim that they have enough professional knowledge to understand them.

Taken together, the HUD requirements may lead the tenant organization to insist that it determine how much security is provided, what the decorating policy ought to be, when appliances must be replaced, or how late-paying tenants should be dealt with. The owner is losing his rights to manage his property if he yields to such demands.

Erosion of Owner's Rights

The courts have supported the erosion of the landlord's private property rights in favor of giving tenants more of a say in management. Writing in *Real Estate Review* (Summer 1971), Jerome G. Rose, associate professor of urban planning at Livingston College, Rutgers University, pointed out that in 1970, 58% of mortgage loans had federal participation, and that: "Where the federal and state governments place power, property, and privilege behind a landlord, the relationship causes the landlord to lose much of his freedom of action as a private individual and subjects private landlords to many restrictions of the public landlord."

Rose cites the case of *Colon v. Tomkins Square Neighbors* (1968) involving an urban renewal housing project with FHA mortgage, tax exemptions, rent supplements, and HUD sponsorship. The courts found that the extent of federal involvement rendered the landlord responsible to the tenants and required the creation of a landlord-tenant relationship.

Rose concludes that the new legal decisions have the "potential capacity of transforming the landlord-tenant relationship from a private agreement between private parties to a quasi-public relationship subject to the principles of fair play incorporated in the United States Constitution."

It is very likely that such court decisions, along with administrative actions by state and federal agencies, will continue to abet the trend toward more tenant participation in property management—regardless of the inherent limitations of such participation.

Forestalling Quasi-Takeover

Therefore, it is in the owner's best interests to forestall the day of a tenant quasi-takeover by acting quickly to avoid situations that lead to tenant discontent and the formation of tenant organizations. Here are some suggestions:

1) Give tenants the best possible service for what they pay. Generally, if this is done, tenants will be content.
2) Hire professionals to manage the property and insist on ability as the primary requisite.
3) Keep rules and regulations reasonable and explain them well in advance to tenants. Tenant education should begin with the lease application. Let them know in advance that they cannot paint their apartment any color they choose, have pets (if this is a no-pets building), play the stereo at all hours, or store a junk car in the parking lot.
4) If it will enhance the life-style of the building, help form social groups, such as bowling leagues, hiking clubs, ski tours. This is a good way to demonstrate personal interest in the tenants.
5) Be wary of cutting back on services, which can cause tenant resentment. Find other ways to raise the funds to provide services that tenants have been getting.
6) Most importantly, deal with tenants individually, not in groups. If confronted with a group, explain that each tenant signed the lease individually and any problems will be discussed in the same manner.

CONCLUSION

Property management is a business, and must be run as such. No business can run itself properly if it must await word from all of its customers and employees before action is taken. Responsibility and authority for decision-making must be delegated. Some well-meaning property owners may feel that democratic participation in management is in tune with the times and can head off trouble, but experience shows that the result is often stalemate, if not outright anarchy.

While the rights and expectations of residents should be taken into account, management must reserve the right to make the final decision.

Local Environmental Impact Statements: The State of the Art

by Robert W. Burchell and David Listokin

BACKGROUND

The purpose of this article is to summarize the nature of environmental impact statements (EISs) at the local or municipal level. It describes legal and growth climates within which the EIS has emerged, participants to the EIS process, style (form and content) of the impact statement, local filing procedure, conflicts between agencies of government which affect local EIS filings, the competency of municipal environmental impact statements, and the future of EIS as part of the local planning process.

Growth, via land use commitments of one type or another, is the most important determinant of environmental quality. Private development decisions, influenced by public investments, regulatory ordinances, and economic incentive devices, ultimately shape the nature of the immediate living environment. The effective participation of local government in private development decisions is crucial, yet currently government's role is weak, underutilized, and poorly understood.

In addition, in this era of "creative localism" brought about by the return of the revenue distribution function to lower echelons of government, municipalities have recognized that their direct actions and indirect sanctions, through the granting of permits, licenses, and so forth, can spur growth which may be environmentally harmful. Local governments, which experience on a day-to-day basis the pressures of development, are increasingly aware that they must incorporate environmental concerns in their decision-making processes. The local EIS is a manifestation of this growing municipal awareness.

Robert W. Burchell is a research professor at the Center for Urban Policy Research at Rutgers University, New Brunswick, New Jersey. Among his recent publications are the *Environmental Impact Handbook*, *Future Land Use*, *Planned Unit Development: New Communities American Style*, and *Residential Abandonment: The Tenement Landlord Revisited*.

David Listokin is an assistant research professor at the Center. He is the co-author of the *Environmental Impact Handbook* and *Future Land Use* and author of *Fair Share Housing Allocation* and *Land Use Controls: Present Problems and Future Reform*.

The authors are currently completing a joint monograph on fiscal impact analysis in the United States.

CONTEXT

EIS is taking place within the context of basic tenets of American land use. Legal theoreticians have noted that within the United States there are indeed liberal and conservative states in terms of their local land use policy.[1] Liberal states allow considerable local discretion in the interpretation of the judicial concept of the police power. Restrictions, one of these being the EIS filing requirement, may be freely placed upon land developers under the guise of protecting the general health, safety, and welfare. More conservative states hew closely to an individual owner's inherent rights of property and sanctify the highest and best use of his land even though this may occasion discomfort to adjacent property owners or to the larger community.

Second, American land use is now in its fourth phase of land development control, having gone through zoning, subdivision control (site plan review), and master planning. These approaches have (respectively) facilitated minor, limited, rampant, and, now—with the EIS—selected control.[2] As opposed to the previous period in which local land use decisions were viewed with a presumption of validity, the courts currently realize that a local regulation may indeed serve a non-legitimate purpose or be the product of parochial vision—unduly harsh with little compensating public benefit or merely inept.

Third, there is a national trend toward moving the control of land from owners and developers acting individually to the general public acting communally through government. Thus, personal freedom to maximize profits from land is being replaced by collective decisions concerning its equitable disposition.[3] An authority on land use controls has summarized the situation aptly.

> As land becomes a scarce commodity in an increasingly urbanized society, the nature of our concepts of property and the constituional guarantees of due process, equal protection, and just compensation must change. Government becomes an intervenor on an ever-increasing scale . . . Due process "rights" of landowners diminish as they constantly evolve toward a recognition that the scope and reach of the police power of government must be ever capable of expansion to solve new problems not conceived of by our forebears.[4]

Fourth, the United States no longer desires to grow. The "Chamber of Commerce" signs which dotted American highways and pleaded for local development are being replaced with the Oregonian view of "visit, but maintain your business and residence elsewhere." As the courts have reacted to this type of growth control vehemently, a new era of "managed growth" has emerged that still seeks to limit population expansion without directly violating rights of individuals.[5]

How then can one sort through these trends to project their impact on the local EIS? The path is circuitous but clear. Reflective of the national trend of increasing public control over private development, EIS has and will continue to grow—first, in the liberal land use states and, subsequently, in the more conservative areas—initially becoming part of the local planning process and ultimately part of a more sophisticated and integrated system to manage and

plan for growth. If, instead, it proves to be arbitrary, restrictive, duplicative, or socially and economically unconscious, it will be significantly curbed and ultimately disallowed by the courts.

PROGENY

Currently, approximately 32 jurisdictions have followed the federal lead (National Environmental Policy Act of 1969 [NEPA]) and have acted either legislatively or administratively to establish NEPA equivalents within the confines of their political bounds. Areas that have legislatively adopted NEPA equivalents of general applicability are California, Connecticut, Indiana, Maryland, Massachusetts, Minnesota, Montana, North Carolina, Puerto Rico, South Dakota, Vermont, Virginia, Washington, and Wisconsin. Progenitors of similar legislation of limited applicability are Alabama, Arkansas, Colorado, Delaware, Florida, Hawaii, Mississippi, Nevada, New Hampshire, New Jersey, Pennsylvania, and Rhode Island. Administratively promulgated NEPA equivalents are found in Arizona, Michigan, New Mexico, New York, Texas, and Utah. Potential environmental legislation of a similar nature is receiving at least some attention in Alaska, Georgia, Idaho, Illinois, Iowa, Kentucky, Louisiana, Maine, Missouri, North Dakota, Oregon, South Carolina, Washington, D. C., and West Virginia. There is little or no current activity at the state level in terms of developing general environmental policy guides in Kansas, Nebraska, Oklahoma, and Tennessee.[6]

EIS progeny at the county and local level in most instances parallels EIS progeny among states. The counties and localities that impose an EIS requirement frequently derive their authority from a "little NEPA" or an administrative equivalent which exists at the state level. The manner in which EIS regulations have been implemented varies considerably by county and locality.[7]

PARTICIPANTS

EIS users at the local level are private planning consultants and public staff planners. While the latter are typically recipients of the impact statement, either may oversee a bevy of specialists in the preparation of an EIS. Both report to a larger audience—first, in the form of the environmental commission or planning board and, second, in the form of the local electorate and general public.

Specialists brought within the realm of EIS are architects, planners, geographers, natural scientists, engineers, economists, and, of course, attorneys.

Architects are called upon to describe in detail the proposed project and, in the process, may introduce a scale model for use at public hearings. Planners are asked to describe the site relative to its potential for development or redevelopment and explain how the specific project fits within a regional development context. They may also be asked to comment on the primary or secondary effects of growth and/or the impact on existing and planned transportation networks, prepare the social impact portion of the EIS, and run the various air/noise pollution models as input to the physical section. Geogra-

phers and natural scientists split the remaining physical impact chores, the former concentrating on water supply/quality, sewerage, and solid waste, and the latter on topography, soils, climate, vegetation, and wildlife.

Engineers report on the load bearing capacity of soils, erosion, and subsurface conditions, development impact on local transportation arterials, and the capacity of municipal capital infrastructure to serve the forthcoming population. Economists frequently project development impact on both the local and regional economy and establish local and regional justification for approval of the development activity.

The attorney serves as the leader and synthesizer, sensitizing the EIS team to political climate and local priorities of environmental concern, while coordinating and integrating each specialist's segment of information for the public hearing as well as the finalized report.[8]

For several of these specialists (geographers, economists, natural scientists) the EIS provides a significant professional employment avenue outside traditional labor billets. Yet for at least one, the planner, the new employment opportunity also frequently carries with it a change of role. Rather than assess and carve the community for development and couch his specialty in a unique competence to interpret the economic, social, and physical forces which influence the location of various land uses, he is asked to provide the rationale to preserve the status quo: to conserve the wetlands, preserve the bay, keep the shorelines as they are; to protect the community against the erosion of air and water quality; and, perhaps most importantly, to protect the community against deterioration of the quality of life.

The planner does this because the mood of secondary participants to the EIS process—the planning board/environmental commission, electorate, and general public—has changed. They like the community as it is and for the most part are willing to pay for the status quo by not sharing the costs of current and future municipal services with more intensive land uses. Tax ratables, golden words in the United States during the 1950s, are unmentioned in the decade of the seventies. The environmental commission, unheard of in 1957, is the fastest growing municipal specialty in 1977.

STYLE

The impact assessment requirement form varies considerably among the cities, counties, and states which require it. In most instances, however, the variations are superficial, reflecting particular local environmental concerns or emphases. All environmental assessment regulations trace their lineage from the same venerable antecedent, the National Environmental Policy Act (NEPA) of 1969.[9] Local EIS form in the United States is essentially a direct reflection of the NEPA requirements. Interestingly, the most significant departure from NEPA of its scions is the very definition of the term "environment." The federal definition, far broader than many of the local ordinances, emphasizes the total human environment, rather than limited consideration of primarily physical or natural science factors. The NEPA format is described in subsection 102(2)(c) of the 1969 National Environmental Policy

Act.[10] The format requires coverage of five specific points, in addition to a description of present conditions and the proposed action:

1) The probable environmental impact of the proposed action.
2) Any adverse environmental effects which cannot be avoided should the proposal be implemented.
3) Alternatives to the proposed action.
4) The relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity.
5) Any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented.

Although not specifically identified in the initial guidelines issued by the Council on Environmental Quality (the NEPA "handbook"), two other items introduced in the California Environmental Quality Act (CEQA) are implied by NEPA and explicitly stated in many of its more recent local progeny:[11]

6) Mitigation measures.
7) Growth-inducing impacts.

Governmental agencies have also added to the proliferation of recommendations on EIS through the issuance of their own guidelines. The Department of Housing and Urban Development, for instance, recommends the following:[12]

1) Describe the proposed project.
2) Describe the existing environment.
3) Discuss the impact of the environment on project design and the development's residents and users.
4) Evaluate the impact of the project on the environment.
5) Discuss internal project environment (for large developments, such as planned unit developments or new towns).
6) Discuss alternatives to the proposed projects.
7) Discuss short and long-term impacts of the projects.
8) Note actions taken by the developer and/or governmental agencies to mitigate the impact of the project on the environment.
9) Describe official and private reaction to the proposed development.

Obviously, no single format has yet been established that serves as the guide in preparing local environmental impact statements. This is not surprising because environmental review, in its infancy, is still in a period of flux. Additionally, given the EIS practitioners' continued demand that review be flexible, it is unlikely that any one rigid approach for all development, under all conditions, will ever be required.

A surprising number of localities, however, have adopted procedures which attempt to invoke the form described above. This is to be expected. The Department of Housing and Urban Development has relegated its responsibility of evaluating the environmental impact of activities funded under section 104(h) of the Housing and Community Development Act of 1974 to the mayor of the locality in which this activity takes place. In so doing, the above

format is recommended for local compliance leading to funding. Since HUD has such a pervasive influence at the local level via community development funding, its recommended format is spreading—in many cases being made applicable as well to all private developments within the locality's bounds. If one were to ask what local EIS ordinances look like, the answer would have to be, "If they have any form at all, other than the simple requirement to file, they look very much like the HUD requirement for section 104(h) 'Entitlement Cities'." Both the procedures that govern publicly funded activities and the ordinances that control private development are becoming surprisingly similar. As such there is increasing parallelism between locally produced public and private responses in the form of derivative EISs.

The *content* of the local EIS is much more descriptive than analytic. In 1973, the Illinois Institute for Environmental Quality produced a handbook for environmental impact statements.[13] Within this text, the Illinois group specifies a hierarchy of EIS content. From the very general and nonquantitative to the very specific and quantitative, the hierarchy is described as 1) an unorganized assemblage of reports produced by multi-disciplinary teams, 2) organized descriptive checklists, and 3) tightly woven assessment tables and matrices. A category that is not included in the hierarchy is the various modeling approaches.

The first category of environmental impact analysis is a largely individual approach to a specific area of environmental impact, in which aspects of the environment are investigated by an assemblage of experts. The analysis from an overall standpoint is frequently uneven, lumping in a single report nominal, ordinal, and interval data. Some impacts are treated in hundreds of pages, others in less than a page.

The second category of analysis, the checklist approach, is the level of analysis which is most frequently seen at the local level. There is an effort to oversee the assessment, to recommend methods of investigation, to standardize inputs, to provide predictable topic coverage, and finally to provide a relatively high level of replicability.

Obviously, this method also has its shortcomings. It is more descriptive than comparative, more "go or no go" than evaluative, more perceptive than analytic. In addition, judgments about the positive or negative environmental impact of a particular project are not put before the reviewer in the form of a numerical score (5 to 1, 4 to 4, and so forth), but rather in an essay format.

The third category of analysis, assessment tables and matrices, is to some the analytic ideal. This is a frequent extension of the checklist approach wherein each proposed action is identified as a column of a matrix, and the impacts are identified by reference to rows of the same matrix. Alternatives are weighed via numerical scores—the highest or lowest score is the most preferable development alternative. The Leopold method and the 88-category Geological Survey format are classic examples of these approaches.[14] The McHargian land suitability mapping is not the typical EIS matrix, but rather is a quantitative approach to demonstrate differences in impacts and costs as a function of variation in land characteristics.

Category four, impact assessment via modeling, is only in its infancy. To date it has been narrow in its scope, virtually untried, and if employed, usually quite costly.

PROCEDURE

Two alternative criteria for filing an environmental impact statement initially confront the developer at the local level. The simplest, most arbitrary, and most frequent is an established threshold above which an EIS must be filed (for example, for subdivisions of five or more acres, eleven or more lots, ten or more housing units). In this case the determination, while arbitrary, is quite simple, and the developer knows whether he is required to file almost immediately.

The other case, derived from the federal and California experience, involves a more complex definition of the severity of environmental impact to determine whether or not there is a requirement to file.[15] In this latter case an environmental clearance (no filing requirement) or a mandated EIS may be issued after a brief description of the project and its potential impact (thumbnail sketch) is submitted by the developer/applicant and reviewed by the environmental officer, planning director, environmental commission, or a multidisciplinary staff committee. From the standpoint of the developer, the thumbnail sketch procedure, while more complicated, is much less arbitrary. In effect, it is a brief glimpse at the type, magnitude, and location of a project to determine the potential significance of its impact, with an aim to screen those projects requiring an EIS from those not needing to file.

Once it is determined that an EIS is necessary, its submission to municipal agencies consists of several steps. The first is the formal submission of the "draft EIS" and attendant site plan application to whomever is designated to receive it locally. In the northeastern United States, this is either the planning or zoning board; in the West it is frequently the environmental commission. This serves notice to both developer and municipality that the filing time countdown has begun.

Once submitted, a basic check of the draft EIS's completeness is undertaken, usually by a subcommittee of the planning board or environmental commission. The third step is a report by the committee evaluating the document's completeness, after circulation to the township engineer, building inspector, health inspector, and municipal planning consultants, if any. The fourth step is frequently the applicant's resubmission of the reworked EIS to the township planning board, county planning board, and state planning/environmental agencies.

A formal public hearing is held on both the site plan application and final EIS. Reports are heard from the township engineer, building inspector, health inspector, municipal planning consultants, county and state officials, and the general public. Revisions may be made to the report by the public agency in response to substantive comments issued during the public hearings. Ultimately a decision is made by the municipality to reject the project, approve, or approve with conditions.

Documentation of the process leading to the determination that an EIS is or is not required, and the ultimate disposition of the EIS, is a frequent EIS accompaniment. One of the fastest growing specialties in the United States' legal profession is environmental law. Comments on the project's movement through the review process are essential if the developer/applicant, private citizens, public funding agencies, or the courts question the determination made at a particular juncture of review.

Input from the local planner and environmental groups, minutes of the planning board or environmental commission meetings, and facts from the developer/applicant are all used to compile this record.

EIS CONFLICT

There is currently considerable conflict between the impact requirements of public agencies that spawn housing in the United States. The Department of Housing and Urban Development has produced guidelines which stated that an EIS would be undertaken by HUD for subdivisions insured by the Federal Housing Administration (FHA) which were in excess of 500 units.

The Veterans Administration (VA), offering similarly insured mortgages on virtually all housing that qualifies for FHA insurance, produced its own guidelines in August 1975 stating that it would undertake an EIS for subdivisions in excess of 100 units. Finally, until recently, in nonmetropolitan areas the Farmers Housing Administration (F|m|HA) had no impact requirements or guidelines regardless of the size of the project.

In effect, the overlapping among these agencies has confused developers regarding the steps necessary prior to undertaking a development. In one case a housing agency may tell them to proceed, yet for the same development another may delay groundbreaking pending the completion of an EIS.

Although these inconsistencies have been noted over the past year, the Council on Environmental Quality indicates that harmony will reign in the future, claiming that previous inconsistency between housing agencies was almost exclusively a matter of threshold. This will be remedied by a HUD-approved, sliding scale EIS filing requirement which is a function of density, location within the metropolitan area, and staging of the project. This sliding scale is currently acceptable and applicable to the three previously mentioned agencies which either influence or directly produce housing.

SCRUTINY

The local environmental impact statement—primarily, the publicly-filed EIS under HUD's section 104(h) program— is undergoing considerable scrutiny at upper levels of government. Monitoring is being undertaken to see if, in fact, a federal agency can pass its responsibility down to lower levels of government without significantly sacrificing either procedure (local compliance with process) or substance (local compliance with content). Evaluations are currently ongoing in HUD, the General Accounting Office, the Council on Environmental Quality, and the Office of the Inspector General. These probes are evenly distributed between procedure and substance.

Results are preliminary and tentative. In terms of procedure, locals are sometimes not giving sufficient notice to the public and developers of their in-house schedule of the processing of the EIS. Further, the EIS record—the document which describes what has happened to the EIS in the filing process—is frequently incomplete or nonexistent. In terms of substance, the quality of the filed EIS seems to vary directly with longevity of state experience with EIS. Local EISs filed in California and Colorado are better than those filed in Maryland or Pennsylvania. Quality also appears to be related to the size of the city which files the EIS. There is much more substance, cohesiveness, and organization in the EISs filed by large cities than in those filed by smaller jurisdictions.

One of the most significant findings, however, relates to the general paucity of EISs. Less than 10% of the section 104(h) "Community Development" entitlement cities filed a full-blown EIS on the activities to which it would commit its tendered funds. To a certain degree this may be interpreted as local disposition of funds to *small capital facilities* not exceeding size thresholds that would automatically trigger an EIS or *programs* (rehabilitation) which do not themselves involve significant capital additions of the type to cause a "significant effect" on the local environment.

Another interpretation is that guidelines are not being strictly followed, or perhaps worse, that the guidelines are insufficiently explicit to indicate the user's obligation to consider the collective impact of multiple actions in estimating the necessity of an EIS. The latter is a serious problem with the local EIS—one which will receive much more attention in the future.

EFFECTIVENESS

Concentration on EIS form, substance, or procedure skirts the basic issue of whether or not EIS is indeed doing the job. Is the environment and the total community better off as a result of the EIS process?

Some seasoned experts say no.[16] Within the present state of the art, they hold that the environmental impact statement is a simplistic approach to complex issues, relating neither to the regulatory nor the planning processes, incapable of estimating the cumulative impact of multiple actions or the probability of an impact on-site or the possibility of an impact off-site. The EIS, they claim, does not distinguish clearly between the identification and evaluation of impacts or specify different levels of alternatives—at the site, in the design, and so forth. In their opinion, the impact statement provides only an incremental perspective rather than a sequential and comprehensive viewpoint.

Professor Donald Hagman notes, and correctly so, that EIS is the antithesis of comprehensive land use control.[17] Under the planning process, the plan is adopted first; if proposals are not in accordance with the plan as expressed through its regulatory ordinances, they are not approved.

Under NEPA and its implementing mechanism, EIS, a proposal is imagined for a particular place and the impacts of that proposal are judged, often in the

absence of guidelines from the community. Advocated by Hagman and many others is a more systematic approach which would achieve an increasing level of specificity in terms of environmental assessment, both as the area under scrutiny decreases and as the level of projection proceeds from plan to project.

The proposal to meet the objectives of the environmental impact assessment laws by relating them to planning processes involves a phased, as opposed to a one-shot, approach. Rather than a final product with an accompanying or subsequent assessment, it is recommended that there be a series of increasingly more specific evaluations.

The first step that should be built into the planning process is a requirement for a systematic, overall analysis of the environmental characteristics of an *entire jurisdiction.* This should be at a general level but be comprehensive in terms of geography and major features of the environment. (The Natural Resources Inventory [NRI] employs a similar approach.) While NEPA has spread significantly to the local level, little effort has been made to incorporate environmental concerns into the comprehensive plan. (The comprehensive plan itself is in effect being subjected to an EIS filing!) The overall analysis requirement is an integral part of the California local planning process and is also mandated by the Department of Housing and Urban Development, if a municipality desires to prepare its plan with a grant from the Comprehensive Planning and Management Assistance Program (section 701). While these comprehensive plan assessments are quite general, the requirement seems misapplied. Environmental sensitivity must derive from the process that formulates goals for community development, not as a result of its impact.

THE FUTURE

EIS at the local level will continue to receive a great deal of scrutiny. If HUD's pass-along idea works, other federal agencies, currently inundated with EIS activities, will also seek to follow this route. As upper-level public EIS requirements and procedures flow to the local level, existing local, publicly-imposed requirements on private development will emulate the form and dictates of higher order government. Presently a developer in a coastal zone locality which has its own EIS ordinance regulating private activity, desiring to offer FHA mortgage insurance on housing that he plans to develop, may easily be faced with three separate EISs—the locality's (because he is developing land within its bounds); HUD's (because he is participating in HUD-sponsored mortgage insurance); and the U.S. Department of Commerce's (because the land which he seeks to develop is designated as part of the Coastal Zone).

There is also a recent trend to look seriously at both the public and private costs/benefits of the environmental impact statement. Are we getting what we're paying for? Initial reports appear to be that we're not getting much but it's also not costing very much either—in most cases, less than $20 a dwelling unit. Obviously, this is an unsatisfactory state of affairs and moves will be made to improve the quality of EISs, perhaps at significantly more pass-along cost to the housing consumer.

The EIS form will undergo significant change. The social and economic impact sections will be greatly expanded. Local fiscal responsibility and neighborhood preservation, very much in vogue in the United States, will receive increasing attention in the overall environmental impact statement.

Perhaps the most significant future change may prove to be the demise of the local EIS itself. By incorporating environmental sensitivity in regular planning activities rather than expressing this concern in occasional monitoring exercises, the future local EIS may only be a small increment of specific site-bound knowledge which adds to comprehensive information about the locality obtained from positive environmental planning.

REFERENCES

1. Norman Williams, Jr., *American Planning Law—Land Use and Police Power* (Chicago: Callaghan and Co., 1974).
2. *Ibid.*
3. Marion Clawson, "A Capsule History of Land in the United States," *American Land and Its Uses* (Washington, D.C.: Resources for the Future, 1975); Fred Bosselman and David L. Callies, *The Quiet Revolution in Land Use Controls* (Washington, D.C.: Government Printing Office, 1972).
4. Robert H. Freilich, "Awakening the Sleeping Giant: New Trends and Developments in Environmental and Land Use Controls," Southwestern Legal Foundation, *Proceedings of the Institute on Planning, Zoning and Eminent Domain* (New York: Matthew Bender and Co., 1975), p. 4.
5. John W. Ragsdale, Jr. and Richard P. Sher, "The Court's Role in the Evolution of Power Over Land," *Urban Lawyer*, vol. 7, no. 1 (Winter 1975), pp. 60-95. For a comparison of attitudes toward land in England and the United States, see Donald G. Hagman and Steven Pepe, "English Planning Law: A Summary of Recent Developments," *Harvard Journal on Legislation*, vol. 11, no. 4 (June 1974), pp. 557-593.
6. See Robert W. Burchell and David Listokin, *The Environmental Impact Handbook* (New Brunswick, N.J.: Rutgers University Center for Urban Policy Research, 1975).
7. Frederick R. Anderson, "The National Environmental Policy Act: How Is It Working, How Should It Work," *Environmental Law Reporter*, vol. 4, no. 1 (January 1974).
8. For a discussion of a "model" environmental review team see Barbara A. Hermann, *The Environmental Review Team, Planners Notebook*, vol. 5, no. 1 (February 1975).
9. See Victor John Yannacone, Jr. and Steven G. Davison, "National Environmental Policy Act of 1969," *Environmental Law*, vol. 1, no. 1 (1970), pp. 8-33.
10. *National Environmental Policy Act* (Pub. L. 91-190, 42 U.S.C. 4321 et seq.) sec. 102(c) (1969).
11. Burchell and Listokin, "EIS Progeny at State, County and Local Levels," *The Environmental Impact Handbook*, pp. 7-36.
12. *Federal Register*, vol. 39, no. 37 (February 22, 1974), p. 6824.
13. Lewis Hopkins, et al., *Environmental Impact Statements: A Handbook for Writers and Reviewers* (Chicago: Institute for Environmental Quality, 1973).
14. L. Leopold, F. Clarke, B. Hanshaw, and T. Balsey, *A Procedure for Evaluating Environmental Impact* (Washington, D.C.: Government Printing Office, 1971).
15. See *Hanly v. Kleindienst*, 471 F.2d 823 (2d Cir. 1972); *Hanly v. Kleindienst*, 484 F.2d 448 (2d Cir. 1973); *Save Our Ten Acres v. Kreger*, 472 F.2d 463 (5th Cir. 1973).
16. See John Rahenkamp, "Land Use Management: An Alternative to Controls," *Future Land Use: Energy, Environmental and Legal Constraints*, ed. Robert W. Burchell and David Listokin (New Brunswick, N.J.: Rutgers University Center for Urban Policy Research, 1975), pp. 192-199.
17. Donald G. Hagman, "Commentary—Land Use Controls: Emerging and Proposed Reforms," *Future Land Use: Energy, Environmental and Legal Constraints*, pp. 123-136.

Strategy of Analysis

by Maury Seldin and Michael Sumichrast

Increasing uncertainty for builder-developers calls for more powerful analytical techniques. Yet, the structure of the industry is such that few builder-developer organizations can afford to spend much on analysis. Typically the firms underspend and underanalyze. Furthermore, what they do get for their cost and effort provides little real help compared with what they could get for the same expenditure.

Unfortunately, most of the so-called "analyses" are really prepared to help convince the lenders, or others, of the merits of the projects; they may then rely on the reputation of the consultant firm so that their loan officer is covered when a loan turns bad. The excuse that "it happens to everyone" is no consolation if the organization goes into receivership. Therefore, the lenders get caught in the "emperor's clothes syndrome": everyone pretends the analysis answers the question, but no one sees how it actually relates to the decision.

Counselors, professors, researchers, and other professionals should be sensitive to the users' needs and realize that the body of knowledge is of special importance. This paper focuses on an application of what we already know and contributes to the fund of knowledge by explaining a strategy of analysis

---

This article is adapted from a speech given at the mid-year meeting of the American Real Estate and Urban Economics Association and Federal Home Loan Bank Board and is based on the authors' book *Housing Markets: The Complete Guide to Analysis and Strategy for Home Builders, Lenders, and Other Investors*, just published by Dow-Jones-Irwin.

Maury Seldin is president of Metro Metrics, Inc. and professor of real estate and urban development at The American University, Washington, D.C. He has served as a consultant to the Executive Office of the President of the United States and the Housing subcommittee of the Banking and Currency Committee of the U.S. House of Representatives. Dr. Seldin is a widely published author whose books include *Land Investment* and *Real Estate Investment Strategy*.

Michael Sumichrast is chief economist and staff vice president of the National Association of Home Builders, Washington, D.C. He testifies frequently on housing as well as finance issues before Congress and for many years has advised the Secretaries of the Department of Labor and Housing and Urban Development. Dr. Sumichrast is responsible for publication of the monthly *Economic News Quotes* and *Quarterly Metropolitan Housing Forecast* and the continual publication of *Construction Component Cost Data* books.

which has been developed and applied to the real world laboratory. The research results are more fully reported in *Housing Markets: The Complete Guide to Analysis and Strategy for Home Builders, Lenders, and Other Investors*. What follows is an adaption of that presentation.

INCREASING UNCERTAINTY

If we were to index uncertainty in the businesses relating to home building, we would see relatively low numbers for the 1950s and the first half of the 1960s. Figures for the last twelve years, however, would be very high.

Cost and Availability of Credit

The cost and availability of credit has been on an upward swing since the end of World War II, with the first critically uncertain time during the credit crunch of 1966. Perhaps it is fortunate that we did not know how close we were then to a financial crisis.

Variations in the cost of money now cover a much wider amplitude than they did in the comparable period prior to the 1966 crunch, and resulting variations in residential construction are dramatic. *Table 1* shows the change in starts from peak to trough. There we see drops that typically ran under 40% were up to a whopping 65%. Also note that the next highest drop—during 1965-66—was 49%, marking what we have described as the beginning of this era of increasing uncertainty.

TABLE 1

PEAKS AND TROUGHS IN HOUSING—STARTS CYCLES

	Months	Difference	Percent Change
1950-51	11	735,000	-39%
1954-57	27	635,000	-37%
1958-60	24	563,000	-35%
1965-66	10	813,000	-49%
1969-70	12	661,000	-37%
1973-74	23	1,606,000	-65%

Adapted from Table 4-3 in *Housing Markets: The Complete Guide to Analysis and Strategy for Home Builders, Lenders, and Other Investors*, p. 91.

Demographics and Demands

We traditionally relate demographics to demand and generally start with the size of population. Now, in our era of increasing uncertainty, we would make two points. First, the elements relating to number and size of households have undergone dramatic changes in recent years. Secondly, the long-run trends are not closely tied to short-run demand, anyway. The significance of these facts is that anyone trying to forecast housing demand is going to have a difficult time with demographics, although in the short run this is not in any case crucial.

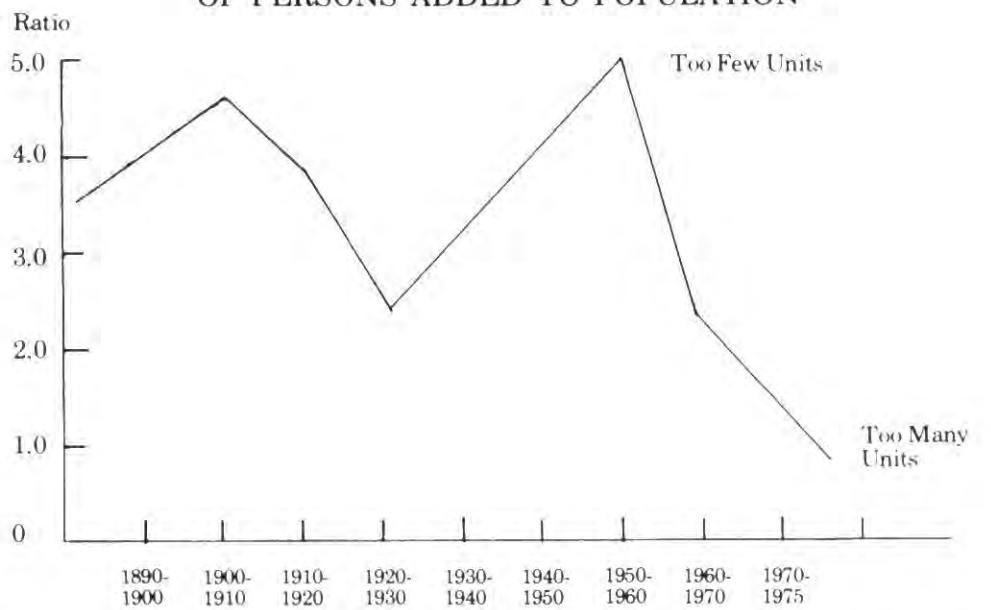
Regarding population forecasting, we would first note that the long-run record for forecasters is poor, due to such factors as the volatility of the birth rate and

the change in household size. The dramatic point is that there is wide variation in the number of units started relative to the number of persons added to the population.

Chart 1 shows that in the mid-1940s we were adding only one housing unit for every five new persons, while in the mid-1970s we built one unit for every additional person—which is far too many.

CHART 1

RATIO OF UNITS STARTED TO NUMBER OF PERSONS ADDED TO POPULATION



There are, of course, explanations for these variations, not the least of which is the use of residential construction as a contra-cyclical device. (These are discussed in the book, as are policy implications.) The point here, however, is that the increasing uncertainty is a fact of life, with which the decision-maker should deal realistically.

Public Policy Constraints

There is another type of public policy constraint—one that inhibits construction by regulations implemented at the local level. This is in contra-distinction to public policy constraints of national stabilization policies.

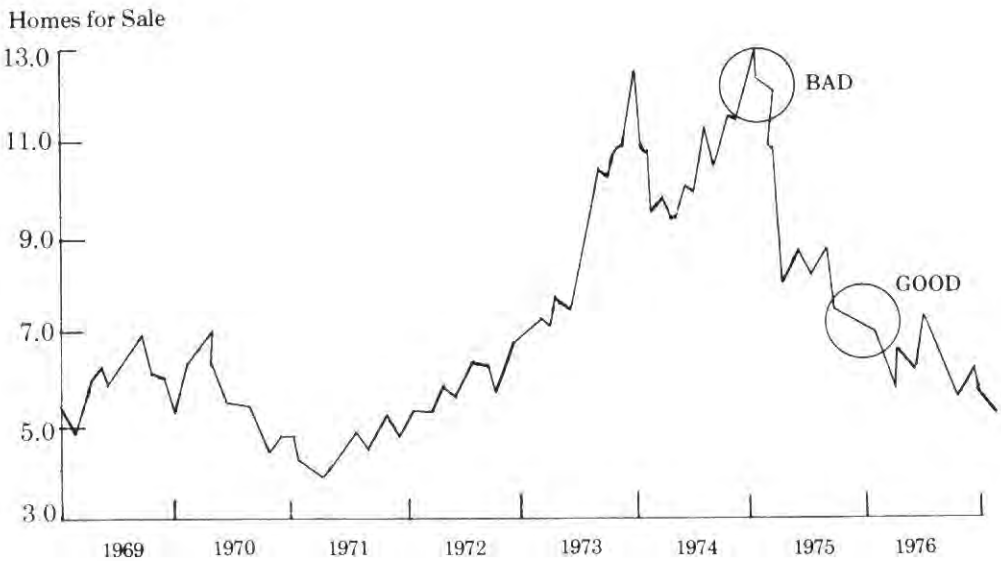
The conflict of housing and other goals is a separate topic. At this point, it is only necessary to note the existence of a laundry list of public policy constraints, the vast majority of which are of recent vintage. They play havoc with a local market by shutting down production in certain areas—as with sewer moratoria—further magnifying the instability in local construction levels.

Conclusion in Uncertainty

In conclusion, a quick way to gauge uncertainty is to inspect the net result. How far out of balance are the local markets getting? The answer can be determined by examining the ratio of homes for sale to homes sold.

CHART 2

RATIO OF HOMES FOR SALE TO HOMES SOLD



With results like those we have experienced in the last few years (including exceptionally large numbers of bankruptcies), it seems that there must be a better way to decide what and where to build. We submit that the better way calls for a strategy of analysis that enables one to recognize and capitalize on opportunities.

ANALYTICAL TECHNIQUES

We have developed some useful analytical techniques which can help builder-developers and their financiers do two things: identify gaps in the market where home building may profitably take place and, perhaps more importantly, identify conditions of excessive supply to avoid the trap of overbuilding.

Among the analytical systems are the following: 1) a perpetual inventory system of housing (see *American Real Estate and Urban Economics Association Proceedings,* 1969), 2) an urban development information system (reported in "Creating an Urban Development Information System" by John L. Hysom, et al., Fairfax County, Virginia) and 3) a system of segmenting

demand and evaluating pipeline supply (reported in *Housing Markets: The Complete Guide to Analysis and Strategy for Home Builders, Lenders, and Other Investors*). The first is simply a system of measuring stock and flow so that an analyst can evaluate the demand and supply on a site specific basis. The latest addition is a combination of systemic explanations, procedural explanations, and case examples on implementing the process.

The more powerful techniques require an economy of scale and a level of detail that lenders and local governments who need similar information for managing capital improvement programs can afford—with the latter, incidentally, providing the information to small and medium-size builders. Most builders and lenders encounter difficulty because they operate—or at least think they operate—on a scale which precludes their use of an integrated market analysis system.

What we intend to show in this and the final section of this article is that the rudiments of an integrated market analysis system are not that difficult. Once the analyst conceptually grasps the logic it's just a question of the quality of numbers, a matter that can be dealt with through another of our approaches.

Short Methods

The short methods of assessing the market conditions are useful for two purposes. They provide a practical tool through which a decision-maker can come to grips with a situation and make a reasonably good decision, and serve as a vehicle for understanding the system so the analyst and decision-maker can refine techniques, improve measurements, and reach substantially better decisions.

The logic of the system is quite simple. Start with the current situation; if it is overbuilt, the market probably does not need more new construction. Then find out where the market is going. If commitments have been made which will lead to overbuilding, stay out.

TABLE 2

SHORT METHOD FOR DETERMINING THE NEW-HOUSING MARKET SITUATION

Base data needed	Rating of the market	
	Normal	Overbuilt
Unsold completed new homes as a percentage of:		
a. For-sale units, annual production	10-15%	25%
b. Houses currently under construction	30-50%	100%
c. Annual starts	100-150%	250%
d. Unsold units under construction	50-75%	100%
Unsold houses under construction as a percentage of:		
e. Total houses under construction (could be sample)	40-60%	75%
All unsold houses, completed and under construction, as a percentage of:		
f. For-sale annual production	20-25%	40%
Presold units as a percentage of:		
g. All completed new units	50%+	30% and below

A good way to begin your investigation of the current situation is to analyze production relative to sales, or "inventory ratios." The key numerator is "unsold completed new homes." The denominators are: 1) annual units for sale, 2) houses currently under construction, 3) annual starts, and 4) unsold units under construction.

The logic of the ratios is quite straightforward. Some new houses must be produced for inventory, the numbers varying with the strength of the market and the anticipated shifts in demand. But one can expect a "normal range" which can be expressed as a ratio of unsold completed new homes to various measures of the volume of production. A variation of the measure of unsold houses calls for relating *unsold houses under construction* as a percentage of total houses under construction; this refers to that portion of the production that does not have committed purchasers. A sharp speculation fervor rapidly escalates the numbers.

Another variation—simply a combination of the first two—deals with presold, rather than unsold, units. We have not constructed an internally consistent mathematical model to show the mechanical relationship between these ratios, a step that would be very helpful on a metro-area basis. The key, of course, is to segment the markets by price and type of units, a case illustration of which is provided in *Table 3.*

TABLE 3

	Units			Percent		
Price range	Singles	Townhouses	Condos	Singles	Townhouses	Condos
Under $17,500						
$17,500-19,999			1			3%
$20,000-22,499			10			42
$22,500-24,999			[236]			[92]
$25,000-27,499	4		320	9%		70
$27,500-29,999	254	30	[654]	48	22%	[72]
$30,000-34,999	279	258	969	44	50	76
$35,000-39,999	[600]	[421]	[714]	[60]	[62]	[81]
$40,000-44,999	298	281	234	(27)	(33)	67
$45,000-49,999	356	120	138	53	35	48
$50,000-59,999	2,094	423	[269]	52	[66]	33
$60,000 & over		193	(145)		46	(24)
	3,885	1,726	2,680	49%	48%	63%
				(average)	(average)	(average)

○ = Good market.
[ ] = Weak market.
▭ = Very weak market.

Source: Federal Home Administration, January 1, 1975.

Adapted from Table 12-24 *in Housing Markets: The Complete Guide to Analysis and Strategy for Home Builders, Lenders, and Other Investors.*

The data for the unsegmented inventory counts are generally available either from local publicly-collected sources and/or relatively low-cost field investigations. The advantage of using multiple types of measurements is that some counts are easier to obtain in one area than in others. The refined, and particularly the segmented, data are harder to locate. *Table 3* is based upon a year-end FHA survey for Washington, D.C. Although it does not contain full coverage, it is complete enough to indicate which segments are overbuilt and which are not.

More Detailed (or longer) Methods

More detailed or longer methods are required when one seeks to refine analyses of the current situation or forecast demand and supply, as illustrated in *Table 4* and *Table 5*.

TABLE 4
FORECAST OF QUANTITATIVE HOUSING DEMAND,
MONTGOMERY COUNTY, MD., 1974

Step	Item	Total
1.	Projected household increase	6,365
2.	Net removals	+ 1,236
3.	Gross demand (1 + 2)	7,601
4.	Available vacancies	5,040
5.	Normal vacancies	4,040
6.	Excess of vacancies (4 – 5)	1,000
7.	Quantitative demand (3 – 6)	6,601
8.	Units under construction	7,500
9.	Normal rate of construction	5,500
10.	Excess of new construction (8 – 9)	2,000
11.	Net demand (7 – 10)	4,600
12.	Annual demand	4,600

TABLE 5
NET EFFECTIVE DEMAND,
MONTGOMERY COUNTY, MD., 1974

Item	Number of units		
	Total	For sale	For rent
Net demand	4,600	3,326	1,275
Adjust for 1 percentage increase in mortgage rates	-500	-400	-100
Adjustment for changes in employment	3,610	2,575	1,035
Adjust for sewer moratorium	1,620	1,160	460
Net effective demand for 1974	1,990	1,415	575

On the supply side the objective is to see what the pipeline contains. Of importance are units under construction, outstanding permits, approved plans, and so forth. Where there is an extreme shortage of waste water treatment

capacity one can use sewer taps as an indication of pipeline supply for housing, particularly by location. These pipeline measures reveal specific locations, an aid in assessing builders' intentions. Furthermore, an analysis of developable land by zoning category can indicate the potential supply.

These kinds of analyses enable builders to respond to opportunity and to pull in their horns when markets get overbuilt or fade as demand falls off. No matter how good the analyses are, they will leave room for some uncertainty, an obstacle with which builders and lenders must learn to cope. Obviously, more analyses will help; the question is how much and what kind. The answer, we submit, is not simply related to the project. Rather it stems from the builder, his objectives, resources, and propensity to take risks. He needs a strategy of growth and development for his organization, from which to develop a strategy for analysis.

STRATEGY

Strategy is becoming an overworked word, probably because increasing uncertainty calls for greater defensiveness in policy. The concept of strategy is to plan for the defense against adversity—the "just in case" plan. For growing builder organizations that means programming a diversity of locations, in the event that they find themselves in an unfavorable political jurisdiction with a no-growth or slow-growth posture. It also means building in various watersheds so that sewer moratoria do not shut down the entire operation.

The same logic applies to different market segments. Thus, when one segment is getting overbuilt there is some stability in the others. This necessitates a level of detail in the market analysis that allows the large firm to diversify or the smaller firm to choose its project very carefully. Diversification is a great defensive policy and, thus, an important element in strategy. Unfortunately, a diversification of poor projects gets only poor projects. That was a lesson learned by a number of real estate investment trusts which went into various metro areas to diversify but knew little about the respective surroundings and were hurt in almost all of them. What the firm needs to inspect is the volume of business and number of projects it expects over the ensuing three to five-year period. It may then plan a diversification to secure these projects.

The multi-year plan—one of the advance land acquisition programs that have killed many builder-developers and made others rich—will involve commitments to land, people, and capital. The strategy is to select that land which is developable for the kind of market that will be ready, an approach that requires a longer run view of the market demand and the competitive position of particular parcels of land—a market-based approach for corporate development planning. The "what is needed and what can be supplied" method must be integrated into the determinants of company goals; sometimes the shifting market calls for shifting objectives based on type, price, or location of markets.

After the market or markets to serve have been determined and a strategy of advance land acquisition or an alternative policy for buying finished lots has been established, the development plan requires the assembly of a manage-

ment team that can expand to meet the markets and contract to a digestible overhead level during slow markets. It also calls for a versatile staff capable of producing despite the organization's rapid size changes; these are also tied to market changes and, furthermore, have tremendous implications on capital requirements. Exceptionally large amounts of capital may be needed for the aggressive expansion state, with good liquidity positions necessary for the slowing stage.

The strategy must then deal with a capital planning program that shows cash-flow requirements for a multi-year program or an annual and quarterly basis, depending on the time horizon. (This is aside from the monthly cash flow for current operations.) Variations in the market will influence planned and actual starts and sales, and then the cash requirements. A firm should know what it is capable of handling and how much risk it can take.

Strategy for Analysis

This brings us to the point of strategy for analysis. First, realize that some projects may be appropriate for one builder-developer, but not for another. The decision should be based upon how it fits into the firm's development plan and how well it can be handled. Aside from considering managerial capability and other necessary production resources, one must ask: "Can the company stand the risk?" To determine this, it is imperative to learn the nature of the risk and the firm's staying powers. If the problem is the developability of a site and the time involved, that is where the analysis should focus. The strength of the market may not be at issue and relatively little effort may be needed on market analyses.

Sometimes the critical step will be selecting the market segment. It may be advisable to take 20 units-to-the-acre apartment grounds and build 14 units-to-the-acre piggyback townhouses. The right question must be asked to get the right answer. We can cover a whole host of analyses in applying the logic of formulating the right research question. The strategy of analysis is to pick the right question to ask.

A prerequisite for selecting the right question is the development of the proper reference points. Thus, if a firm has a multi-year plan, a set of forecasted absorption rates, and expectations which are articulated in numbers, it can gauge current activity against the expectation. This method of interpreting the data is illustrated with a multi-year market forecast and the variables included. (Incidentally, the National Association of Home Builders offers the service.)

If any of the key indicators are changing beyond acceptable ranges it may be necessary to reanalyze the project or projects, realizing that analysis, like planning, is a continuing process. The builder-developer makes a preliminary analysis when he decides what kind of land to look for; he completes another when he makes a tentative commitment to the land, refining it when the final commitment is made. More market analysis takes place when the product is designed, which should be when the starts are made.

Consider the response to one builder's query, "Can I build 400 a year?": "Yes, but you'll be lucky to sell 250." The strategy of analysis calls for setting parameters of operations and successively moving through the process of analysis, the most critical variables in the company development plan.

Land developability obstacles and market volatility have been compounding the problem in recent years. Most developers, and indeed lenders, have not come to grips with the real issues. The evidence is the trouble in which they have found themselves and it is obvious that a better analysis should have been executed. But, it's not simply more analyses that are needed—rather, it is those which focus on the real problems. Furthermore, the most effective way to evaluate the result is through the use of this systemic approach whereby one can see how the project and its risks fit into the company development plan. One then knows what is really being evaluated.