Real Estate Issues

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Just as constitutional debt limits have been evaded, there are a number of ways to avoid the kind of tax limits represented by Proposition 13 and its progeny, according to the author. One means is to expand the property tax base by adopting a so-called "general property tax system," making all property—not just real estate—subject to taxation. Another alternative would be the amendment of state income and sales tax laws to provide a state-collected local tax; this would have the same effect as a property tax without being an ad valorem tax of real property. The article claims that limitations on taxes and expenditures will be permanent only for political—not legal—reasons.

Section 2124 of the Tax Reform Act of 1976 enacted into law three new incentives for preservation of historically significant properties. This article analyzes two of those new incentives—the alternative use of a five-year amortization period for certified rehabilitation of historic structures, or accelerated depreciation of the structure's combined basis and rehabilitation cost as it affects the actual after-tax return on a small apartment building in a National Register Historic District. The authors suggest that countervailing sections of the tax code and the TRA '76 (recapture and the tough new provisions increasing the minimum tax) tarnish the allure of old buildings as new tax shelters and require additional tax incentives to foster historic preservation.

On June 26, the U.S. Supreme Court sustained New York City's right to designate individual landmark buildings and to halt a proposed demolition. It was this court's first review of a local historic preservation law. The case involved the rejection of plans to build a 55-story building on the site of Grand Central Terminal, a designated city landmark. In the court's opinion is language strongly supporting the provisions in the laws that have established landmark and historic district commissions in more than 500 cities and towns. This decision has given a status to historic preservation that can only come from a review of a controversy by the Supreme Court. The opinion said that the New York City law permitted Penn Central "not only to profit from the Terminal but to obtain a 'reasonable return' on its investment."

The urban land market lets firms enjoy synergy via mutual aid, without loss of independence. Synergy entails mutual access, sharing costs, specialization, competition, choice, flexibility, pooling, innovation, and information. But, the author contends, parasitic land uses hinder synergy. These are uses which pollute, crowd the lot lines, overload the infrastructure, are cross-subsidized, are absentee-owned, dilapidated, too self-contained, or simply absent. He illustrates how constructive remedies combine user charges and measured subventions in optimal balance with land taxation.

Bank Trust Department Operation of Commingled Real Estate Funds — **Mike Miles and Janette Langford,** *Page 62*

Real estate as an investment medium offers certain distinctive advantages which have been well known for some time. Associated with these advantages are certain diversification, management, and liquidity problems not associated with alternative types of investments. This article explores commingled real estate funds as a mechanism for offering clients the distinctive advantages of real estate investment without many of the normally attendant problems. Specifically, the article deals with commercial banks operating commingled funds and focuses on the banks' investment criteria. The investment counselor should be aware of the requirements of these new and potentially very significant participants in the real estate investment marketplace.

Young Professionals and City Neighborhoods — **The Parkman Center for Urban Affairs,** *Page 79*

Boston continues to attract "young professional" home buyers whose tastes lean toward the kind and quality of housing available in the city—namely, the Victorian mansion and the mini-Victorian "cottage." In examining this migratory trend, the Parkman Center discusses the attractions that draw the young home-seekers—affordability, a sense of community, the phenomenon of "urban chic," a vital environment in which to pursue personal goals—as well as negative influences—crime, adequacy and responsiveness of public institutions, and less definite elements characterized as the "civility" of the urban atmosphere and uncertainty about the future. This study suggests that as the baby boom generation reaches home-buying age, older urban centers across the nation have a better chance of reinvigorating themselves than they have had for 30 years or more.

Real Estate Issues

The Professional Journal of the American Society of Real Estate Counselors

PRESIDENT'S MESSAGE

The American Society of Real Estate Counselors now consists of some 500 men and women in the United States and Canada who, because of their experience and competence in the field of real estate, have been invited into membership. These persons provide professional advice and guidance on a fee basis in accordance with the Society's Code of Ethics and Standards of Practice, which clearly set forth the membership's responsibility to the public it serves.

On this our 25th Anniversary, as we take stock of our various accomplishments, it is fitting that we offer our congratulations to our editors and associate editors and the members of our professional staff for their efforts in successfully launching *Real Estate Issues.* Gaining recognition and acceptance of a new professional publication within the North American business community—as we have done—is certainly no small feat. To this end we must also congratulate the entire membership for its vision and perseverance despite the agonizing decisions which had to be made along the way.

So as we raise our glasses to toast the Society on its 25th birthday, we also add one more to its young and sturdy offspring, *Real Estate Issues.*

Abram Barkan, CRE
ASREC President

Some years ago I wrote the following which was presented to the Executive Committee of the American Society of Real Estate Counselors on May 24, 1958:

> If ASREC is to establish itself as a virile, useful organization, it must now turn its attention to professional contribution.
>
> The organization stage has been completed.
>
> The establishment of standards is under way.
>
> Professional contribution should come next.

It seems quite appropriate that at the close of 25 years of professional endeavor in the field of real estate counseling there should appear on the scene ASREC's new professional journal, *Real Estate Issues.*

Its time has come.

More power to *Real Estate Issues* in the next 25 years.

Roland Rodrock Randall, CRE
ASREC Founding President

EDITOR'S STATEMENT

With this number, *Real Estate Issues* enters its third year of publication. Like its twenty-five year old parent, the American Society of Real Estate Counselors, *Issues* has done well and expects an even better future. In the two years of its existence it has more than lived up to its name, providing a forum for the serious discussion of topics that interest real estate practitioners and educators alike. It has brought together much of the best current work of leading authors in the field, making available to our readers a breadth of knowledge and a depth of understanding not often encountered in the real estate literature.

The current number carries on this tradition. It opens with a provocative new article on Proposition 13 by Donald Hagman, whose recent book, "Windfalls for Wipeouts" co-authored with Dean Misczynski, has dropped a few ripe apples on the hardheads of the land-use community, and closes with an analysis of the problem of neighborhood revitalization; Robert Fichter and the Parkman Center for Urban Affairs share their research into the attitudes and forces behind the new trends toward urban reinvestment and the repopulation of the inner city. In between, Mike Miles and Janelle Langford provide a careful factual review of the operations of commingled real estate funds by bank trust departments; Richard Roddewig and Michael S. Young offer a new and useful analysis of the 1976 Tax Reform Act's incentives and disincentives; and Frank Gilbert caps his series of updates on the Grand Central case with a report of the U.S. Supreme Court decision, the implications of which promise to be nearly as far reaching as those of *Village of Euclid v. Amber Realty Company,* the 1926 case that confirmed the constitutionality of zoning. In addition, Mason Gaffney presents an extensive, broad-brush summation of his penetrating insights into the dynamic of cities.

As Editor-in-Chief, I have often had to make difficult choices, and still more often to cajole and prod leading personalities into putting pen to paper. The results have been, I feel, more than worthwhile. If *Issues* has provoked controversy, I am glad of it; if it has caused a few sacred cows to jump, I rejoice; if it has encouraged experts to re-examine outworn assumptions or to explore new areas of knowledge, I am deeply grateful.

It is a continuing pleasure to work with an excellent staff under the distinguished sponsorship of the Society. For that pleasure, for the constantly improving flow of new materials, and for the opportunity provided by that flow to stay in touch with the best minds in our field, I am deeply appreciative. The job of the Editor-in-Chief may be uncompensated financially, but it is not without substantial rewards.

Jared Shlaes, CRE
Editor-in-Chief

How to Comply with Property Tax Limitations and Raise Taxes on Property at the Same Time

by Donald G. Hagman

In the last quarter of the 19th century, constitutional debt limits were being swept into state constitutions. One popular limitation is that state and local governments cannot incur debt unless it is approved by a vote of the people and extraordinary majorities are often required.[1] Given such a debt limit in California, how is it that Los Angeles County has $516.1 million in debts, only $18.1 million of which were approved by the voters?[2] The answer: clever lawyers.

In the last quarter of the 20th century, constitutional property tax limits are sweeping the country. California's Proposition 13 was adopted on June 6, 1978. Its progeny will be voted on in Idaho, Michigan, Nevada, and Oregon on November 7, 1978.

Among its other features, Proposition 13 limits real property taxes to 1% of market value (cutting yearly revenues from property taxes in California from $12 billion to about $5 billion) and precludes other taxes from being increased except by two-thirds vote of all members of the legislature at the state level or a two-thirds vote of those eligible to vote at the local level. Oregon's Ballot Measure 6 is identical, except for a 1½% limit.

The thesis of this discussion is that these limitations, just as debt limitations, are legal creampuffs in the hands of clever lawyers. Their efficacy is in their political message, not in their legal efficacy. Assuming diminishment of political fervor about tax limitation, therefore, the constitutional limits are only temporary palliatives to high taxes on property.

Donald G. Hagman, Professor of Law at the University of Southern California, specializes in state and local tax, local government, planning, and environmental law. His latest book, co-authored with D. Misczynski, is *Windfalls for Wipeouts: Land Value Capture and Compensation*, published in 1978.

EXPANDING THE PROPERTY TAX BASE

The first proposal for legally avoiding a Proposition 13 type tax limitation is to return to the so-called general property tax system which prevailed earlier in our history. For example, the California Constitution of 1879 required that "all property . . . shall be taxed in proportion to its value" and "all property subject to taxation shall be assessed for taxation at its full cash value." If we implemented today a maximum 1% property tax rate on all property, $125 billion in property tax revenues would result. That is a figure calculated by using the best estimate of national assets in 1966 of $5.8 trillion and in 1973 of $9.9 trillion[3] and assuming the same growth rate through 1978, meaning national assets must be about $12.5 trillion. The amount of property taxes actually to be collected in 1978 is about $69 billion.[4]

States, of course, vary in how much property taxes they now impose and how much a 1% maximum on all property would yield. Wealth statistics are difficult enough to find for the nation; they are virtually nonexistent by state. But one could make a rough approximation. In California, for example, assume the ratio of wealth to national wealth is about the same as the proportion of California personal income is to national personal income. Assume further those proportions have not changed since 1976, when California personal income was 11.2% of national personal income.[5] The full cash value of all California property must then be about $1.4 trillion ($12.5 trillion x 11.2%). If all of that property was taxed at the maximum rate permitted against real estate by Proposition 13, it would produce $14 billion in property tax revenues in 1978. That's almost $3 billion over the California Legislative Analyst's estimates of what 1977-78 property taxes in California would have been had the property tax law remained unchanged.[6]

Using the same technique, Oregon's wealth must be about $137.5 billion. A maximum 1½% limit on all that wealth would produce property taxes of $2.06 billion in Oregon. Property taxes in Oregon are only about $1.0586 billion now. Calculations in other states could be similarly made.

Having a broad-based, low-rate property tax has a number of advantages. First, the property tax would be more "neutral," as economists say. People would not invest in particular kinds of property for tax reasons. An unneutral tax causes inefficient deployment of resources. Second, the tax would be easier and hence less costly to administer without loopholes. Third, since no property would be taxed more than $1 per $100 per year, there would be less incentive for evasion than now when taxes on some property approaches ten times that amount. Fourth, the property tax could be made markedly more progressive. For example, the wealthiest 1% of wealth holders in America in 1972 owned 56% of all corporate stock, 60% of all bonds and 53% of debt instruments.[8] The taxation of all property would place a property tax on that kind of wealth and that kind of wealth is the biggest loophole under the existing property tax.

One trouble with the proposal to expand the property tax base is that it would shift taxes and wealth dramatically. The holders of property not now taxed (such as owners of stocks and bonds) would be less wealthy and the holders of property now taxed (such as homeowners) would be wealthier. Of course, the proposal is no worse than Proposition 13-like limitations since they, too, cause massive shifts in taxes and in wealth.

TAX ON TENANCY

The shift would be smaller if the legislature responded to Proposition 13-like limits by enacting an alternative proposal. The second proposal is to adopt the kind of local tax on property used in England and in a number of other countries. A 1976 English government report describes the English local tax on property:

> . . . as a tax on the benefit of occupation of land and buildings. . . . The benefit of occupation . . . is . . . the rent at which the property might reasonably be expected to . . . (rent for) from year to year if the tenant bore the cost of repairs, insurance and maintenance. . . . The rents . . . are not the actual rents . . . but the rents which a tenant might reasonably be expected to pay for a tenancy from year to year.

The economic effect of the English tax is somewhat different than the typical American property tax because rental values in England are based on the existing or current uses of property rather than on highest and best use. For example, if one had land in England improved with a single family house, it would be valued in its use for single family purposes even though there was a demand for using the property for a more valuable multiple-family use. Despite the difference in the valuation principles, the tax and wealth shift would not be marked because most properties in America are now valued for property tax purposes at what amounts to their capitalized rental value in existing use—they have no other potential uses. Even if the values are different, valuing properties at existing use is no novel concept to assessors. Property tax law in many states requires certain properties to be assessed at existing use.[11] In California millions of acres of agricultural land,[12] timberland,[13] golf courses,[14] and other open space lands[15] are already taxed under existing use principles as are certain single family houses[16] and historic buildings.[17] Some argue that existing use valuation is fairer in any event because a tax measured by the value of a potential use "forces" conversion of the property to that use in order to pay the higher tax.[18]

No change in economic effects from adopting the English system would occur if the assessor used hypothetical rents based on the assumption that the tenant could change the use to the same extent that the owner could change the use. The taxes under such an English-like tax on property would then be virtually the same as would existing property taxes. Only the rates would be different. For example, suppose a homeowner now has a house with a market value of $100,000 and an assessed value of $25,000 on which the tax rate is $10. The tax is $2,500 per year. Assume that the house could be rented for 10% of its market value per year. Rent of $10,000 taxed at a rate of 25% would result in a tax of $2,500 a year.

Such an English-like tax has been held not to be a property tax, and it thus likely avoids the Proposition 13-like limitation of 1% for "any ad valorem tax on real property." Unfortunately, an English-like tax is not deductible from the federal or state income tax.[19] It could be made deductible by a change in the income tax laws. But a change in federal law is not likely. Therefore, the problem is to revise the English-like tax on property to make it a real property tax, and thus deductible on the federal return, but not an "ad valorem tax on real property," because Proposition 13-like provisions limit such taxes to 1%.

After considerable scholarly pursuit,[20] the New York legislature has taken the step to make an English-like tax deductible from the real property tax. A bill which became Chapter 471, Laws 1978 on July 6, 1978 has a summary as follows:

> An Act to amend the real property tax law . . . providing that certain renters of residential property have an interest in real property, are personally liable for the real property taxes due on their interest and are entitled to a federal itemized deduction for these real property taxes.

Rather than tax occupancy, the New York statute gives the renter an interest in real estate which is taxed and the renter is made personally liable. The change is really cosmetic. For example, the landlord collects the tax and pays it to the tax collector—but it is the tenant's, not the landlord's, tax that is paid.

Kee and Moan[21] estimated that the federal tax savings to persons in New York City in 1973 under their proposal would be $200 million. Assemblyman Siegel, the main author of the New York legislation, estimated that New Yorkers would save $120 million in federal taxes under his less sweeping legislation.[22] The Kee and Moan scheme applied to California in 1978 could probably have reduced federal taxes to Californians by some $1 billion. Even after Proposition 13, it would still be a good idea, saving Californians some $300 million in federal taxes.

Not faced with a Proposition 13-like limit, New York was not concerned about how to change the English-like tax enough to make it deductible and still avoid Proposition 13-like limits. But lawyers are clever. One could draft a statute which would make a tax deductible from the federal income tax by either owners or tenants but without making it an ad valorem tax on real property.

TAX ON RENTS

Another alternative does just that. The third proposal is to amend state income and sales tax laws to provide for a state-collected, local tax which is the same as the property tax in economic effect but is not an "ad valorem tax on real property." It thus avoids Proposition 13-like limits but is still a tax deductible from the federal income tax.

Consider an owner-occupier of real estate first. The state legislature would pass a law declaring that income of owner-occupiers for state income tax purposes[23] includes imputed rent. Imputed rent is the income an owner would receive on a residence if it was rented out. The occupant, under an imputed rent scheme, is deemed to be paying rent to the owner even though both are the same person. The owner is then taxed on the rental income. Thus a homeowner with a $100,000 house assessed at $25,000 paying $10 per $100 of assessed value property tax now pays $2,500 in property taxes. After conversion to an income tax and assuming a 10%, $10,000 rental, a 25% surcharge tax on *that* income would also be $2,500.

The legislature in California has already experimented with disguising a tax as an income tax to make it deductible. Senate Bill 1 was proposed to implement Proposition 8, the California Legislature's alternative to Proposition 13 on the California ballot. Until the very last moment, when the feature was defeated by massive lobbying by Realtors, Senate Bill 1 contained a provision for a tax of 5% from the sale of an "owner/occupied" home. So described, the tax would not likely be deductible from federal income taxes.[24] So the legislature provided for the tax by amending the state income tax laws to provide a special tax rate on income from such sales. Deductibility from federal taxes was the intended result.

Tenants could be taxed by a different state-collected, local tax. The sales tax laws[25] could be amended to provide that the rental of real estate was consumption of property taxed under the sales tax. The sales tax rate could be surcharged so that the rate on rentals was 25% rather than the typical percent. Thus, if one rented residential real estate for $10,000 a year, the example previously used, one's sales tax would be $2,500. The owner could collect and remit the tax to the state, just as a retailer now does, but the tax would still be deductible by the renter (consumer).

A SPECIAL ASSESSMENT

A number of further proposals might emerge if one were not just coming up with these off the top of one's head. For the moment, a fourth proposal, to convert property taxes into special assessments, exhausts imagination. A number of special districts in America levy special assessments which look very much like ad valorem property taxes but have been held not to be ad valorem property taxes.[26] A special assessment is not *based* on the value of property (ad valorem), as is the property tax, but on benefit received. But the benefit received under special assessment law can be *measured* by the value of the property receiving the benefit. For example, operation and maintenance assessments of reclamation districts in California are based on a "valuation per acre for each parcel which is in proportion to the benefits to be derived . . ."[27] County water districts levy a tax "in proportion to the assessed valuation of the land . . . benefited . . ."[28] These special assessments are very difficult to tell from property taxes. They are even billed on the property tax bill.

Generally, a special assessment is not deductible from federal income taxes, but a special assessment measured by ad valorem principles and used to pay for current operations as distinguished from capital improvements could be deductible.[29] Ordinarily, a special assessment is assessed only against land, not buildings. But there is nothing in theory which says buildings could not be regarded as receiving benefits. Thus, while more awkward than some of the others, the proposal for a special assessment on property to replace the ad valorem tax on real property has theoretical possibilities.

Getting around Proposition 13-like 1% limits is as easy as fishing in a hatchery. Depending on convenience, the alternative could be a state tax, a local tax state-collected (as is the local sales tax in many states), or a state tax distributed locally (as is the tax on automobiles in many states). They could be made deductible against federal income taxes, all would evade the Proposition 13-like limit and the tax could be made identical in amount and in distribution to the property tax.

AVOIDING PROPOSITION 13-LIKE LIMITS ON OTHER TAXES

Supporters of Proposition 13-like initiatives, reading another of its provisions, will hope they have anticipated and invalidated the fourth proposal. Section 1.a. of Proposition 13 provides that the 1% limit "shall not apply to ad valorem taxes or special assessments" to pay preexisting debt. The implication is that the 1% limit may apply to special assessments generally or to pay special assessments for new debt. A trouble is that the term "special assessments" in Proposition 13 could be interpreted by a court unimpressed with Proposition 13 to mean that revenues from a specially-assessed property tax could not be used to pay off new debt. A special assessment is not the same as a specially-assessed property tax. Further, the fourth proposal is not limited to a special assessment for either old or new debt but could be for current expenditures as with the property tax.

If traditional special assessments were meant to be banned by Proposition 13, it is a dumb idea. Suppose you want some new street lights in front of your house? You and your neighbors can now get together and have them put in by the city. The city can borrow money to finance them on a tax exempt basis and pass on the saving to you. If you did it privately, the money to finance the lights would have to be borrowed on the private market. If borrowing on the private market were an economic advantage, the U.S. Chamber of Commerce would not be in favor of industrial development revenue bonds which essentially do for business what a special assessment technique can do for homeowners—lower costs. Of course, Proposition 13 is not concerned about lowering costs; it is only concerned about lowering taxes.

Supporters of Proposition 13-like initiatives may by this point believe that these proposals to replace property taxes with taxes on property are legally viable. There is a strong possibility that the limit imposed on real property taxes could be avoided. They will now bring up the big artillery in the form of Section 3 of Proposition 13 to prevent the proposed alternatives from being adopted.

> . . . any changes in State taxes enacted for the purpose of increasing revenues collected pursuant thereto whether by increased rates or changes in methods of computation must be imposed by an Act passed by not less than two-thirds of all members elected to each of the two houses of the Legislature. . . .

There are several legal ways around that provision. The easiest evasion is to have the state enable local governments to enact taxes. A state-enabled local tax is not a state tax. Another possibility is for the legislature to state a purpose other than increasing revenues. Suppose the legislature increases the tax on cigarettes and states that the purpose is to improve our health? Or a tax on gasoline with the purpose of lowering pollution? The revenue increase would then be incidental. The real purpose would be to improve health or lower pollution. Courts have upheld legislatures in similar situations in the past.[30]

What is an "increased rate or change . . . in methods of computation?" Suppose the legislature decides to impose a sales tax on services as well as on sales of tangible personal property? Surely it is open to argument that an increase in the tax base is neither an increase in rate nor a change in the method of computation of the sales tax. Finally, of course, if Proposition 13-induced shortfalls are bad enough, a two-thirds vote of each house of the legislature is a distinct possibility. The budget of some states is now passed by such a majority. If that can routinely occur, why would one suppose that the taxes necessary to finance the budget could not be similarly obtained?

The supporters of Proposition 13-like initiatives are now down to their last lines of defense. Section 4 of proposition 13 provides that:

> Cities, Counties and special districts, by a two-thirds vote of the qualified electors of such district, may impose special taxes on such district, except ad valorem taxes on real property or a transaction tax or sales tax on the sale of real property within such City, County or special district.

This provision would not preclude the adoption of the proposals. First, school districts are not covered so the proposed taxes on property could be authorized for and by them. Second, while a two-thirds vote can impose taxes, that is not stated as the only way that taxes can be imposed. There may be other ways. City charters in some states can authorize imposition. A state legislature can authorize imposition. The state is not barred from enabling local taxes.

What is a special tax? Does that mean "new" or "additional" tax? Suppose local sales tax rates are increased? Is an increase in rate of taxes already authorized a special tax? "Cities, Counties and special districts . . . may impose . . . taxes on such district." It is true, districts do own property. Does Section 4 merely permit cities and counties and districts to tax the property owned by special districts?

CONCLUSION

Property tax limits based on the Proposition 13 model have all the legal tenacity of soft yogurt. For those who wish to limit government taxation or expenditure, the Proposition 13 model is a delusion in the long term. There are a number of other types of limitations now being proposed. The second generation may be a better vehicle to limit government grown too wasteful for the public taste.

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2. *Final Report of the County Formation Commission for the Proposed South Bay County* 27 (March 24, 1978).
3. J. Kendrick, *The National Wealth of the United States* (March 1976), table 2-2.
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5. U.S. Bureau of the Census, *Statistical Abstract of the United States 1977*, table 703.
6. California Assembly Revenue and Taxation Committee, *Facts About Proposition 13—The Jarvis/Gann Initiative* (Feb. 15, 1978), app. 8.
7. Property taxes in Oregon were $633.8 million in 1974-75 and $775.4 million in 1975-76, an increase of $141.6 million. See U.S. Bureau of the Census, *Governmental Finances in 1974-75*, table 17; *id.* 1975-76. Assuming an equal increase in the next two years, taxes now must be about $1.0586 billion.
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15. *Ibid.*, sec. 9; California Revenue and Taxation Code, sec. 421 *et. seq.*
16. *Ibid.*, sec. 8; California Revenue and Taxation Code, sec. 401.4.
17. *Ibid.*, sec. 8; California Revenue and Taxation Code, sec. 439.
18. *Supra*, note 11.
19. *Waxenberg v. Commissioner*, 62 T.C. 495 (1974); Rev. Rul. 1973-2 C.B. 47.
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21. *Supra*, note 20.
22. Telephone interview Aug. 15, 1978 by author with Paul Moore, staff, Ways and Means Committee, State Assembly, Albany, New York.
23. Forty-five states have income taxes. See *All States Tax Handbook* (Prentice Hall, 1977), p. 210.
24. Hagman, "Special Capital and Real Estate Windfall Taxes," *Windfall for Wipeouts: Land Value Capture and Compensation*, ed. Hagman and D. Misczynski (1978).
25. Forty-six states have sales taxes. See *All States Tax Handbook* (Prentice Hall, 1977), p. 210.
26. *City of San Diego v. Linda Vista Irrigation Dist.*, 108 Cal. 189, 41 P. 291 (1895).
27. *California Water Code*, sec. 41323.
28. *Ibid.*, sec. 31703.1.
29. *U.S. Treasury Regulations*, sec. 1.164-4(b) (1).
30. See *e.g.*, *Railway Express Agency v. Virginia*, 358 U.S. 434 (1959); "the use of magic words or labels" can be decisive.

New Shelters In Old Properties: The Tax Reform Act of 1976

by Richard J. Roddewig and Michael S. Young

THE NEW FEDERAL CONCERN FOR THE BUILT ENVIRONMENT

One facet of the new environmental concern of the 1960s was a realization that our built environment needed as much protection as our natural environment. Important components of the built environment were disappearing as quickly as the quality of our air and water. Since 1933 more than 25% of the buildings recorded by the first Historic American Buildings Survey have been destroyed.

In the late 1960s government began to respond to this new awareness. At the local level, historic district zoning or regulations began to appear, and at the federal level, matching grant programs to assist state preservation efforts were inaugurated. The National Trust for Historic Preservation, a private organization chartered by Congress in 1948, put its finger on the principal stumbling block to a wider acceptance of its preservation viewpoint when it quoted urbanologist Ada Louise Huxtable who said, "Cities are built and unbuilt by the forces of law and economics, supply and demand, cash flow and the bottom line, far more than by ideals, intentions, talents and visions or architects and planners."

Because federal income tax policy has long been an important contributor to making real estate deals work, Congress incorporated into the Tax Reform Act of 1976 the provisions of Section 2124, "Tax Incentives to Encourage the

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This is a condensation of an article entitled "Neighborhood Revitalization and the Historic Preservation Incentives of the Tax Reform Act of 1976: Lessons From the Bottom Line of a Chicago Red Brick Three-Flat," appearing in *The Urban Lawyer*, volume 11, issue 2, January 1979.

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Preservation of Historic Structures."[1] There were three incentives and two disincentives in the legislation as finally enacted into law. The first incentive provision allows rehabilitation expenditures incurred with respect to certifiable historic structures used in a trade or business or held for the production of income to be amortized over 60 months. The second incentive, an alternative to the first incentive, allows the owner to use accelerated depreciation methods as if the owner were the first owner of a new real estate asset when an historic structure is "substantially rehabilitated."[2] The third incentive was a new charitable contribution deduction of a partial interest in property (e.g., limited term conservation easements or remainder interests in real property granted exclusively for conservation purposes).

The two disincentives are potentially the widest reaching (and most controversial) provisions in the legislation. When a certified historic structure is demolished or when any structure located in an historic district listed in the National Register of Historic Places is demolished,[3] the owner will not be allowed to deduct for tax purposes the cost of demolition or even the undepreciated basis of the structure. Instead, both the demolition cost and the undepreciated cost of the building must be added to the basis in the land. Because land is not a depreciable asset, the owner or developer would lose two important tax deductions that heretofore were advantageous to developers of new buildings. In addition, the depreciable basis of any new structure erected on the site of a demolished National Register property or certified historic structure may only be depreciated at the straight-line rate.[4]

In the section-by-section analysis of the bill and the environmental impact statement that accompanied it, Maryland Senator Glenn Beall suggested strongly that central city commercial areas were intended to be the main beneficiaries of the tax incentives:

> The rehabilitation proposals are specifically aimed at preserving a variety in the size and architecture of urban structures by offering to the investor an attractive alternative to the demolition of older buildings. Center city commercial areas have been particularly affected by a tendency to convert land usage to large multistory structures or to parking lots and other low density uses often related to motor vehicle accommodation. The resultant loss in the character and charm of our cities is a permanent concession to economic realities.
>
> . . . over the long term the effect of moving toward more equal tax treatment of demolition and rehabilitation should result in greater variety and character in the urban environment. More older structures should be retained and renovated. Downtown areas should provide a broader range in architecture as the ages of buildings will be more varied. Smaller older structures should be saved and used where before they might have been converted to parking lots. Residential areas with a high number of rental units should show greater numbers of rehabilitation structures. Fewer structures should be abandoned and left to decay.

The economic factors that make the bottom line in an investment in an older building unattractive are many. As the Department of the Treasury's Environmental Impact Statement on the proposed legislation made clear: "Present economic incentives do not favor the retention and restoration of these [historic] buildings, particularly those in private ownership. Maintenance costs are high and restoration expenses often exceed potential future returns for buildings held for commercial purposes." Do the historic preservation incentives of the Tax Reform Act of 1976 alter that bleak assessment of the prospects for rehabilitation? Does Section 2124 have a chance to accomplish all the grand goals its sponsor envisioned? Are the tax incentives strong enough to generate the amount of rehabilitation necessary to change the pattern of inner-city development and demolition? In this article we shall discuss the likely impact of the first two incentives, i.e., the alternative use of a 60-month amortization of rehabilitation expenditures or accelerated depreciation on the entire basis of a renovated building in designated historic districts in Chicago.

What magnitude of added tax savings would be provided by the 60-month amortization or accelerated depreciation deductions in a typical residential rehabilitation project? How does another aspect of the Tax Reform Act of 1976, the new punch given the minimum tax on preference items, offset the appeal of the historic preservation incentives?

THE TAX REFORM ACT OF 1976 AND THE PROSPECTS FOR NEIGHBORHOOD REVITALIZATION

The Scope of the Historic Preservation Provisions

The first flurry in the use of the preservation provisions of the Tax Reform Act of 1976 is likely to be in residential rehabilitation rather than in commercial office building rehabilitation. Neighborhoods near some major urban centers have undergone spontaneous rejuvenation during the last ten years. The catalyst has often been a combination of factors including proximity to downtown cultural and recreational amenities, easy and quick journeys to and from work, and an architecturally interesting stock of well-crafted, pre-1900 townhouses and small apartment buildings. Most of the rehabilitation effort has been by small developers or owner-occupiers of one- to six-flat buildings. Larger development companies have shown interest in six to 20-unit buildings or in adaptive reuse of commercial space for residential purposes once neighborhood rehabilitation reaches some undefined tipping point toward increasing property values. This residential rehabilitation phenomenon is poised to assimilate the Tax Reform Act rehabilitation incentives.

By contrast there has been relatively little experience with rehabilitation of commercial office buildings. Many of the highly touted commercial renovation attempts of recent years, such as Ghirardelli Square in San Francisco and Trolley Square in Salt Lake City, have been examples of adaptive reuse for new purposes rather than renovation of buildings to better serve the originally intended use. Because adaptive reuse projects usually involve major alterations of interior spaces, reducing the building to nothing more than an "historic container," certification of those projects for Tax Reform Act rehabilitation benefits is problematical.

The scope of the new provisions is quite narrow. The Tax Reform Act benefits only apply to individual buildings or historic districts listed on the National

Register of Historic Places. The Register was created pursuant to the National Historic Preservation Act of 1966 that requires the Secretary of the Interior "to expand and maintain a national register of districts, sites, buildings, structures and objects significant in American history, architecture, archaeology and culture . . ."

Anyone may nominate a property to the National Register. It need not even be the owner or a civic group. Nominations are sent to a designated State Historic Preservation Officer (SHPO) in the state in which the property is located. If the SHPO approves, the nomination is forwarded to the Office of Archaeology and Historic Preservation (OAHP), once a division of the National Park Service but now under the newly-created Heritage Conservation and Recreation Service (HCRS), for final approval. The criteria for evaluating the historic significance of a building nominated to the National Register include its association with significant events or persons in American history and its embodiment of a distinctive style or type of construction or work of a master.

By the end of 1977 there were approximately 12,500 individual properties on the National Register, and new additions are made annually. Nationwide about 1500 historic districts containing perhaps one million buildings have been listed, including 30 districts in Illinois and eight districts within the City of Chicago. However, not every property within a designated National Register historic district or individual listed property qualifies for the 1976 Tax Reform Act benefits. The property must be depreciable; that is, it must be used in a trade or business or in some other way to produce income. For example, commercial office buildings and apartment buildings are income-producing properties. An owner-occupied single-family home does not qualify.

The Dual Certification Process

Special Standards Govern Building Significance and Rehabilitation

Not every commercial office building or apartment complex in an historic district automatically qualifies for the historic preservation tax benefit. The property owner must have the building "certified" by the Secretary of the Interior if it is not already individually listed on the National Register of Historic Places. The certification process has been explained in the final regulations for implementing Section 2124 of the Tax Reform Act of 1976 issued by the National Park Service in October of 1977.[5] To qualify for the tax benefits, the owner of a property in a registered historic district must first convince the State Historic Preservation Officer that the property is "of historic significance to the district." The documentation which the owner must supply is not too rigorous:

> (1) Name of owner; (2) name and address of structure; (3) name of historic district; (4) current photographs of structure; (5) brief description of appearance including alterations, distinctive features and spaces, and date(s) of construction; (6) brief statement of significance (architectural and/or historical); and (7) signature of property owner requesting the evaluation.

The State Historic Preservation Officer makes a written recommendation to Washington concerning the application. The recommendation, pro or con, is based on the following standards:

(a) A structure contributing to the historic significance of a district is one which by location, design, setting, materials, workmanship, feeling, and association adds to the district's sense of time and place and historical development.

(b) A structure not contributing to the historic significance of a district is one which detracts from the district's sense of time and place and historical development intrinsically; or when the integrity or the original design or individual architectural features or spaces have been irretrievably lost.

(c) Ordinarily structures that have been built within the past 50 years shall not be considered eligible unless a strong justification concerning their historical or architectural merit is given or the historic attributes of the district are considered to be less than 50 years old.

As the 50 State Historic Preservation Officers gain experience, it is likely that the Secretary of the Interior will accept their recommendation on certification of the historic significance of individual buildings in almost every case.

Merely obtaining the certification of the building's historic character is not a carte blanche to begin gutting and rehabilitating. The property owner must have the program of rehabilitation certified as well. The standards for certification of the rehabilitation are lengthy and complex:

(1) Every reasonable effort shall be made to provide a compatible use for a property which requires minimal alterations of the building structure, or site and its environment, or to use a property for its originally intended purpose.

(2) The distinguished original qualities or character of a building structure or site and its environment shall not be destroyed. The removal or alteration of any historic material or distinctive architectural features should be avoided when possible.

(3) All buildings, structures, and sites shall be recognized as products of their own time. Alterations that have no historical basis and which seek to create an earlier appearance shall be discouraged.

(4) Changes which may have taken place in the course of time are evidence of the history and development of a building, structure, or site and its environment. These changes may have acquired significance in their own right, and this significance shall be recognized and respected.

(5) Distinctive stylistic features or examples of skilled craftsmanship which characterize a building, structure, or site shall be treated with sensitivity.

(6) Deteriorated architectural features shall be repaired rather than replaced, wherever possible. In the event replacement is necessary, the new material should match the material being replaced in composition, design, color, texture, and other visual qualities. Repair or replacement of missing architectural features should be based on accurate duplications rather than on conjectural designs or the availability of different architectural elements from other buildings or structures.

(7) The surface cleaning of structures shall be undertaken with the gentlest means possible. Sandblasting and other cleaning methods that will damage the historic building materials shall not be undertaken.

(8) Every reasonable effort shall be made to protect and preserve archaeological resources affected by, or adjacent to, any rehabilitation project.

(9) Contemporary design for alterations and additions to existing properties shall not be discouraged when such alterations and additions do not destroy significant historical, architectural, or cultural material, and such design is compatible with the size, scale, color, material, and character of the property, neighborhood or environment.

(10) Whenever possible, new additions or alterations to structures shall be done in such a manner that if such additions or alterations were to be removed in the future, the essential form and integrity of the structure would be unimpaired.

Certification Ambiguities—Resolved and Otherwise

The Office of Archaeology and Historic Preservation within the HCRS handles the final certification reviews and it is beginning to clarify the many ambiguities in those two sets of certification standards. When the draft regulations on building certification were first proposed, it was widely feared that many buildings in a district might not qualify. Note that the standards for building certification require "location, design, setting, materials, workmanship, feeling, *and* association." What if a structure had the design, materials, workmanship, and feeling of the era which the district celebrates, but was boxed in by more structures? Did that mean it failed to meet the location, setting, and association standards? Suppose a district celebrated a particular style of architecture or use. Did a building from the same era but in a totally different architectural style or use qualify?

At a series of regional conferences on the historic preservation provisions of the Tax Reform Act of 1976, the Office of Archaeology and Historic Preservation indicated it would loosely interpret the language of paragraph (a) of the building certification standards. It would encourage State Historic Preservation Officers to certify as many buildings as possible within an historic district. For example, the OAHP has certified an historic 1830s hotel in an historic district in Paterson, New Jersey, even though the district was designated because it is the largest and finest assemblage of late eighteenth to early nineteenth century industrial buildings in the east. And in the New Orleans Vieux Carré Historic District, the OAHP would certify buildings from the late Victorian era even though the district commemorates an earlier era of the nation's history.

In broadly reading the certification standards, the OAHP is saying that a National Register historic district is not a highly polished museum for display of an historic architectural style, forgotten lifestyle, or particular building use. Rather it is an assemblage of various architectural forms, lifestyles, and building uses dynamically changing over time with the urban development process. Building uses out of character with the rest of the district, and even later stylistic additions, are certifiable as long as they "contribute to the space within the district, maintain the continuity of the district, and contribute to the streetscape."

The Sheffield neighborhood of Chicago is a designated National Register Historic District composed mainly of three- to six-flat red brick and graystone walkups from the 1880s and 1890s with a smattering of townhouses and single-family homes from the same era. Scattered throughout the district are a few ten to 30-unit apartment buildings constructed in the 1920s. These larger "courtyard buildings" contrast sharply with their red brick and graystone Victorian neighbors, and inside they have none of the fancy oak or maple woodwork or ornate plaster ceiling medallions of the older buildings.

Yet under the broad interpretation of the standards, even these courtyard buildings could be certified. In doing so, the OAHP would be, in effect, inserting a new standard in the gap between standards (a) and (b). The courtyard building does not contribute to the historic character of the district (as required by paragraph (b)). Although wider and deeper than the Victorian era buildings, the courtyard buildings are generally the same height (three to four stories) as their Victorian neighbors. They at least "maintain the continuity" of the district and might contribute more to the district's streetscape than any new building which might replace them.

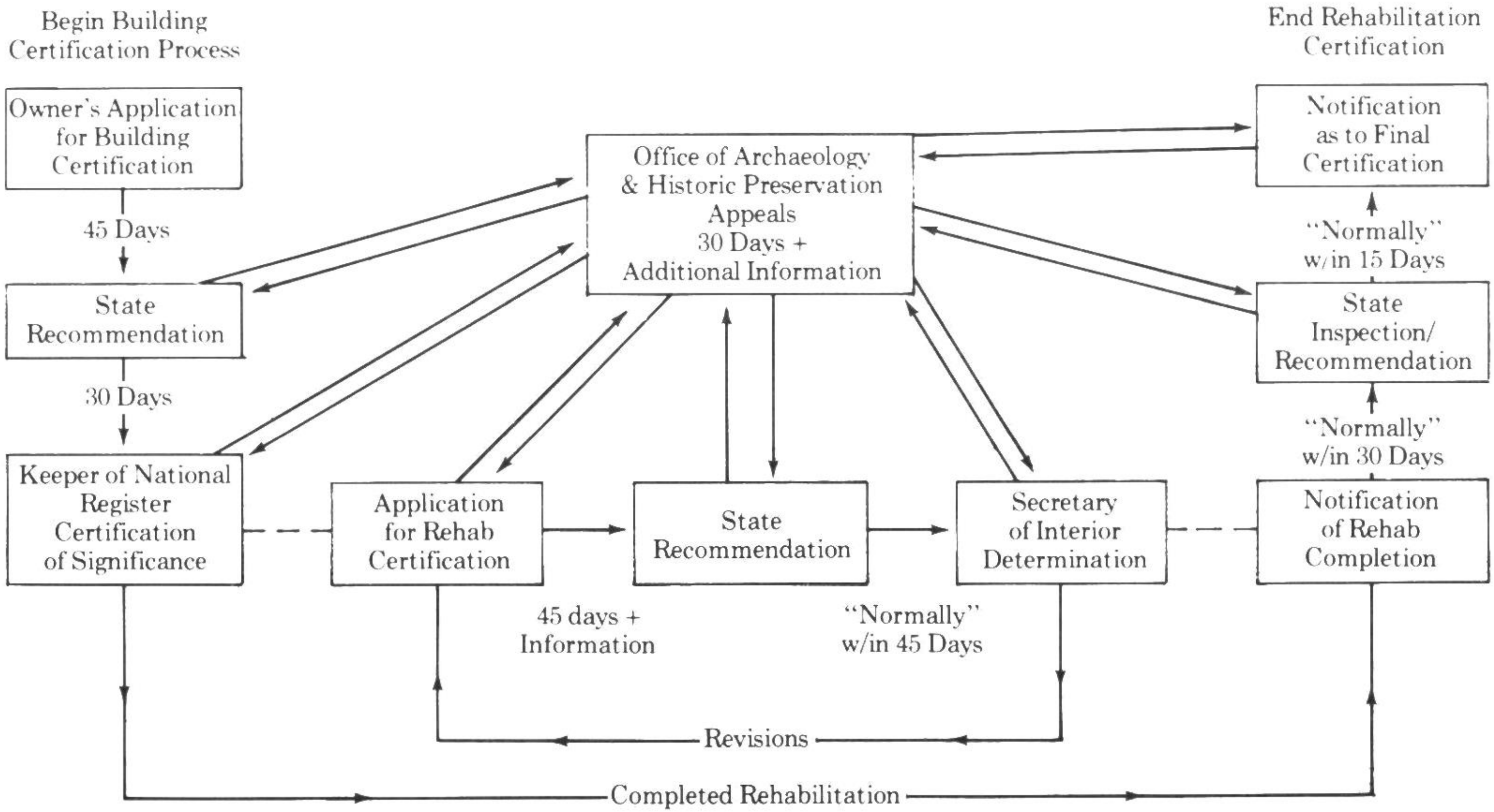
OAHP's willingness to certify as many individual buildings as possible within historic districts may be more than offset by finickiness in certifying their rehabilitation. Many redevelopers will take one look at the ten rehabilitation criteria and label the Tax Reform Act historic preservation provisions as nothing more than an invitation to a bureaucratic nightmare. However, the rehabilitation standards deserve more careful scrutiny. The chief of the Technical Preservation Services Division of OAHP has summarized the overriding principle by which the ten standards will be applied: "The Tax Reform Act of 1976 historic preservation provisions are about rehabilitation—not restoration." The standards are flexible enough to permit alterations important to the economic viability of a rehabilitation project and also to preserve the essential historic qualities of the building.

For instance, final standards (9) and (10) provide guidance for contemporary design alteration of interior spaces as well as exterior appearance. Contemporary interior layouts will not be "discouraged" as long as *significant* historical features are not destroyed and the design is compatible with the character of the building. The guiding principle is to design any interior alterations so that if the "alterations were to be removed in the future, the essential form and integrity of the structure would be unimpaired."

The Dual Certification Time Schedule

If OAHP scrutinizes small details of interior layouts there could be costly time delays for any property owner interested in the historic preservation tax benefits of the Tax Reform Act of 1976. As *Table I* makes clear, the certification that a building is of significance to the historic character of its district could take as long as seventy-five days. Then, if the proposed rehabilitation work has not already been completed, the owner must submit an application for rehabilitation certification to the SHPO. The state recommendation to Washington must be made within 45 days, but the state reviewing officer can delay the review by requesting more information. If more information is requested, the state reviewing officer presumably has another 45 days to digest it once it has been received. Judging from the scrutiny with which rehabilitation proposals will be reviewed, requests for more information could become routine.[6]

TABLE I
DUAL BUILDING AND REHABILITATION CERTIFICATION PROCESS



Once state review is completed and the SHPO has made his recommendation to Washington, the Secretary of the Interior must notify the owner of final approval or disapproval "*normally* within 45 days." The Secretary may also notify the owner directly (or indirectly through the state review officer) that revisions to the rehabilitation proposal are needed before he will give final certification. Presumably the entire rehabilitation certification process must be commenced again once the plans are revised accordingly.

When the owner has completed the rehabilitation work, or if he is seeking certification of an already completed project, he must have the completed project certified. Although there is an optional opportunity for state inspection of the completed rehabilitation, the final notification from the Secretary of the Interior "normally" occurs within 45 days after the owner informs the SHPO that the project is completed.

If an owner receives a denial at any stage of the double certification process, he may appeal directly to the OAHP. He has up to 30 days from denial to make his appeal, and, if successful, he then continues on from the point in the certification process where he had left off. However, in the course of the appeal, the OAHP has the right to ask for more information on which to judge the appeal; yet another delay in the process. The entire process from start of building certification to notification of the final certification could take seven months, or longer if appeals and requests for additional information are required.

Of course work may proceed while a developer puts his rehabilitation proposal through the certification mill, but, for obvious reasons, the OAHP prefers owners to request certification before rehabilitation is completed. That allows the SHPO and the OAHP to request changes in the plans according to their interpretation of the ten rehabilitation criteria. Once the pattern of National Park Service interpretation of the ten rehabilitation criteria becomes clear, it may actually be in a developer's best interest to seek certification only after rehabilitation is completed since the OAHP is likely to forgive mistakes in completed projects that it might otherwise try to alter when reviewing a proposed project. The developer must be confident in his interpretation of the ten rehabilitation criteria and sure that his historic preservation "pluses" outweigh the "mistakes."

The Best Bet For Rehabilitation: Plain Buildings in Fancy Neighborhoods

How much rehabilitation is likely to occur in neighborhoods on the National Register, and how much of that rehabilitation will be able to take advantage of the historic preservation provisions of the Tax Reform Act of 1976? As of February 1978, there were eight historic districts within the City of Chicago that had been listed on the National Register of Historic Places. In only four of those districts—the Sheffield District on the western fringe of the now fashionable Lincoln Park neighborhood, the Lakeview Historic District immediately to the north, the Pullman Historic District at the far south end of the city, and the South Loop Printing House Row Historic District on the edge of downtown Chicago—is there a stock of income-producing properties that may qualify for the rehabilitation tax benefits.

As in the Sheffield District, the qualifying building stock in the Pullman and Lakeview Districts dates from the period 1880 to 1925, and is predominantly small two- to six-flat red brick or graystone apartment buildings. Those three neighborhoods in the late 1960s were among the first in Chicago to attract private rehabilitation capital. The Sheffield neighborhood had already experienced extensive interest in rehabilitation long before it was approved for National Register status in January of 1976, and the same pattern has been repeated in the Lakeview neighborhood recently added to the National Register. There is a strong demand for townhouses and small apartment buildings among young professionals who prefer the excitement of the city to the monotony of the suburbs—and enjoy having tenants make their monthly mortgage payments for them. As a result, property values in parts of the Sheffield and Lakeview Districts are among the highest in the city and still rising.

It was not until a large coterie of well-educated, white-collar singles and marrieds had moved into those areas that interest in National Register listing appeared. Strong new neighborhood organizations were formed, and old ones were given new animus, to promote the area's historic charm and encourage more renovation. The National Register listing was perhaps the culmination of the changeover of the neighborhood from lower- and middle-income blue collar status to middle to upper-income white-collar areas.

The National Register designation process was not designed to be an upper-income phenomenon; it just is. Anyone may propose a neighborhood for designation, but it is perhaps only the well-educated, well-heeled newcomers who can afford to appreciate the fine old architectural features and the invisible quality of the behind-the-walls construction. The old-time neighborhood residents see only the cracks in the plaster, the rotting window sashes, and the peeling paint which their limited incomes (or those of their landlords) cannot repair. The new neighborhood organizations are willing to take the time to research the neighborhood history and fill out (or hire an expert to fill out) the application form which starts the designation process rolling.

Will the rehabilitation benefits of the Tax Reform Act of 1976 make the National Register process something other than an upper-income phenomenon? In Chicago, at least, any change from this pattern is unlikely. Landlords in low-income areas with the architectural character to make the National Register are more interested in deferring maintenance and squeezing more dollars from deteriorating buildings. Rehabilitation is too risky in neighborhoods where property values have been steadily declining, and landlords fear the close supervision by city building inspectors that accompanies the rehabilitation process. When the OAHP is looking over your shoulder to protect the "historic integrity" of a building it is difficult to hide cracking plaster with imitation wood paneling, lower lofty cathedral ceilings to eight feet with the help of furring strips and cardboard acoustic tile, install inexpensive shag carpeting over the painted and battered hardwood floors, and plant plastic evergreens in the yard.

The Sheffield and Lakeview rehabilitation phenomenon was a spin-off from the earlier rehabilitation in the East Lincoln Park and Old Town neighborhoods. Now, areas adjoining Sheffield and Lakeview are experiencing rehabilitation spin-off interest as well. Redevelopers nibble at those neighborhoods as prices in the already rejuvenated neighborhoods soar. An early sign of redevelopment potential is investor interest in the larger courtyard buildings. Developers know that as the smaller historic buildings in the neighborhood are discovered and the neighborhood improves, they will be able to sharply escalate rents in line with the new demand for the ambience of the neighborhood—tenants are willing to pay dearly merely for the chance to walk by a block of turn-of-the-century red brick Victorians to get to their own comparatively dull building.

Are the owners of those 1920s courtyard buildings likely to take advantage of the rehabilitation provisions of the Tax Reform Act of 1976? The OAHP has expressed its intention to give them every opportunity for building certification, and, ironically, the ten rehabilitation certification standards will be less onerous for a 1920s courtyard building in a red brick Victorian district than for the truly historic buildings in that same district.

The courtyard building neither contributes to nor detracts from the historic character of the district. So according to what standard is its interior rehabilitation to be certified? It has none of the fine old woodwork or other historic materials or distinctive architectural features. Even if the renovation of a courtyard building is to be judged by its sensitivity to that building's own architectural style, by its concern for that building's own distinctive features, and by its compatibility with that building's own size, scale, color, material, and character, it will present far fewer problems in the rehabilitation certification process than in the certification process for rehabilitation of a red brick or graystone three-flat.

The older Victorian era apartments are narrow rectangles divided into a maze of small, closetless cubbyholes which require much moving of walls to make them functional by today's standards. The design of the courtyard buildings by contrast is more functional—bedrooms are large and even have closets! Plaster walls and floors are 30 years younger and in much better shape. Courtyard buildings generally only need new kitchens and baths, new carpeting in the common hallways, fresh paint, and perhaps a gas lamp in the courtyard to command significantly higher rents.

As courtyard building owners learn of the after-tax income benefits of the Tax Reform Act of 1976 now available for their kitchen and bathroom remodeling, they may be anxious to have their rehabilitation certified. To date it has primarily been the owners of the small Victorian era buildings who have sought National Register designation and the rehabilitation benefits of the Tax Reform Act of 1976, because their interest in historic buildings has made them more immediately aware of the rehabilitation incentives.

IMPACT OF THE REHABILITATION BENEFITS ON A SHEFFIELD THREE-FLAT: MAKING THE NUMBERS WORK

The High Costs of Acquisition and Rehabilitation (And the Low Cash Flows)

How truly conducive to rehabilitation are those tax benefits? In *Table II* we have analyzed the purchase and rehabilitation expenditures on an actual three-flat apartment building in the Sheffield Historic District. The previous owner had already initiated rehabilitation and had spent approximately $20,000. Therefore the relatively high purchase price of $86,000 reflects the building's partial rehabilitation. More importantly, however, it reflects the high demand for small apartment buildings in the Lincoln Park/Sheffield neighborhood of Chicago.

TABLE II

SHEFFIELD THREE-FLAT
REHABILITATION EXPENDITURES

Purchase Price (3540 sq. ft.)	$ 86,000	$24.30/sq. ft.
Second Floor Rehab (1500 sq. ft.)	$ 13,634	$ 9.09/sq. ft.
First Floor Front Rehab (1250 sq. ft.)	21,385	17.11/sq. ft.
First Floor Rear Rehab (750 sq. ft.)	4,661	6.21/sq. ft.
Common Areas Rehab	8,434	2.38/sq. ft.
Total Rehabilitation Expenditures	$ 48,114	$13.59/sq. ft.
Total Purchase Price & Rehab	$134,114	$37.89/sq. ft.

In *Table III* we have forecast incomes and cash flows for the Sheffield three-flat over a seven-year period. Alternative net cash flows were calculated based on outside professional management and self-management by the building's owner. Because the pre-tax cash flows on a small apartment building are marginal, most owners attempt self-management at least until such time as cash flows can support a professional management fee. Even with the savings from self-management, the net cash flows as a percentage of cash equity ($34,114) in the project are quite low, but increase steadily.[7]

The Tax Reform Act Rehabilitation Benefits Applied: Double the After-Tax Return and Get Out Quickly

In *Table IV* we have forecast the after-tax income on the Sheffield three-flat before using either of the two alternative Tax Reform Act of 1976 historic preservation provisions, and after each alternative. We have assumed an investor in the 36% tax bracket because the individual most likely to be interested in this type of investment is a young professional with an income in the $24,000 to $28,000 range. We have also assumed a 20-year useful life for

TABLE III

SHEFFIELD THREE-FLAT
FORECASTED INCOME STATEMENT

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Gross Income[1]	$13,140	$14,100	$14,805	$15,545	$16,323	$17,139	$17,996
Expenses	$ 2,137	$ 2,244	$ 2,356	$ 2,475	$ 2,598	$ 2,728	$ 2,864
Management (6% Gross)	788	846	888	933	979	1,028	1,080
Property Taxes[2]	772	811	852	1,700	1,785	1,874	1,968
Total Expenses	$ 3,697	$ 3,901	$ 4,096	$ 5,108	$ 5,362	$ 5,630	$ 5,912
Debt Service[3]	10,694	10,694	10,694	10,694	10,694	10,694	10,694
(Closing Costs)	1,500						
Total Expenses	$15,800	$14,504	$14,699	$15,711	$15,965	$16,233	$16,515
Net Cash Flow	$(2,751)	$ (495)	$ 5	$ (257)	$ 257	$ 795	$ 1,380
Net Cash Flow (Self-managed)	$(1,963)	$ 351	$ 893	$ 676	$ 1,236	$ 1,823	$ 2,460
As % of Equity ($34,114)	(5.8%)	1.0%	2.6%	2.0%	3.6%	5.3%	7.2%

A 5% inflation factor was used except as follows:
1. 7% increase in year 2; 5% thereafter
2. 5% increase in non-reassessment years; 100% in year of quadrennial reassessment.
3. $100,000 principal amount, 9-3/4% interest, 25 years, monthly payments.

TABLE IV
SHEFFIELD THREE-FLAT: TAXABLE INCOME

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7
Gross Income	$13,140	$14,100	$14,805	$15,545	$16,323	$17,139	$17,996
Less:							
Mortgage Interest	9,706	9,606	9,495	9,372	9,238	9,089	8,926
Other Expenses	3,697	3,901	4,096	5,108	5,362	5,630	5,912
Depreciation	6,938	6,504	6,097	5,716	5,359	5,024	4,710
Total Deduction	$20,341	$20,011	$19,688	$20,196	$19,959	$19,743	$19,548
Taxable Income	$(7,201)	$(5,911)	$(4,883)	$(4,651)	$(3,636)	$(2,604)	$(1,552)
Tax Savings @ 36%	$ 2,592	$ 2,128	$ 1,758	$ 1,674	$ 1,309	$ 937	$ 559
Plus Net Cash Flow	(1,963)	351	893	676	1,236	1,823	2,460
Eff. After-Tax Income	$ 629	$ 2,479	$ 2,651	$ 2,350	$ 2,545	$ 2,760	$ 3,019
As % of Equity	1.8%	7.3%	7.8%	6.9%	7.5%	8.1%	8.8%
TAX ACT ALTERNATIVE I							
Depreciation							
Rehab	$ 9,600	$ 9,600	$ 9,600	$ 9,600	$ 9,600	$ 0	$ 0
Building	3,938	3,691	3,461	3,244	3,042	2,852	2,673
	$13,538	$13,291	$13,061	$12,844	$12,642	$ 2,852	$ 2,673
Taxable Income	$(13,801)	$(12,698)	$(11,847)	$(11,779)	$(10,919)	$(432)	$ 485
Tax Savings	$ 4,968	$ 4,571	$ 4,265	$ 4,240	$ 3,931	$ 156	$(175)
Eff. After-Tax Income	$ 3,005	$ 4,922	$ 5,158	$ 4,916	$ 5,167	$ 1,979	$ 2,285
As % of Equity	8.8%	14.4%	15.1%	14.4%	15.1%	5.8%	6.7%
TAX ACT ALTERNATIVE II							
Depreciation	$11,100	$ 9,990	$ 8,991	$ 8,092	$ 7,283	$ 6,554	$ 5,899
Taxable Income	$(11,363)	$(9,397)	$(7,777)	$(7,027)	$(5,560)	$(4,134)	$(2,741)
Tax Savings	$ 4,091	$ 3,383	$ 2,800	$ 2,530	$ 2,002	$ 1,488	$ 987
Eff. After-Tax Income	$ 2,128	$ 3,734	$ 3,693	$ 3,206	$ 3,238	$ 3,311	$ 3,447
As % of Equity	6.2%	10.9%	10.8%	9.4%	9.5%	9.7%	10.1%

depreciation calculations. Accelerated depreciation at the 125% declining balance rate is the maximum permissible for used residential rental property outside the historic preservation provisions of the Tax Reform Act of 1976. Although the after-tax incomes are higher than the pre-tax returns in *Table III,* they are not near the levels that a real estate investor in the 36% bracket might expect.

Note that the impact of the first alternative historic preservation provision of the Tax Reform Act of 1976, the 60-month amortization of rehabilitation expenditures, is to increase the first year's after-tax return from 1.8% to 8.8 %. For the next four years thereafter the after-tax return varies between 14.4 and 15.1%, an acceptable range for an investor in this tax bracket. By year six, however, all the added tax shelter from the 60-month amortization has been consumed, and the annual accelerated depreciation on the remainder of the building's basis is not enough to completely shelter the income generated.

Under the second alternative historic preservation provision of the Tax Reform Act of 1976, 200% declining balance depreciation on combined building basis and rehabilitation expenditure,[8] the after-tax incomes are lower in the first five years than under alternative one, but there is continued shelter after the fifth year. Therefore, deciding which alternative historic preservation provision to utilize depends on the objectives and circumstances of the investor. If the property is purchased with intent to sell within five years, the first alternative provides more shelter. If the investor intends to stay with the investment longer than five years, the second alternative may be the better choice.[9]

The Minimum Tax and Recapture: Pitfalls that Tarnish the Allure of the Historic Preservation Incentives

Table V emphasizes the potential capital gains over and above the annual after-tax return which makes real estate such an attractive (although risky) investment in today's high inflation economy. In no other class of investment in the last ten years has the effective after-tax return been in the 12 to 15% range and has there been capital value appreciation on equity investment at a rate of increase higher than the inflation rate.

In the Lincoln Park/Sheffield neighborhood of Chicago, high demand has caused some property values to appreciate at an average annual 15% rate over the last ten years. In forecasting future appreciation on our Sheffield three-flat example we have chosen a more conservative 10% rate. *Table V* forecasts the tax consequences on sale in three alternative years in the future.[10] Because our Sheffield example would not qualify for the second alternative historic preservation provision of the Tax Reform Act of 1976, we have made our forecasts on the basis of the first alternative (60-month amortization of rehabilitation expenditures).

The purpose of *Table V* is not merely to dramatize the capital appreciation which the real estate market can provide. The table also evidences the large preference taxes payable on sale which make the Tax Reform Act of 1976 a two-edged sword. Although real estate was the only tax shelter left substantially intact by the Tax Reform Act of 1976, the rules for payment of the minimum tax on preference items were substantially altered.

TABLE V
SHEFFIELD THREE-FLAT
HISTORIC PRESERVATION ALTERNATIVE I
PROFIT ON SALE

	Year 3	Year 5	Year 7
Capital Gain on Sale:			
Market Value @ 10% Increase/Year (Purchase & Rehab $134,114)	$178,508	$215,995	$261,355
–Commission & Closing Costs @ 7%	12,496	15,120	18,295
Net Sales Price	$166,012	$200,875	$243,060
–Adjusted Basis	71,110	45,624	40,099
Gain Subject to Tax	$ 94,902	$155,251	$202,961
Accelerated Depreciation:			
Rehab Amortization	$ 28,800	$ 48,000	$ 48,000
+Building Basis	11,090	17,376	17,376
Total Accelerated Deprec.	$ 39,890	$ 65,376	$ 65,376
–Allowable Straight Line Deprec.	16,650	27,750	38,850
Gain Subject to Ord. Inc. Tax	$ 23,240	$ 37,626	$ 26,526
Gain Subject to Cap. Gain Tax	$ 71,662	$117,625	$176,435
Taxes Due on Sale:			
Ordinary Income Tax (Bracket)	$ 13,479(58%)	$ 24,081(64%)	$ 17,666(66%)
+Capital Gain Tax	20,782	37,640	58,753
+Preference Tax @ 15%*	6,053	9,935	11,796
Total Taxes Payable	$ 40,314	$ 71,656	$ 88,215
Profit on Sale:			
Net Sales Price	$166,012	$200,875	$243,060
–Loan Balance	93,666	88,419	82,177
–Taxes	40,314	71,656	88,215
Net Profit	$ 32,032	$ 40,800	$ 72,668
Capital Appreciation:	$ (2,082)	$ 6,686	$ 38,554

*See *Table VI*

The minimum tax on preference items was first added to the tax code in 1969 to assure that income which might otherwise go untaxed (e.g., income from tax shelters or other types of income given preferential treatment in the Internal Revenue Code) would at least be assessed a minimum tax. The two preference items subject to the minimum tax when real property is sold are accelerated depreciation (i.e., difference between accelerated depreciation and allowable straight-line depreciation), and the untaxed half of long-term capital gains. Prior to the Tax Reform Act of 1976, there was an annual exclusion of $30,000 plus the amount of the regular income tax due in the year of sale. The Tax Reform Act of 1976 slashed the annual preference income exclusion for individuals to $10,000 or one-half the regular income taxes due in year of sale, whichever amount is greater. The minimum tax rate was also raised from 10% to 15%.

Some of the allure of real estate as a tax shelter, and therefore the effectiveness of the historic preservation inducements of the Tax Reform Act of 1976, was tarnished by the tough new rules for the minimum tax on preference items. A sale in year three results in a net profit less than the equity invested in the project. That loss has the effect of reducing the annual after-tax returns. From *Table VI* it is clear that if the pre-1976 rules for calculating the minimum tax on preference items were still in effect, no minimum tax would have been payable. The elimination of the minimum tax otherwise payable would more than offset the loss on equity which actually occurs on an anticipated sale in year three.

TABLE VI

COMPARISON OF MINIMUM TAXES PAYABLE BEFORE AND AFTER TAX REFORM ACT OF 1976

	Year 3	Year 5	Year 7
TOTAL PREFERENCE ITEMS	$59,071	$96,439	$114,744
Exclusions Prior to 1976:			
–Standard Exclusion	30,000	30,000	30,000
–Ord. Inc. Tax Deduction	37,441	60,421	72,208
Gain Subject to Minimum Tax	($8,370)	$ 6,018	$ 12,536
Minimum Tax (10%)	$ 0	$ 602	$ 1,254
Exclusions After Tax Reform Act of 1976:			
–Half Ordinary Inc. Tax	18,721	30,211	36,104
Gain Subject to Minimum Tax	$40,350	$66,228	$ 78,640
Minimum Tax (15%)	$ 6,053	$ 9,935	$ 11,796

The tightening of the standard exclusion and income tax deduction and the increased rate of the minimum tax is merely the latest step in a 15-year tightening of the permissible tax shelter in real estate. The recapture of accelerated depreciation at ordinary income rates is the most onerous limitation on tax shelter, but, in terms of the amount of tax payable on sale of our Sheffield three-flat, the capital gains tax is the most burdensome.

Only one-half of capital gains are taxed, but the size of even half the gain realized can push the investor into a much higher tax bracket. For our investor in the Sheffield three-flat, the combination of that portion of his gain subject to ordinary income tax due to recapture of accelerated depreciation plus one-half the capital gain changes his tax bracket from 36% to 58% if he were to sell after year three. The gain on sale in year five would move him into the 64% bracket, and in year seven the 66% bracket.

The spectre of the large tax payment which must be made is rarely foreseen by the anxious real estate investor who quickly tallies the market appreciation and the expected sales price in the year of sale without a realistic analysis of the impact of the sale on his tax bracket. In our Sheffield example, almost 44% of the gain on sale in year three would be paid in taxes, 48% in year five, and 45% in year seven. What looks like a good short-term investment because of the rapidly accelerated depreciation in the first five years, looks much better as a long-term investment if the investor desires to realize significant net capital appreciation on his equity after paying all taxes due on sale.

THE LIMITED PROMISE OF THE TAX REFORM ACT OF 1976 FOR NEIGHBORHOOD REVITALIZATION

Problems in the Residential Rental Market: The Culprit for Poor After-Tax Performance

There is promise for neighborhood revitalization in the Tax Reform Act of 1976 but it is a limited one. The amortization deduction does, in our example, make the after-tax return on small apartment buildings at least competitive with other real estate tax shelters—for the first five years. Thereafter the shelter is depleted and the net cash flow as a percentage of equity investment is unattractive. The long-term net cash flow prospects are therefore less than desirable, but because of the preference tax, recapture, and increased bracket problems, the investor in a rehabilitation project under alternative one of the historic preservation provisions of the Tax Reform Act of 1976 may wish to remain with the project until year seven at least if he desires any significant capital appreciation after taxes.

The unattractiveness of the bottom line in a five-year amortized rehabilitation project after the fifth year, and the general failure of the second alternative, double declining balance depreciation, to provide an attractive after-tax return in any year, is evidence of the severity of other problems which affect investments in small apartment buildings. The problems can be summarized quickly: low rents, high expenses. Chicago rents have failed to keep pace with the escalating price of small apartment buildings in attractive areas undergoing rehabilitation.

High purchase prices mean greater debt servicing costs to be carried by a rental base only adequate to carry a much smaller mortgage *and* still provide the desired net cash flow before taxes. The cost of that increased debt service has also increased. The 6.75% mortgages common eight years ago are history. The prevailing rate in Chicago at the end of 1977 was between 9.75 and 10%. The possible net cash flow is therefore squeezed by escalating purchase prices and debt servicing costs at one end, and the resistance of the rental market to the incremental increases necessary to keep pace.

The situation in the rental market is a supply and demand phenomenon which may improve (much to the chagrin of renters) as a result of normal market pressures,[12] but it is unlikely to improve enough to keep pace with the continued rapid appreciation in the cost of unrehabilitated buildings. There are few expense items in *Table III*, the forecast income statement on our Sheffield three-flat example, where costs can be cut. Eliminating the 6% management expense through self-management is the most obvious cut. The general expenses line is composed of items such as insurance, maintenance and repairs, decorating, and utility service (electricity, gas, and water for common areas). They too have escalated rapidly in recent years and are the principal cause of the unprofitability of older apartment buildings that have not changed hands in recent years. In terms of government policy, none of these expense items present any opportunity for intervention and incentives.

Property Tax Abatements as a Preservation Incentive

The real property tax is an increasingly serious impediment to the profitability of small apartment buildings, and an expense area in which incentives and abatement are feasible. Properties in Chicago are reassessed once every four years, and in the Lincoln Park/Sheffield neighborhood the property tax bills after the 1976 reassessment increased by as much as 200 or 300% for many owners of rehabilitated buildings.

The real property tax could be utilized by local government to induce rehabilitation of buildings and conservation of neighborhoods. A 1977 study by the Chicago Commission on Historic and Architectural Landmarks recommended that Cook County adopt a contract assessment tax scheme in neighborhoods selected according to historic preservation criteria.[13] The proposed plan is similar to Oregon's preservation tax law[14] which allows owners of qualifying historic property to, in effect, freeze the value of the building for purposes of calculating the real property tax for a period of 15 consecutive years. An owner interested in rehabilitating a qualifying historic structure covenants with the tax assessor to rehabilitate and maintain the property in exchange for the 15 year freeze on reassessment which allows the property to be rehabilitated without fear of increased assessment.

Fifteen years may be an unnecessarily long freeze on reassessment. It seriously delays the day when the assessor's office may begin to recoup the increased tax assessments which rehabilitation will generate. It also subjects the property owner to a serious cash flow problem in the fifteenth year if he has not set aside a sinking fund to offset the tax which will be due.

Applying such a system to the cash flow on our Sheffield three-flat reveals both the benefits and potential problem. Property taxes paid by the previous owner in the year prior to initiation of our rehabilitation project were approximately $518. Freezing the property tax at that level over the first seven years of the project's life assures that by year five the pretax net cash flows are in the acceptable range for a real estate investment:

1	2	3	4	5	6	7
(5.0%)	1.9%	3.6%	5.4%	7.3%	9.3%	11.5%

Any change in the real property tax to generate historic preservation and neighborhood conservation can be implemented only by local and state government action. To the extent that the historic preservation incentives of the Tax Reform Act of 1976 stimulate private capital interest in rehabilitation of structures within National Register districts, it may also build a constituency to press state and local governments for corresponding tax incentives to add the necessary additional stimulus to make rehabilitation economically feasible.

Historic Preservation Incentives And the Future of Neighborhood Revitalization

Tables IV and *V* make it plain that the historic preservation incentives of the Tax Reform Act of 1976 do not brighten the bleak investment picture in small residential apartment buildings enough to make them clearly attractive. The 60-month amortization of rehabilitation expenditures does bring the annual after-tax returns close to an acceptable level, but, to stimulate capital to enter the central city rental housing market rather than the suburban housing market, the expectation of greater than ordinary returns is necessary. The historic preservation incentives of the Tax Reform Act of 1976 do not, at least in Chicago, create that expectation.

Without some further inducement, few investors will utilize the historic preservation provisions of the Tax Reform Act of 1976, at least in the rehabilitation of the predominant small, red brick and graystone apartment buildings in Chicago's National Register neighborhoods,[15] and in other neighborhoods of the Midwest and Northeast. And because of the willingness of the OAHP to certify them, and the relatively inexpensive remodeling of kitchen and baths needed to make them command top rental dollar, there may be greater interest in time in the certification of rehabilitation in the buildings of more recent vintage in those historic districts. The effect of the historic preservation incentives of the Tax Reform Act of 1976 may be to hasten the conversion of those 1920s courtyard buildings to condominiums once the five-year amortization shelter is depleted. By selling the building piecemeal as individual condominium units after the fifth year, the investor reaps the full advantage of the 60-month tax shelter and avoids the low return thereafter. Selling the apartments as individual condominium units also effectively accelerates the appreciation in market value which would otherwise occur. A rehabilitated apartment building sold as individual condominium units generally nets much more than if sold wholesale as a single apartment building.

Conversion of Chicago apartment buildings to condominiums has been occurring at a frenetic pace in the past few years. The dwindling stock of rental apartments has not been augmented by new rental unit construction. Under existing qualifications for National Register designation, there is only a limited stock of Chicago manufacturing or commercial buildings that could be placed on the National Register and then rehabilitated for residential uses pursuant to the incentives of the Tax Reform Act of 1976 even if the city were to look favorably upon such conversions. The Chicago Fire of 1873 destroyed the city's stock of the fine old loft buildings which line the commercial streets of so many other cities of the Midwest and East. The boundaries of existing National Register Districts in Chicago and other cities are drawn to specifically exclude the industrial and manufacturing buildings that ring their edges. The readiness of the OAHP to certify buildings of a non-conforming age, style, and use as long as they do not detract from a district's character suggests that future National Register Districts should include any warehouses or manufacturing and commercial areas linked to the historic neighborhood by history or geography. Many of those commercial and manufacturing buildings are small and no longer profitable for their originally intended use. Conversion to residential uses rather than demolition may make sense for many of them.

Structures in districts designated by local landmarks commissions can also qualify for the historic preservation incentives of the Tax Reform Act of 1976. In regulations issued in August of 1977 by OAHP, the only criterion required is that the local landmark statute "generally must provide for a duly designated review body, such as a review board or commission, with power to review proposed alterations to structures within the boundaries of the district or districts designated under the statute."

Once a city has its statute certified by the Secretary of the Interior, every local historic district already designated, as well as every future historic district, qualifies for the Tax Reform Act incentives. That would allow a city to pursue a systematic program of neighborhood revitalization through local historic district designations. When combined with other possible local programs such as a freeze on reassessment increases due to rehabilitation, improvement of neighborhood amenities including parks, shopping areas, and schools, and even special building codes to make rehabilitation easier, historic district designations could become a powerful force for neighborhood conservation and revitalization.

The historic preservation incentives of the Tax Reform Act of 1976 are merely a starting point for neighborhood revitalization. They will encourage some rehabilitation from which we may learn the types of housing and housing markets in which the incentives are now enough, and help formulate proposals for the additional federal, state, and local tax incentives necessary to make the bottom-line work in markets where they presently are not enough.

REFERENCES

1. Pub. L. 94-455, October 4, 1976, 90 stat. 1520 *et seq.*
2. Defined to occur when "the additions to captial account for any certified rehabilitation . . . during the 24-month period ending on the last day of any taxable year, reduced by any amounts allowed or allowable as depreciation or amortization with respect thereto, exceeds the greater of (a) the adjusted basis of such property, or (b) $5,000." 26 U.S.C. 167(o)(2).
3. Unless the owner has obtained the opinion of the Secretary of the Interior prior to demolition that the structure is not of historic significance to the district. 26 U.S.C. 280B.(b).
4. 26 U.S.C. 167(n)(1). The developer of a new building on the site of a structure within a National Register Historic District only loses the right to depreciate at accelerated rates if the demolished

structure had been individually listed on the National Register, or had been certified by the Secretary of the Interior as of significance to the historic character of the district. Proposed technical amendments to the Tax Reform Act of 1976 would apply the loss of accelerated depreciation disincentive to every replacement structure in a National Register district unless the developer had requested the Secretary of the Interior to rule that the structure to be demolished was *not* of historic significance to the district, and the Secretary had so ruled. Technical Corrections Bill of 1977 (H.R. 6715), #2 (f) (4), 64 CCH Fed. Tax Reports, no. 22, May 11, 1977, part II, pp. 14-15. That would bring treatment of the loss of accelerated depreciation in line with treatment of loss of demolition deduction. See note 3 *supra*.

5. *Federal Register* 42, no. 195, October 7, 1977, p. 54548 *et seq.*
6. At the discussion of our Sheffield rehabilitation example at the National Park Service Conference on the Tax Reform Act of 1976 in Chicago, the representative of the Illinois SHPO indicated he would want detailed information as to why totally new appliances were required in all three apartments, why fireplaces needed to be added at all, and what plans for cleaning and rehabilitation of the exterior facade of the structure had been considered even though the rehabilitation outlined for discussion included no mention of exterior changes to the front facade.
7. With the exception of year four in which real property taxes are expected to double and offset what would otherwise be an increase in the net cash flows. Real property taxes in Cook County in which Chicago is located are reassessed on a four-year cycle. Based on the increase in tax bills after the quadrennial reassessment for rehabilitated properties in Lincoln Park/Sheffield, a doubling of the tax bill is a conservative estimate. Some property owners received a 300% increase after the latest quadrennial reassessment.
8. One condition to the use of this alternative is that the dollar value of the rehabilitation expenditures must exceed the adjusted basis of the property, normally the purchase price in the situation in which the property is purchased with a view to its rehabilitation. See note 2 *supra*. Although our Sheffield rehabilitation example would not qualify because the purchase price was $86,000 and total rehabilitation expenditures approximately $48,000, if the $20,000 in rehabilitation expenditures incurred by the previous owner is added to the new owner's rehabilitation expenditure, the combined rehabilitation cost exceeds the adjusted depreciable basis (assuming the non-depreciable land value is approximately $25,000).
9. The second alternative is not automatically the better shelter for an investor desiring to hold longer than five years. The stream of effective after-tax income up to any projected year of sale provided by each alternative incentive should be reduced to present values and computed.
10. The forecasts in *Table V* are premised upon passage of the Technical Corrections Act of 1977 (H.R. 6715), *supra* note 4. In its rush to pass the complex Tax Reform Act of 1976, Congress overlooked many technical errors in the Act. One such error was to make the recapture of depreciation on certified historic structures upon sale subject to the rules for personal property (IRC #1245) but not real property (IRC #1250). The effect of that omission is to recapture the entire 60-month amortization at ordinary income rates. Under the Technical Corrections Act, the 60-month amortization is recaptured at ordinary income rates only to the extent that it exceeds otherwise allowable straightline depreciation, the usual rule for depreciable real property. If the Technical Corrections Act is not enacted, the heavy onus of the ordinary income tax due on sale will seriously diminish the appeal of the historic preservation provisions of the Tax Reform Act of 1976 as a viable tax shelter.
11. 26 U.S.C. 56-8. In effect the minimum tax is now a surtax added to other tax liabilities rather than a tax in lieu of substantial or total shelter. The minimum tax on preference items was added to the *Internal Revenue Code* to assure that at least some annual income tax would be paid by investors in highly leveraged, rapidly depreciated, real estate investments or other tax shelters. The various exclusions and deductions were originally intended to eliminate from minimum tax coverage those individuals who did in fact incur annual income tax payments. The Tax Reform Act of 1976, in severely tightening those exclusions and deductions and increasing the minimum tax rate, has effectively altered that purpose and made many more investors who otherwise incur some income tax liabilities subject to the minimum tax also.
12. There is some evidence that the rental market may be recovering. Vacancy rates in the Chicago area have dropped to under 3%, their lowest level since World War II. The principal cause of the resurgence in rental market demand is a combination of little new rental unit construction (1310, 1061, and 1258 multifamily building permits issued in Chicago in 1975, 1976, and through October of 1977 respectively) and conversion of existing rental units to condominiums.
13. *Property Tax Incentives for Landmark Preservation: Draft Program for Use in Chicago and Cook County, Illinois* (Chicago: Shlaes & Co., 1977).
14. Oregon, *Revised Statutes*, sec. 358.475-.565 (1975).
15. It could very well be that owner-occupiers of the small apartment buildings in Chicago's historic districts will take advantage of the Act in large numbers. They usually take the most rapid form of depreciation allowable on the rental portion of their buildings because, as owner-occupiers, they generally expect to live in the building long enough for the recapture problem to be minimized.

The Grand Central Terminal Case: The U.S. Supreme Court Upholds New York City's Historic Preservation Program

by Frank B. Gilbert

With its thorough, 31-page opinion in the Grand Central Terminal case, the U.S. Supreme Court has settled the doubts that existed about laws passed to save historic buildings. The decision in *Penn Central Transportation Co. v. City of New York* has given a status to historic preservation that can only come from a review of a controversy by the Supreme Court.

In the last 20 years historic preservation has grown tremendously, but even in 1978 lawyers, legislators, and laymen had serious doubts about the validity of preservation laws while well-drafted municipal landmarks and historic district ordinances were being passed. The Grand Central decision settled a specific case, but the reasoning in the opinion supports the provisions in many historic preservation laws. In fact, as the final arbiter on legal questions, the Supreme Court in this decision declares what the law is and rejects many of the arguments made against historic preservation statutes.

This article is reprinted from the August 1978 issue of "Preservation News," and appears as a follow-up to Mr. Gilbert's two previous pieces in *Real Estate Issues*: "The Grand Central Case: The Preservation of Individual Historic Landmarks" in the Summer 1977 edition (vol. 2, no. 1) and "Update: U.S. Supreme Court to Hear Grand Central Terminal Case" in the Summer 1978 edition (vol. 3, no. 1).

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.

Examples of legal arguments that were rejected include the taking of property without compensation when a designation is made, the placing of an unfair burden on the individual who owns a landmark, and the selecting of buildings to be protected by arbitrary means.

SIMILAR TO ZONING

The Grand Central decision may be compared with developments in zoning laws. Zoning laws had been enacted in American cities for about 25 years when, in 1926, the U.S. Supreme Court finally considered and upheld a comprehensive zoning ordinance in a famous case, *Village of Euclid v. Ambler Realty Co.* That decision has been cited ever since (as it was in this case), and it made zoning efforts much easier for cities. In its own area, the Grand Central opinion may have the same effect.

It is worth noting that the size of the disputed project may have made this a harder—and better—case for the preservationists to win. Usually a city government is confronted with a smaller landmark to save. Hard cases are the ones that reach the Supreme Court, and the six justices forming the majority are a cross-section of the current court adding to the value of this case as a precedent. Many persons describe the present Supreme Court as conservative, and this point probably contributes to the significance of this support in a quite new area of law.

In deciding this specific controversy, Justice William J. Brennan, Jr., chooses to place the dispute in the context of what has been accomplished by historic preservation. (The dissenting opinion confines itself to the current dispute.) Justice Brennan notes, "Over the past fifty years, all 50 states and over 500 municipalities have enacted laws to encourage or require the preservation of buildings and areas with historic or aesthetic importance."

Describing the New York City statute as "typical of many urban landmarks laws," the opinion gives recognition to the municipal laws passed to protect historic buildings "by involving public entities [landmark or historic district commissions] in land use decisions affecting these properties and providing services, standards, controls and incentives that will encourage preservation by private owners and users." While there are restrictions in the New York law, according to the court "the major theme of the Act is to ensure" landmark owners a "reasonable return" and "maximum latitude" consistent with preservation goals.

PUBLIC OWNERSHIP

In a footnote Justice Brennan adds, "The consensus is that widespread public ownership of historic properties in urban settings is neither feasible nor wise. Public ownership reduces the tax base, burdens the public budget with costs of acquisitions and maintenance, and results in the preservation of public buildings as museums and similar facilities, rather than as economically productive features of the urban scene."

After this detailed and sympathetic introduction, the court returns to this topic 20 pages later in the opinion and approves of laws designating and regulating individual landmark buildings. It says, "Stated baldly, appellant's [the Penn Central] position appears to be that the only means of ensuring that selected owners are not singled out to endure financial hardship for no reason is to hold that any restriction imposed in individual landmarks pursuant to the New York scheme is a 'taking' requiring the payment of 'just compensation.' Agreement with this argument would of course invalidate not just New York City's law, but all comparable landmark legislation in the nation. We find no merit in it."

This language is likely to encourage the designation of more individual landmarks in addition to the many buildings that are already protected by being within an historic district. Where the mayor and the city government are committed to an expansion of the local historic preservation programs, it should be easier to overcome legal objections to bringing individual structures under the jurisdiction of a municipal landmark commission. This agency will then have the responsibility to try to find some alternative to demolition if the tearing down of a landmark is threatened. Elsewhere in the opinion Justice Brennan shows his awareness of the fact that landmarks commissions may have to give permission to demolish a building when acceptable alternatives are not found.

One consequence of the Grand Central opinion may be to shift the tactics of owners who do not want their buildings designated as landmarks. They may increase their opposition as expressed to the mayor and other political figures rather than relying on the fears about the constitutionality of a designation.

A significant victory for preservationists is the Supreme Court's holding in this case that property was not taken without compensation when government restricted the use of a landmark site the owner had wanted to redevelop. The "taking" issue has been a major problem whenever preservationists wish to regulate an historic building, and now the Supreme Court has related an historic preservation law to zoning and other accepted uses of the police power.

The court notes that it "has upheld land use regulations that destroyed or adversely affected recognized real property interests" when a state court has "reasonably concluded that 'the health, safety, morals, or general welfare' would be promoted by prohibiting particular contemplated uses of land."

DISSENTING VIEW

Early in the dissenting opinion, it is stated, "only in the most superficial sense of the word can this case be said to involve 'zoning.' " However, the majority opinion uses a number of zoning cases to resolve the controversy. It refers with approval to cases that upheld zoning and other land use laws, although owners suffered large diminution in the value of their property. In one case a sand and gravel mining business was closed down.

In historic preservation situations, city officials are often confronted with a related but different problem. The owners refer to the possibility that they may make large profits on the property through a development at some point in the future. In response to this type of argument that was made in the case, Justice Brennan says it is "quite simply untenable" for the Penn Central to assert that they "may establish a 'taking' simply by showing that they have been denied the ability to exploit a property interest that they heretofore had believed was available for development."

Continuing its analysis, the court says "the New York City law embodies a comprehensive plan to preserve" individual landmarks, thus rejecting the argument that a few buildings are being discriminated against under the statute. Next the court discusses whether the New York City landmarks law places too great a burden on Penn Central when compared with owners of adjacent non-landmark buildings. It notes, "Legislation designed to promote the general welfare commonly burdens some more than others," and it cites four earlier decisions sustaining regulations although the owners of the property "were uniquely burdened."

As a final point on the "taking" issue, the Supreme Court gives great weight to the legislative decision to pass an historic preservation law. The court says "we are unwilling" to "reject the judgment of the New York City Council that the preservation of landmarks benefits all New York citizens and all structures." This judicial response disposes of the landmark owner's argument that it is solely burdened and unbenefited.

While landmark owners in the future may argue that an historic preservation law and its implementation take their property without compensation, the Supreme Court precedent in the Grand Central case will give strong support to the preservation program then under attack.

Having decided that there was no "taking" under the provisions of this landmarks law and thus no need for just compensation, the court discusses the present status of the Terminal. The court evaluates the application of the New York City landmarks law to Grand Central and determines that the use of the law there does not have such a severe impact that the government must employ its eminent domain powers. Justice Brennan says, "The New York City law does not interfere in any way with the present uses of the Terminal. Its designation as a landmark not only permits but contemplates that appellant may continue to use the property precisely as it has for the past 65 years: as a railroad terminal containing office space and concessions. So the law does not interfere with what must be regarded as Penn Central's primary expectation concerning the use of the parcel. More importantly, on this record, we must regard the New York City law as permitting Penn Central not only to profit from the Terminal but to obtain a 'reasonable return' on its investment."

(In its decision, the Supreme Court does not comment on the 1977 New York State Court of Appeals analysis of the "publicly created" components in the present value of Grand Central.)

FUTURE STANDARD

At the end of the court's opinion, it sets a standard for historic preservation laws that will be useful when efforts are made to save a threatened landmark. "The restrictions imposed are substantially related to the promotion of the general welfare and not only permit reasonable beneficial use of the landmark site but afford appellants opportunities further to enhance not only the Terminal site proper but also other properties." Related to this standard is the court's statement, in a footnote, that the landmark owner "may obtain relief" when its building is no longer "economically viable."

In his dissent, Justice William H. Rehnquist says, "Valuable property rights have been destroyed" by the action of the New York City Landmarks Commission. He states, "A multimillion dollar loss has been imposed on appellants; it is uniquely felt and is not offset by any benefits flowing from the preservation of some 500 other 'landmarks' in New York." The dissent adds, "If the cost of preserving Grand Central Terminal were spread evenly across the entire population of the City of New York, the burden per person would be in cents per year—a minor cost . . . "

Differing with the majority, Justice Rehnquist declares, "A taking does not become the noncompensable exercise of police power simply because the government in its grace allows the owner to make some 'reasonable' use of his property."

Chief Justice Warren E. Burger and Justice John P. Stevens joined in dissent.

PRINCIPLES ESTABLISHED

In the coming months and years there will be additional preservation lawsuits in which lower courts will apply the principles established by Justice Brennan's opinion. Some landmarks will still be lost as will some lawsuits. Nevertheless, historic preservation today is a much stronger movement because our highest court has examined and approved the way Americans try to save their landmarks.

The Synergistic City: Its Potentials, Hindrances, and Fulfillment

by Mason Gaffney

The object of human organization is synergy, combining parts into a whole greater than their sum. Large organizations seek synergy in hierarchy and financial controls. Cities achieve it by bringing independent actors into mutual access so they can cooperate via free contracts and association in the marketplace, in government, and society.

This paper purports first to show how market allocation of land operates to foster urban synergy. It seeks to define the elements of synergy as follows: The synergistic city maximizes access to the resource features that determined the city's location. It maximizes mutual access among residents and visitors. It lets them share common costs. It encourages specialization. It increases competition. It maximizes options. It increases flexibility. It pools and diversifies risks. It facilitates innovation. It nourishes and spreads information, culture, education, and discovery. It is a medium in which small businesses can flourish through mutual aid.

Second, the paper treats hindrances to realizing the urban promise. There are parasitic and sapping land uses which prey on the surpluses generated by synergy and weaken the city. Polluting uses are one. Then, there are land uses which are cross-subsidized in mass systems. Absentee ownership may be parasitic. Crowding the lot lines may sap value from neighbors. Some land uses demand more than their share of the social infrastructure and overload it. Old buildings sap value from new ones. Unused land breaks up urban synergism. Some land uses appear parasitic because they benefit from redistributive taxation. Some uses are too self-contained to participate in a synergistic city.

Third, the paper recommends policies for discouraging the sappers and encouraging the mutually nourishing land uses that can potentially bring cities to full flower and make our cities the best of all human environments.

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THE URBAN PROMISE AND THE LAND MARKET: THE CITY THAT MIGHT HAVE BEEN AND MIGHT BE

The Neo-Classical Rationale for the Urban Land Market— A Reminder of Old Truths

There has long been a tolerably developed rationale for the function of the urban land market. Land rent is the return net of all costs, and market forces drive land to the use yielding the highest net rent. High rents in good locations reserve land from lower uses in order to make it available for higher ones. The dollar as a measure of benefits and costs is much more comprehensive and well balanced than single-valued alternatives touted by many critics of the market. Some of these are agricultural fundamentalism, highway imperialism, elitism, naturalism, alleged "needs" and engineering "requirements" (regardless of price), and various theories of value based on labor, energy, residuals' generation, export earnings, open space, and judgments about distributive equity.

The market rationale may be found in neo-classical writers like Richard T. Ely, George Wehrwein, Richard Ratcliff, Homer Hoyt, and Arthur Weimer. A related group, the location theorists, have given special attention to the importance of minimizing transportation costs. They have shown that when land goes to the highest bidder the result is to minimize society's aggregate transportation burden. Location theorists have observed an artificial distinction between "urban" theory which asks at what point things are located and "agricultural" location theory which asks also how much land is to be used. Agricultural location theory is obviously misnamed, and of paramount importance in cities.

Although some location theorists have no doubt overstressed minimizing transportation costs, most have remembered that other location factors are important too, such as bearing strength, drainage, air quality, and so on. Demands and costs expressed in money make these different values commensurable.

Rents on good land do not drive people away unless inadvertently by being set too high for anyone. In general, charging rent forces land to be used intensively. Rent drives away lower users only to save land for higher ones. Occasionally even good economists lapse into a confusion of the distributive and allocative effects of rent. Distributively, rent neutralizes the advantage of a good location from the user's point of view, since the landlord charges what the land is worth. Allocatively, however, paying this rent does not inhibit land use but, to the contrary, it forces intensive use.

Some Underemphasized Aspects of the Neo-Classical Rationale for the Urban Land Market

There is a tendency for scholars to bounce the same ideas back and forth and overwork a few parts of The Great Conversation, neglecting equally important matters. While the following points are touched upon in the literature they do not receive proper attention. Yet they are implied by the neo-classical rationale and might fairly be considered part of it.

Compacting and Centripetal Forces

Land values are marked by continuity in space, both concentric and axial, resulting in a kind of star-shaped pattern. The call of the market is to develp land adjacent to land already developed, rather than to leapfrog. This strong clustering propensity results in great economy of all area-sensitive costs. Many public and semipublic costs are functions of area served rather than population served. There is fire protection, especially brush and wildland fires; drainage and flood control; pest control; aquifer recharge; refuse disposal (because of the need for disposal sites); air quality control; protection from noxious land uses; noise control, like protection from runways; access to all breaking points where trunk transit is converted to local transit; access to the urban growth pole; access to government; circulation networks and collection and distribution networks of all kinds; access to any specialized service or facility; radio spectrum coverage; and so on.

All these factors are interacting and reinforcing. Compact settlement caused originally by one factor, say common water supply, creates the precondition for economical provision of other public and private services requiring a compact focused population. Each trip may now serve more purposes. Mass transit and foot transit may replace individual vehicles, and the more so as each linkage requires a shorter trip. High-rise buildings develop the third dimension of the city with vertical transportation providing additional linkages without loading the streets. Increased central tendency reduces cross traffic. Increased volume at the center makes it more economical to bridge and pierce natural barriers there, thus increasing mutual access. Load factors increase on all capital facilities, spreading the costs around the clock and calendar. The need for interurban travel and freight movement is sharply reduced as the larger city becomes more self-contained.

In recent years there has been increasing attention to the costs of sprawl and, by implication, the gains of compact settlement.[1] Both the friends of sprawl and the enemies of the market have sought to attribute sprawl to workings of the market; but sprawl results from distortions and subsidies in the market rather than a fair market. Recent studies have emphasized how sprawl wastes time and wastes capital. Future studies will certainly emphasize how it wastes energy. A free market would have—and still would spare us from—energy-intensive settlement patterns.

Another important market function is to coordinate and synchronize private investment with public investment. Public spending on streets and associated capital gives value to privately-owned lots. It is to secure the latent rents from these lots that owners improve them, thus preventing the public investment from lying waste. This process works even better if the public raises land assessments at the time of investing in streets, thus building a double fire under the landowner. Synchronizing private response to public investment saves the public from paying interest on unproductive capital by putting it right to use. Anticipating this economy, public agencies can plan their infrastructure better: they can build short lines of high capacity serving small compact areas fully, rather than long lines of low capacity, making service available to large areas most of which will not be developed for some time.

A most important effect is the mutal reflection of external gains. The improvement of lot A enhances the rentability of lot B, motivating its owner to improve it even more. The greater improvement of lot B in turn enhances the rentability of lot A, and so on back and forth. Anticipating this effect, each owner may very well improve to a higher level than he would if he lacked confidence that the other owners would be improving. If this process works right, it has somewhat the same effect as "internalizing externalities," an advantage sometimes thought to be peculiar to planned unit developments (PUDs). Here is perhaps the greatest and most subtle beauty of the well-functioning synergistic city. It achieves the gains of scale without the costs of scale. It gets atomistic individual landholders working together without crushing their individuality in a large organization. It lets there be association with independence, without hierarchical control. To pull individuals together without crushing or regimenting them is surely the highest aspiration of human organization.

The result of all this constructive interaction is urban synergy which means there are increasing returns to the city collectively, even while each individual land parcel is used in the stage of diminishing returns. Realizing the potential of increasing returns calls for skill on the part of city government as it supervises urban circulation, because the returns are not to gross mass of population but to mutual access. They are realized most strongly at points of maximum access, urban nuclei of maximum intensity, and maximum land value from which both intensity and land value taper off at a steep gradient.

Sheer size is important, however. William Alonso summarizes his findings: "In every country for which I have found evidence, local product per capita . . . rises with urban size, and where comparable figures on cost are available, these rise far more slowly if at all."[2]

The philosophical proof of increasing returns is that urban land values rise without taking anything from the returns to other inputs, capital, and labor. The free flow of capital and labor among regions keeps their risk-adjusted returns at more or less common levels throughout the economy, and indeed wage rates are somewhat higher in bigger cities. So urban rents and land values do not rise because city landlords have any superior formula for exploiting labor. They rise because urban land is more productive. This premium productivity is a kind of "free lunch" generated by social and economic progress and the spillover benefits of good mutual access. Its very existence testifies to increasing returns in urban growth and organization. Alonso might have added to his data the evidence that land values per capita tend to rise with city size, too, a fact we can never explain if we focus only on the faults of cities.

Institutional Bias: Government Failure and Market Failure

Some leading neo-classical urban land economists let themselves be drawn into the role of "explainers" who not only analyzed but had to vindicate everything that happened. This leads to defending the indefensible and, finally, to disrepute. We need to understand how a fair, unbiased market would work but we also need to understand the market is rarely free from bias. Part of what an observer may dislike about market choices he needs to accept and simply say he was outvoted by the preferences of others. Other things about the market one may properly lay, however, to unfair bias. The part of wisdom is to learn the difference.

One form of government failure is in its manner of levying taxes. Urban synergism obviously generates taxable surpluses, and generations of economists have identified urban rent as a splendid taxable surplus. But when taxes vary with the use to which land is put they bias landowners in favor of the use taxed more lightly. Another failure of government is bad planning of urban circulation. The general bias is towards cross-subsidy within the consolidated accounts of city public works departments. Another government failure is dereliction of duty to control pollution or, almost as bad, controlling pollution in capricious and irrational ways.

Then there are market failures. A conspicuous bias in the bidding for urban land is the differential power of accumulated wealth to put up front money. Wealthy individuals, wealthy corporations, and large financial institutions have a special advantage in any investment that requires much "patient money" that can wait a long time for a large payoff. This means holding exurban land for appreciation. It means assembling land for large integrated developments where "externalities may be internalized." It means holding land around operations with growth potential "for future expansion"—maybe. Neo-classical explainers have seen these phenomena as part of the best of all possible worlds and thus given arms to market critics who see the whole thing as a conspiracy of the rich against the poor. They have failed to forearm market supporters against the siren song of planned unit development, and failed to draw a clean clear line between functions properly private and those properly public.

In the following pages I will use the term "fair market" to mean a market free of institutional bias both public and private. "Free market" has come to mean a market without price controls but that is not enough. To serve society a market must be free of bias: a fair market.

Timing

The explainers missed the mark badly in their treatment of timing land developments as they sought to rationalize land speculation. Ely's theory of "ripening costs" made a virtue of holding for the rise, and overlooked or accepted the institutional biases that carried it to excess. Economists in other fields have developed the concept of maximizing present value as a guide to timing investment and replacement decisions. Real estate professionals use the concept of maximizing discounted cash flow as a standard guide. Still lacking is any global demonstration that the sum of individual timing choices leads to a system optimum. In the highly interdependent business of land use succession in urban neighborhoods, the land uses are interdependent but the individuals are wrapped in the cocoons of their personal income tax circumstances and credit ratings. What is needed is not a rationale since the results are indefensible. What is needed is a formula for institutional reform to make the market work better.

The Elements of Increasing Returns

Urban synergy has been called a black box by some and an empty box by others. Let's itemize its contents.

Access to Key Resources

Cities locate originally on harbors, railheads, crossroads, hubs, confluences, crossings, water sources, amenities, capitals, and so on. Good circulation focuses access on these features and aids their further development.

Mutual Access of Urban Dwellers and Visitors

Those who cluster around the original attracting resource find and create a supplemental attraction in each other. Sometimes they may degrade the original amenities like the clean air of Los Angeles, yet create artifical amenities like Disneyland which we may ridicule and yet which attract still more people. Markets and storage facilities develop synergistic relations with each other, leading to manufacture, innovation, and tertiary services. In addition to the commercial and industrial convenience people cluster for social, educational, and cultural reasons. Access is mutual so clustering is self-reinforcing over a long stage of increasing returns.

Sharing Common Costs

There are common costs of developing basic locational resources; of local consumption facilities like utilities and services whose optimal scale is large; of common supplies needed by many producers; of bringing in buyers who will support many sellers; and so on.

Allowing Higher Specialization

The division of labor, said Adam Smith, is limited by the extent of the market and the same is true of the division of buildings, equipment, and inventories. The same is true of urban land which may also specialize. The extent of the market is greatest where access is best. Everyone can supply his own examples of specialized people and machinery. Specialized land refers to neighborhoods like a carriage trade shopping center, or furniture district, or Vieux Carré, whose development attracts a particular clientele or supports the development of specialized facilities like unloading cranes in a port.

Large markets permit large scale production, of course, but equally important they support specialized production by small sellers who serve a minute part of the total market. Variety of sellers and available goods and services fosters specialized and unusual and innovative manufacturing which requires a variety of small inputs on tap in one place. Specialization in the simple sense of monoculture is found in many company towns and small cities. It is specialization in the sense of variety and diversity that marks the large central market. Regional specialization in farm and other primary producing areas outside of cities presupposes cities as centers of exchange and processing and storage and finance, for which the city takes a large cut of the pie.

Whetting Competition

The conditions of workable competition, that is, many sellers and many buyers, presuppose a central meeting place where many come together. Cities not only support varied facilities, but more of each. By competing these make the city more attractive and attract still more buyers and sellers, and the total effect spares consumers from monopolistic exploitation in many forms. Competitors seeking to differentiate themselves will be led to add choice, variety, innovation, and improvement.

Although large markets permit large scale operations, the average size of firms in larger cities is smaller than outside them. It is in large cities that small independent firms find the infrastructure and support which they need to fill a small niche in a large economy. Specialization is not peculiar to large firms but to large economies. It is easier to enter business with a small amount of capital in the city and less devastating to exit. Entry and exit are the life of competition. There is also a large labor pool for the small businessman and a large supply pool and a number of competing lenders. The large numbers assure him the continuity of service even though he does not control his sources, nor is he obliged to stick with them in the event his needs change. Small firms achieve the gains of vertical integration without losing their freedom, adaptability, and speed.

Adding Range of Choice

A large central market brings a variety of services, products, and facilities over the threshold of viability, giving substance to "free choice." It also adds choice to social life and personal friendship. The courtship market is a very real and important phenomenon attracting young people to cities. The existence of many options makes the city a place for discovery. It is a place to learn, to keep "with it" for profit, education, excitement, and enjoyment. The city as a big apple is a sort of collective public good, like a library whose use by one person does not interfere with use by others. It is indeed the obvious place to locate public goods like libraries to maximize their exposure and, therefore, their value.

The central market also offers more choice in disposal of products. By-products may be used and put to higher uses where there are many buyers. Salvage and recycling of old parts and materials are central market functions. In lean territory, collection costs prevent otherwise economical salvage and recycling. The Navajo Indians, it is true, use every part of the sheep far from cities, but their isolation prevents the by-products entering into exchange and moving to the highest use; while in the city, the hides of worn-out dairy cows are tanned for leather and finally subdivided into grades and distributed to hundreds of specialty uses throughout the market area, always in search of the top dollar which is to say the use most wanted by consumers. The mutual interest that buyers and sellers have in access determines the amount each bids for land in particular places, causing the market to locate activities for maximum mutual aid and synergism of this kind.

Promoting Flexibility and Adaptability

The central market with its backup pools of resources is the place where inputs may be combined and recombined quickly in the face of shifting demands and costs. Penalties for starting and stopping are lighter, leading to faster turnover and replacement with embodiment of the latest knowledge in physical capital. Subcontracting allows organizational flexibility. Excess diversified capacity accommodates variations in supply and demand. Peak needs for capital may be accommodated from the central pool, and peak needs to invest surplus capital find many outlets. The slack is there for change, emergency, and innovation.

Pooling Resources and Risks

The flow of rivers varies much less at their mouths than their various tributary sources because offsetting variations are pooled. Likewise, central markets have an aggregate stability in spite of large individual variations. Load factors on large capital facilities are smoothed. Labor unemployment is minimized. Several family members may find suitable work within one market, minimizing needs to migrate. Inventory requirements are reduced because of pooled variations, increasing turnover and volume per unit of capital. Savers and borrowers get together through an elaborate financial apparatus. Control over capital leads to control over industrial organization—a mixed blessing for the world, perhaps, but an advantage for the city.

Stimulating Creative Activity and Thought

Central markets serve an incubating function for new industries and techniques which require access to varied supplies and the stimulation of varied ideas. In primary producing areas monoculture breeds monotony and simple minds limited by the routines of just one industry and often, too, by the dependency of branch plant psychology. In cities, information and ideas from many sources and viewpoints impinging on one mind provide the stuff of creative thinking. Urban cliquishness and overspecialization, social stratification, and strife limit the realization of this potential, but the potential is there.

Providing a Medium for Culture

The central market with its variety of people, resources, and ideas is the medium for the flowering of education, research, entertainment, social life, cooperation, and advanced thinking. Periodic retreats from the tension and tyranny of fashion can also be creative, but the central market is the place where the idea generated anywhere finds its greatest exposure. The city is the stage for the fullest personal development and fulfillment in a social context.

Reciprocating-Reinforcing Spillovers

This most subtle synergistic effect gives small landowners in large cities the advantages of planned unit development without the heavy cost of stifling individual spontaneity in large organizations. Suppose, to introduce the point, that buildings could be heightened one story at a time. Owner A opens the scene with a three-story building complementary to Owner B, his neighbor. Owner B responds with a four-story building which causes Owner A to go to five stories, and so on until diminishing returns call a halt to further heightening. In fact, height decisions can be made only once every 30 years or so, but the market tends to orchestrate the process by setting a level of land values that requires buildings of a certain height, with each builder anticipating the others. The market works best, of course, when lubricated by a stiff tax on land values. A planned unit developer, to accomplish the same end, would have to spend years and decades assembling land in secret, blighting a neighborhood to weaken holdouts and reduce his own tax costs while waiting. And the completed PUD, even if successful, would be isolated from the rest of the city and detract from the synergism of the whole by self-containment.

Facilitating Communication

Close personal association of buyers and sellers in central markets lets them read each other with a minimum expenditure on costly advertising, wasteful packaging, and artificial preserving such as characterize modern merchandising in our sprawled settlement patterns.

In summary, cities exist to bring people together for mutual aid. The land market when properly lubricated allocates land so as to support this basic urban function.

KILLERS OF THE DREAM: PARASITES IN PARADISE

Urban surpluses attract sappers the way blood attracts leeches. We now itemize these parasitic effects, picking up clues as we go as to whether we might best overcome them by perfecting the market mechanism, by government regulation of private land use, or by increasing the power of large private landowners to plan and implement large unit developments.

Pollution

Polluting one's neighbors is sapping them economically. The polluter, in effect, appropriates an easement over the neighbor's property in order to help himself. I do not accept the idea that victims who strike back are equally demanding easements over the property of polluters, because they are not objecting to what is contained within the polluter's lot lines; they are objecting to what spills over. The Coase-Chicago proposal that victims negotiate with polluters over payments to cease and desist would, I believe, subject victims to extortion and be unworkable and inequitable. Where there are many polluters and victims there is no way to organize the market. Where there are few polluters and few victims, there is no way for the market to be competitive, even if we settle upon a definition of property rights before the bargaining begins. We here dismiss this approach to pollution control as an overenthusiastic overextension of the generally good case for free markets, and will seek other avenues for applying market solutions to the problem.

It is a serious mistake on the part of many and perhaps most observers to think that pollution is a necessary cost of central city density, and a limit on it. Open space, in fact, generates a good deal of pollution directly, and more indirectly. Open space includes, for example, dumps and junkyards, parking lots, the aprons of drive-ins including gas stations, car lots, industrial open storage, mines, farms sprayed with pesticides, artillery ranges, airports, rail yards, and freeways. Large lawns in residential areas mean powermowers which destroy much of the peace and quiet sought in the seclusion of the large lot. They imply weaker social controls over adolescents with unmuffled vehicles and PA systems, whose ability to penetrate the air seems to increase with the square of the distance from us. Vacant lots and acreage in urban areas, once defended as playfields for the innocent sports of childhood, now harbor acoustical vandals with motorcycles. Weeds grow uncontrolled, seeding the neighbor's lands. Sidewalks go unshoveled in winter and some day the fields are sold for tracts so the community that relied on them in lieu of parks goes without.

The indirect effects of open space are polluting because open space has to be traversed, and transportation is the greatest polluter, especially when we include stationary sources that serve transportation demands, like oil refineries. Land reservations near the central market do not really create open space, they rather relocate it. That is, they destroy it elsewhere. As settlement sprawls outward seeking unreserved space, the sprawl process destroys more than it reserves, for to reach the remote sites people drive further using more roads and cars, both of which require vast space themselves.

Some open space has positive edge effects, notably certain exclusive golf courses. But cemeteries—which, in Milwaukee, occupy more space than all industry—have a demonstrable negative effect on values across the street, especially commercial ones, while industrial plants have demonstrable positive effects. Both these effects stood out clearly in an intensive study of land values in Milwaukee which I performed with data from 1958 to 1965. Parks, which used to have positive effects, are changing more and more into nuisances with the modern decline in public behavior and social controls.

Pollution, therefore, does not place a limit on urban compactness and agglomeration. Clean environment is a complement of intensive urbanization and not a substitute.[3]

Individuals, neighborhoods, and small communities find some refuge in large lots and the preservation of vacant acreage roundabout. It would be a fallacy of composition, however, to generalize from these subsystems to the whole system. Since most people are more aware of neighborhood subsystems than whole metropolitan systems, this fallacy is widespread. But, at best, low-density enclaves export pollution, beggaring their neighbors. In the process, they create much more in view of the effects on metropolitan circulation.

Overall, therefore, land use controls are a small part only of the antipollution effort. They are no substitute for direct action against polluters. Public policy at the state and federal levels should discourage local policies of reducing pollution by dumping it on others and encourage direct action against polluters. We are undergoing in our generation the prolonged cultural shock of accepting this necessity with its limitations on our license and its need to spend money and political effort to curb unreconstructible vandals by force and social control.

Government landownership does not hold much promise of solutions when we look at the record. Public behavior in public places is often controlled by Gresham's Law because so much offensive behavior is below the threshold of legal and social control. The police have not succeeded in making highways and streets pleasant neighbors. Military bases and the TVA are among the polluters least responsive to victim protests, but government officials are responsive to the demands of motorbikers who are allowed extensive access to federal lands administered by the Bureau of Land Management. On public waters, motorboats receive more protection from state laws than those wishing not to be the victims of noise pollution. The operating principle is that the ownership of an expensive vehicle carries with it the privilege of preempting more public space than is allowed to the simple pedestrian or swimmer. An attack on the offending vehicle by the naked victim would be a crime against property, while the constant assaults of the vehicle on the victim are unpunishable.

It is not, therefore, the weakness of government but the mindless attitudes of the government and the people that are at fault. The attribution of power and prestige and even affection to large polluting vehicles is at fault. A change in these attitudes is thoroughly consistent with a return to urban civilization and an appreciation of the benefits of closeness. Closeness makes us more aware of each other and more considerate. It is easier to remonstrate with the person who blows smoke in your face than the one whose car blows exhaust in your air as he speeds away.

There is this idea that nature ennobles a man while cities degrade him. But, in fact, face-to-face contact of unarmed individuals outside the shells of motorboats, snowmobiles, all-terrain vehicles, landrovers, and other apparatus of being "close to nature" is the basis of civilized behavior. In a compact group, the burden of proof rather naturally slips from the victim to the polluter where it belongs, and this is the most effective remedy. Pollution, then, is not a limit on closeness. It is, rather, a limit on the distance that can be kept between people while maintaining some sort of civilized society. The solution to pollution is not dilution but control, and control, by whatever means exercised, is a natural by-product of the synergistic city.

Cross-Subsidy in Mass Systems

Wilbur Thompson has labeled the city "a distorted price system."[4] Most mass systems which comprise urban circulation use consolidated accounts, masking the fact that service to some places makes money while service to others loses it. The rich territory carries the lean territory, thus transferring rents from one to the other. In the process, a great deal of potential rent is dissipated and destroyed by extending service to subeconomic areas which have to be subsidized. The overall patterns are primarily two: the center is sapped to serve the fringes, especially ragged fringes; and high-density areas are sapped to serve low density areas. This pattern of cross-subsidy follows simply from "postage-stamp pricing"—that is, charging common rates regardless of location and different distribution costs. The bias is exaggerated by the impact of promotional rate structures which give discounts based on volume per meter, without regard to volume per unit of area, or distance from the load centers.[5]

City street systems, as an example, are priced by gasoline taxes. Yet, they are paid for by city property taxes while the gas taxes are used to extend long, narrow roads into lean territory for farmers and exurbanites. Commuters congest the city streets, pollute the city air, and sap value from the real estate that finances these streets. Commuters by train strengthen a central city, but car commuters sap it.

Open space and low-density land uses, in addition to increasing circulation costs, make less positive contributions to urban synergism. Cities exist to bring people together; open space holds them apart. Open space in its place is a joy, but it is not the best use of central city land, either for the individual owner or for the whole urban system. There is some small optimal need for open space even at the hottest 100% location, but it is there to enhance the used land, not as an end in itself; and its value needs to be demonstrated, not assumed. Remember, too, we are not questioning the value of open space, but the location. Every acre of open space in the central market destroys at least an acre elsewhere and usually much more.

The problem is not that government is weak but that government is perverse, for many reasons, including the dereliction of most (not all) economists and political scientists who have done too little to clarify these problems. Government regulation of utility rates guarantees a fixed return on aggregate invested capital without requiring that marginal extensions support themselves. This creates regulatory bias, actuating utilities to invest submarginally at their fringes to maintain their rate bases and justify higher rates to sap their centers. Where private sellers resist submarginal extensions, government often imposes a "duty to serve" which ignores marginal extension cost.

Government subsidizes or requires the subsidy of rural extensions in countless ways. Governmental power imposes zoning which interdicts rent-generating high density.

Legislatures instinctively impose territorial cross-subsidy in the process of legislative logrolling. It results from seeking to equalize benefits in kind rather than by money payments, without regard to efficiency (something that legislatures traditionally undervalue).

Strong government, rather than helping solve the problem, is making it worse. Where ignorant armies clash by night, nothing is gained by more fire power. The growing dependency of cities on federal largesse creates more and more benefits to landowners with no corresponding obligation to pay. This means more logrolling in city councils. In addition, it raises logrolling to higher levels. Cities, regions, and states compete at the federal trough.

The only workable remedy has to involve recoupment from beneficiaries, mainly through taxation of the unearned increment of land values. By this means, government recoups its outlays, those who get none are not injured, and landowners will stop demanding subeconomic extensions. Wasteful cross-subsidy only develops to the full as a species of equity in kind among competing landowners once they have established a system of taxing sales and income to support land values, and a system of state and federal subventions to local governments. Take these away and cross-subsidy among places will lose major support.

Taxing land values, which is popular among economists, may be viewed as a means of making compensatory payments in money rather than in kind. It lets planners go ahead and favor some areas over others, developing neighborhood specialization and differentiation such as the urban promise requires. Central rents are then redistributed in money through the tax system rather than as now in kind through cross-subsidy. This solution has the added benefit of being compatible with a free market in land and, indeed, I would say necessary to lubricate the market for optimal performance.

Absentee Ownership

The synergistic city carries the seeds of its own destruction when its high central and speculative land values attract absentee owners. The absentee owner, being absent, neglects civic duties, the many unpaid services people do for each other out of public spirit, social pressure, mutual cooperation, and enlightened self-interest. He may not even be a person, for many absentees are estates and institutions. He spends his income elsewhere and he may pay most of his taxes elsewhere, too. He does not contribute to community chests, churches, or service clubs. If "he" is a multi-national corporation, he is disposed to put the branch plant on and off standby for the convenience of the corporate center. Buildings deteriorate and employment declines. Much of this has been documented in Jon Udell's remarkable study of the merger movement in Wisconsin.[6]

Many a central business district has gone to seed because its absentee owners milked their holdings and failed to get together to make timely response to the challenge of suburban shopping centers. The research of Joseph Monsen in San Francisco identifies estates as the worst drag on central business district redevelopment, causing outmigration of business to new districts.[7] Estates, he finds, are quite inactive, seldom selling properties and accounting for little new construction even though they hold large areas.

The effective medicine for absenteeism is the same as for cross-subsidy. Cities can build fires under derelict owners by levying taxes based on the value of their land. These will impact differentially hard on absentees because the ratio of land values to buildings is in general higher for absentees than residents; the ratio of land value to sales and income, alternative tax bases, must also be higher. Another useful reform would doubtless be a sunset law for unsettled estates.

Crowding the Lot Lines

When B crowds neighbor A's lot line, he may trespass on A's psychic territory by blocking his view and exposing him to noise and odors. He increases the potential for conflict between A and B, and if A backs away then B preempts some of the open space which A pays for. B is likely less wealthy and many Bs will crowd community infrastructure which a few As may have paid for already. This kind of parasitic effect is the one first and last perceived by many people. It appears to put a limit on closeness and, hence, the realization of synergism. It leads to zoning whose major thrust is to limit density and which, where misapplied, becomes a major obstacle to the synergistic city.

The problem in the aggravated form that we know it today is largely the product of leapfrogging. The aggravation occurs mainly during land use succession where a high density use is invading a low density zone. If cities grew compactly and sequentially, if apartment districts and commercial districts did the same, the problem would be *de minimis*. At its best, the spillover effect is beneficial. It can help to synchronize compact succession of land uses. This is most evident where new apartments are invading an old slum area, for example. It is leapfrogging that makes this problem so widespread and aggravated with the constant mixing of incompatible uses. Leapfrogging turns temporary successional phenomena into permanent threats without much redeeming grace.

The universal and single-minded remedy applied to this problem is low-density zoning. Zoning at its best could be helpful where applied intelligently based on analysis of a whole metropolitan system. It could contain leapfrogging and increase pressure for infilling. Zoning which limits density could actually often increase density by obviating defensive buying of excess land by individuals seeking to preclude the worst possible spillovers from Kallikak neighbors.

Zoning in practice probably worsens leapfrogging because it is the product of episodic political pressures rather than systems analysis. Zoning keeps many near-in areas at low density. It often limits access to the most desirable amenities like the lakeshore bluffs of north Milwaukee or the California Coastal Zone, forcing population to concentrate in less desirable areas. In newer areas with looser zoning, on the other hand, there is a strong preemptive motive to build at high density and establish one's future grandfatherhood before low-density zoning blankets an area. When the zoning does come, there is a strong incentive to receive a capital gain by breaking it through inveigling councilmen of grey ethics and expedient ideology. Between developer-financed councilmen overstimulating building in some jurisdictions, and citizens of exclusionary bent closing down others, the market is shouldered aside as the arbiter of land use choices.

A proper and limited objective of zoning would be to maximize the joint value of contiguous lands—let's say two contiguous parcels. A showing of damage by B to A is not enough reason to limit crowding. A may be more damaged by losing his reciprocal right to crowd A. Thus a suburban village might impose minimum lot size of five acres, as River Hills, Wisconsin, in fact, does. The result is a remarkably low value of land per square foot, evidenced by actual sales. Here the owners are mutually damaging each other much more than if all could divide into small lots. (As a coordinated holding action for later synchronized succession with short-term minimization of county taxable values, the policy might make sense, a point not pursued here.) The rule of maximizing joint value is consistent with and implied by Michelman's fairness test: requiring one to bear a loss is fair if the policy applied to others is likely to help him more.[8] If we could "purify" zoning and the motives of its practitioners we would end up with something like this—not like River Hills.

But zoning which focuses on building positions probably misses the main mark. Demands for psychological space are culturally determined and highly flexible, not only from culture to culture but among regions. Much more objective is the factor of noise and noise trespass. A concerted campaign to control noise with appropriate legislative changes would do much more than holding our neighbor's walls so many feet distant. Proximity is almost totally harmless if the neighbor is quiet. Noise control would accomplish the desired end of privacy, peace, and quiet without the enormous resource costs in land and capital required by low-density zoning.

Another aspect of the small lot-large house problem is the ticky-tacky tract—the most common kind of Planned Unit Development, incidentally. Cookie-cutter subdivisions provoke feelings of nausea in most beholders, provoking great resistance to density. But why must tracts be so repulsive? Before World War II, subdivision of land was one function and building houses was another, as a rule, meaning we got custom homes in tracts. Many attractive older, middle-aged neighborhoods remind us of this era. What went wrong? The killer of the dream was the lot speculator. To overcome him, postwar builders turned to tract housing.

Besides lending itself to depressing uniformity, tract housing lets private landowners lay out the public streets. Attorney John Murphy of Baltimore is campaigning currently for a return to public street planning, including initiative in subdivision, and integration of subdivision streets into total urban systems. This seems to me the right way to go, and it can be made to work by synchronizing private response to public investment by laying heavy annual land taxes on improved lots. Exempting building values from property taxes would also reduce the pressure to skimp on building quality.

Another way to protect the lot lines is to let buildings rise higher. The very pleasant tree-shaded Milwaukee suburbs of Shorewood and Whitefish Bay support densities of ten thousand persons per square mile, mostly on fifty-foot lots with two-story houses. The second story is important. The postwar rambler precludes any such density unless the house covers the whole lot.

Going above two stories, and perhaps even that high, builders meet diminishing returns to height as they, in effect, substitute capital for land. In addition, as they go higher some one-third of their capital cost consists of building the utility core of a high-rise building to provide vertical transportation and circulation. These substitute for the horizontal public systems but do not receive the same subsidies. On the contrary, they are taxed. The property tax on buildings, where heavy, raises the cost of substituting capital for land and discourages utilization of the third dimension. This forces buildings to spread laterally and gobble up curtilage or open space. This becomes part of the argument, then, for exempting buildings from the property tax and focusing on land values instead.

Multi-story buildings are notably cheaper to heat per cubic foot of usable space than ramblers. Collectively they reduce energy use in transportation by increasing density. So, if our institutions do not bring us back to multi-story building, the energy crisis will, and in a much less pleasant manner. Nature has her own ultimate penalties for those who defy fact and geometry. But a happy by-product of an energy catastrophe, if it must come, would be a rediscovery of the synergistic city which we are losing by wasting energy.

Overloading the Public Services

Any underpriced public service invites expansion of dependent land uses. "Services" include access to public capital, public land, and public resources —such as streets and highways, parks, and water.

Example number one is the auto-oriented land use. Vehicles are generally exempt from property taxes and they occupy mainly bare land with minimal taxable buildings. The result is a large bias towards expansion of car lots, drive-ins, driveways, carports, gas stations, parking lots, outlying shopping centers, cars and campers parked on lawns, junk yards, trucking terminals, and so on, with a big competitive advantage to richer employers who can afford all the bare land for employee parking. These tax-exempt vehicles give one privileged access to the astronomical public investment in streets and highways along with license to pollute the air and the airwaves over adjoining private land. The vehicles give knight-in-armor dominance over peasants on foot or bicycle. The capital and land in the highways themselves are tax exempt, and powerful trucking lobbies keep increasing the allowable truck size and weight and forcing greater spending on wider, costlier highways. Outlying and scattered land use is also more auto-dependent: it overloads busy streets and also requires new roads be extended for it alone.

Streets and roads themselves take vast lands, too, and mega-capital to pave. Private vehicles are "appropriative capital"—a class of capital that serves its owner to occupy and control a piece of common land. Thus autos and trucks cause expansion not just of private but also public auto-oriented land use.

Other appropriative capital items are boats, portable radios, cigars, aircraft, beach umbrellas, water diversion weirs, and water wells. The last two, under our appropriative approach to water law, result usually in underpriced water, which in turn subsidizes water-intensive land uses to expand. These are lawns, cemeteries, farms, and golf courses, all more scenic than Exxon aprons but equally anti-synergistic. And they sap the community's limited water sources.

Any community with amenities open to all has cause to regard new residents as sappers of these amenities, in which all residents have a species of equity (even though the amenities may have been acquired without cost historically). Sellers of raw land capture some of this amenity value each time a new development occurs.

Tax-exempt land users, of course, are encouraged to occupy more space and more valuable space than if they were taxable, and to support their physical plant munificently while they may starve their employees. With due respect, there is something absurd about a church requiring a prime downtown location to serve a handful of people for a few hours a week and to withdraw from the life of the city behind walls designed for the needs and tastes of a generation long departed.

Young parents, from a parochial view, are parasites because their children crowd the schools. Fear of school taxes is a major source of support for exclusionary land use controls which break up urban synergism. The solution here is clearly that the state which mandates compulsory schooling should also support it. This, of course, is the thrust of recent court decisions and will gradually be implemented. It is important that the support go to the parent or child as such, however, and not to the local government as such, for the latter could support the governments without creating an incentive to accept school children. It is also important that the property tax be shifted to the state level along with fiscal responsibility for schools.

Land uses harboring welfare cases evoke similar antipathies; but these have had less effect on land use controls because welfare cases live in old houses with grandfather clause protection. It is institutionally easier to oppose new building than demolish old, although the victims of "urban removal" know that the latter is also possible. Again it is a good principle that the state should finance welfare which the state mandates. Cities and counties preaching this text have not been willing to relinquish their monopoly of the property tax, which seems the reasonable counterpart. A state property tax together with a state assumption of redistributive spending would go far to mitigate the indefensible aspects of exclusionary local policy.

To overcome the present privileged standing of vehicles is a long-term job calling for concerted state, local, and federal action. We must tax vehicles much more and buildings much less. Vehicles should be taxed first because they are capital, and if any capital is taxed vehicles should be included. Second, vehicles should pay for preempting space on the public highways, and third for polluting. It is questionable if the insurance they pay really compensates society for the death and injury they cause and the enormous cost of avoidance imposed on others. However accomplished, taming of the individual vehicle would contribute as much as anything to releasing the constructive forces of synergism to create great environments and great cities.

The problem of overloading the local amenities is largely a vehicle and apparatus problem, too. There is an alchemy which can transmute a small, noisy, overcrowded lake into a serene, spacious vista: simply outlaw motorboats. Likewise, keep cars and motorbikes and PA systems out of the parks. Allocate some police time to enforcing a few more basic behavioral controls as well—this is much cheaper than making new parks, and less resource-using than sterilizing all the undeveloped land in a community to save the parks for early settlers. The policeman's salary appears in the budget every year and is subject to heavy payroll taxation, creating a strong cultural bias against doing anything in a labor-intensive way. In the longer term, this cultural bias needs correction, but even so, there is a case for more policing of public access amenities to offset the Gresham's Law which otherwise acts to reserve them for the most offensive individuals.*

In terms of equity, the right of acreage holders to sell to people who will crowd local amenities would be stronger were property taxes to be based primarily on land value, so that all landowners would have shared equally in the cost of developing the amenities. Cities should annex land only shortly before it is actually ripe for urbanization and might levy on the annexation increment as the price of admission—a proposal that warrants more study.

The problem of overloading local schools is a financial one since schools can be duplicated, and is on the way to being solved thanks to recent court decisions (although it would be an unhappy economic solution if we lost the property tax in the process). Overloading welfare finances is similarly being solved by shifting the burden to higher levels of government (this, too, is an unhappy solution if we neglect the primary solution of increasing employment opportunities). In terms of protecting urban synergism, the major business ahead is the problem of the insolent chariots. To contain the land-gobbling vehicles, there are several powerful greed lobbies to overcome. These, in turn, thrive in a culture that worships big toys and submits to their owners; that drives people off the land and into the streets; and that then idealizes aggressiveness and vehicular vagrancy and despises the victims, whether silent or in protest. To redress the balance, we must tax private land to actuate the owners to make it more accessible to labor; and we must either untax buildings or tax vehicles or both.

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* In a still larger sense, it is the national choice to substitute heavy welfare payments for the creation of job opportunities that drives so many rough-edged juveniles to overload the public amenities, and the only ultimate solution is a basic reversal of our bread and circuses approach to the unemployment issue.

Old Buildings Amid New

Old buildings often sap value from new ones nearby. There are exceptions where the old buildings are well maintained or rehabilitated or were outstandingly sturdy and munificent from the start. But on the whole, older buildings downgrade neighborhoods while new ones upgrade them. Old ones pose greater fire hazards and generate more vermin and public health problems. They also have more old, inefficient furnaces which aggravate air pollution, and are usually linked with more tenancy, turnover, and neighborhood disruption.

Public policy, although it often strikes against new buildings of low value, tends to favor old buildings of low value. Old buildings are exempt from requirements for offstreet parking which are forced on new ones, thus reserving free street parking for the old. Old ones are often exempt from some space, sanitary, and just plain arbitrary requirements imposed on new buildings. Property taxes focused on building values clearly favor the old over the new, so long as the old remain blighted. Defenders of the property tax on building values have often explained it as a kind of user charge on the theory that public costs are in proportion to building values. But this becomes nonsense when we compare buildings of different age and quality. The old ones contribute more to public costs and less to public revenues.

These institutional biases reinforce the natural bias and make old buildings even more parasitic. Thus, abetted by public policy, the feedback principle that blighted land blights back has ruined whole neighborhoods. It has brought many to the tipping point where renewal never occurs; and a few of them to the extinction point where land in the centers of the greatest cities of the greatest country becomes absolutely worthless and is abandoned by the owners to the state.

There is a natural market mechanism for continuous urban renewal which has worked again and again so that in many older cities already four or five generations of buildings have occupied the same site. So long as a city has strong neighborhoods, the land adjacent has renewal value. When pockets of blight do develop, they are ringed by strength which preserves the renewal value of land at the fringes. This causes renewal to proceed from the fringes progressively inward to the center until the pocket of blight is eliminated. Natural market renewal anchors itself on one side for strength and builds strength for the next step of renewal.

To preserve this natural renewal mechanism, we need a fair market. An important attitudinal change is to stop confusing slums with the welfare system (and a step beyond that, stop confusing any welfare system with social justice and full employment). Of all the ways to help the poor, the preservation of unfit housing is the least humane.

The good effects of taxing land instead of building values should be apparent. The tax on land values offers no obstacle to renewal, but does build a fire under the owners of land with blighted buildings and redevelopment value.

Other kinds of discrimination in favor of old buildings—the various grandfather clause privileges—should be removed and, if anything, reversed. It is fair to levy differential charges on land with old buildings on the same rationale that it is fair to levy a charge on polluters: because they blight their environs. At the same time, to strengthen this process we need remove any hint of subsidy to outlying building. The same collection of ordinary buildings that will downgrade and menace an exclusive estate area will serve to upgrade a blighted area, as well as use existing public works in the old city. It is the city's interest to prevent the former and encourage the latter.

Holding Land For Future Use

A good deal of city land is empty and unused. Empty land pulls the city apart and hinders synergy, without the redeeming grace of lawns and shrubbery. Like other empty space, vacant land increases circulation costs. Let us add to the points made previously that empty space increases the distance from the city center to the hinterland on which the city depends for food, refuse disposal, building materials, rural retreats and resorts, water supply, and a significant flexible labor force element that alternates between rural and urban work.

A rationale could be that the landholder is reserving land for a higher, more synergistic later use. If so, reserving land could have some value. But on the whole this rationale is a rationalization, a less than half-truth blown into a whole truth. It overlooks the fact that most of the costs of waiting are borne by the public while most of the benefits go to the owner. It is also a golden outlet for procrastination by those with the means to be insulated from ordinary pressures to maximize their wealth and deal with others.

Empty land radiates uncertainty in the interdependent business of neighborhood and community building, hampering the coordination and synchronization among private owners described earlier. Vacant land has rights to potential service from capital-intensive city infrastructure, including extensions around the empty land, without paying for it but reserving a contingent right to load it at the owner's convenience.

Some land held for future use is not vacant but kept in the terminal stages of its previous use. This can be worse than vacant land. Farming in the van of expanding cities runs down. The land moves to strong hands in large tracts and the ordinary business of farming becomes incidental. Capital is milked instead of replaced; no one plans for permanent farming; and healthy farm communities are destroyed much earlier than need be. In the van of expanding commercial districts, the results are frightful. High speculative prices preempt land from resident owners. Absentee owners milk old buildings and foster neighborhoods of tenants and transients. These denizens in turn invade public places downtown, and Gresham's Law weakens or destroys the very force on which the speculation is based. Blighted property blights back. It wounds the central business district deeply, often mortally.

Owing to institutional bias, the timing of development calculated to maximize individual wealth is not that which maximizes social wealth. Taxes are based mostly on either buildings or activities rather than land values. Building, improving, buying, selling, working, earning income: these are all occasions for tax levies. The tax collector is put off by deferring improvement and minimizing action. Raw land, on the other hand, is traditionally underassessed while it appreciates quietly. This unearned income is treated much more favorably than ordinary income under our income tax. The individual's optimal timing is made much slower than that which would maximize the present value of tax collections by such tax-slanted incentives. In addition, since income tax incentives are individualized, neighboring landowners are subject to very different timing incentives and the synchronizing mechanism of the market is in ruins.

Before there was an income tax, there was the same problem, less aggravated than today, because of "front money bias." Internal discount rates vary among individuals almost as much as income tax circumstances, and the speculative land market has always been one where accumulated wealth dominates, a point established by 19th century historians.[9]

Antipathy to "land speculators" often has an anticommercial undertone and is easily deflected by citing the worthy individual who holds empty land, not for sale but for his own future use. Crusading politicians melt like butter before the pathos of this argument. If I buy cheap today and use dear tomorrow, there is no income tax on the appreciation. Only when I let someone else at it am I a bad guy who deserves to be taxed.

Business is likewise above reproach when it holds empty land for possible "future expansion." The future expansion rationale has its problems. It is, for one, invidious. Policies that make it cheap for A to hold land for future expansion at the same time make it difficult for B, who has no land, to acquire it for future expansion. This is a high-ante game with a sharp front money advantage reserved to those with accumulated wealth.

More subtle, more pervasive, is the effect on the competitive land market. There is a fallacy of composition here, "the fallacy of universal vertical integration." Imagine a city where all the firms held land around their plants for possible expansion on the assumption there was no free market in which the few who actually will expand can buy land at the time of need. This arrangement would enormously increase the aggregate demand for land and in the process go far to destroy the synergistic city. It would also destroy the market for land.

When several large firms acquire circumjacent land for future expansion, they begin destroying the land market and force others to hoard too, that is, those who have the strength. The land assembly market is hard to keep working at best. This is hitting it at the weakest point. There is a snowballing or feedback effect, just as in the analogous market for scarce raw materials. Vertical integration by some forces it on others because of the threat that the free market will disappear. If we want an economy and society organized around free markets, we do not want to encourage firms to hold land for future expansion.

The future expansion rationale is based on the convenience of those with great wealth who want to get bigger, but a free market economy and a healthy society both need more small independent owners. Over-concentration is a major problem anyway. Where land carrying costs are high, i.e., when land taxes are high, the market is fluid and new firms have a chance to get in. In those rare cases where there are real economies of scale through expansion, it permits firms to expand at the time of need. It eliminates that spurious and invidious economy of scale which consists in superior ability to hold land in advance of need.

Redistributive Taxing and Spending

Schooling and welfare spending is mandated by the state and imposed on localities. So is support of religion and charity to the extent of property tax exemptions. At the local level these requirements appear parasitic, even to the same people who approve them at the state and federal levels. This leads to large biases in locational incentives on the one hand and zoning practice on the other. Poorer people seek to invade jurisdictions of high per capita wealth, with developers running interference and local zoning boards on the defense. Both the offensive and defensive platoons have developed high levels of skill at this game in which efficiency, equity, and consumer sovereignty are lost in the shuffle.

I have previously noted how these twisted incentives may be straightened by having the states pay individuals directly—or, if they must work through local government, make payments proportional to population. Here let me add that such payments to be effective should be *net* payments above tax burdens exacted by central government. Alfred Marshall distinguished "onerous" from "beneficial" taxation, the former being taxes levied for a higher government without compensating services to the locality. Immigration invites onerous taxation by state and federal governments because these governments tax primarily persons rather than things. The message to local government is, "the more people you accommodate, the more taxes you pay," while government spending is based on other criteria not limited to population and often not including it. Taxing-spending formulas become major determinants of location.

Central governments wishing to redistribute wealth should tax wealth rather than persons and distribute to persons rather than to governments. This simple truth has been masked by generations of infatuation with the word "income" and the idea that income taxation can be substantially neutral. Income taxes as they actually exist tax persons for working much more than they tax wealth for yielding services or cash or unearned increments, and are the antithesis of a social dividend. Indeed an effective way to distribute social dividends today would simply be to abate income taxes.

The antipersonnel bias inherent in taxing income *in personam* is fortified by an antimetropolitan bias in the structure of the tax laws. One telling evidence of this is research by Finis Welch and Robert Evenson finding that farmers reported, for income tax only, up to 69% of their income in North Dakota, the highest state, and as little as 2% in California and other low states.[10]

Another indicator is from the Bureau of Labor Statistics: "Urban family budgets and comparative indexes for selected urban areas."[11] Personal income taxes are reported as a budget item. For the low-income budget personal income taxes are 30% higher in metropolitan than nonmetropolitan areas; for the high-budget family they are 40% higher. In effect, the Federal Government taxes people for moving to metropolitan areas. After the Feds have skimmed the cream, there is that much less left to support local government.

Territorial Segregation

Segregation is the seamy side of choice. The urbanite's wide range of choice forces him to screen most people out and limit his sense of community. A wide choice of schools leads to concentration of successful families around some, thus impoverishing others. One or a few big-city schools come to specialize in education and others in keeping kids off the street. Suburbs are the next step and now we have walled compounds, prominent in Orange County, California, with gates and guards.

Is the answer then to reduce people's range of choice to select their own associates? I think not. Extreme alienation can also be found in rural and sylvan areas. The IWW indeed was the most militant and alienated of labor unions, and farm workers, although powerless, are certainly as alienated as any urban tenant. The basis of alienation is the concentrated ownership of property by others rather than its residents, workers, and managers. This is compounded by subsidizing highways to exclusive suburbs and exclusionary PUDs. The same policies recommended above for other purposes would alleviate the worst aspects of urban segregation and alienation.

Self-Contained Land Uses

Early America offered a contrast between two kinds of land settlement. Plantations dominating some regions were self-contained. They did not need cities and did not encourage their growth. Small farmers in other areas depended on trade, each other, and urban craftsmen. They needed cities and cities grew to serve them.

Self-containment within the city is a contradiction. The modern growth of self-contained vertically-integrated multinational corporations owning large tracts of urban land is therefore seriously weakening cities. The more self-contained the firm, the greater its need for secrecy, the greater its tendency to promote from within, to reward seniority, and to hold people with pension promises. Corporate man becomes a citizen of the corporation first and the city second, if at all. The corporation needs its neighbors less and less and its New York banking and Washington political contacts more and more. Large business landowners become an alternative to the city, not part of it but a hindrance to it. The decline of the city and the rise of the corporation go hand and hand, just as the decline of ancient Rome went hand in hand with the rise of *patrocinium* and the benefice, the PUDs of that era.[12]

SUMMARY OF POLICY

The synergistic city is the product of free choices by independent decision makers in free markets, abetted by public policy and planning. To make it work, community leaders need attend to the working of the private market; to planning and financing public works; to equity among persons; and to land use regulation.

With respect to the private market, the job is to keep it fair by exorcising institutional biases. At present there is a great deal of "noise" jamming the signals of the market. Tax policy adds most to the noise. Even a tax on net income is bad because it weakens market signals compared to the noise (and adds noise of its own). On the other hand, a tax on land values not only transmits market signals but helps the market work better by amplifying the call of the consumer. It does this by applying leverage: the tax is a fixed cost, while revenues vary with the effort and skill managers apply to serving consumers.

Taxing land values lubricates the market by making it more costly to hold land in reserve. This does not destroy the reserve function, but has the effect of pooling reserves by making it easier for expanding firms to acquire land through the market when and if they need it.

With respect to public works and municipal services, we need to deconsolidate accounting so that separable parts are analyzed and evaluated separately. This lets us eliminate cross-subsidy. Then we can apply the logic of marginal cost pricing without abusing it, as now. We need to foster private capital that improves land served by public works. Even though this results in loads on public works, it obviates extensions to serve the same loads further out.

We need a more positive attitude toward private capital which supplements and extends public works vertically at private expense. We need a more negative attitude towards "pre-emptive capital" which occupies public land and capital where access is open without adequate price. And we need to avoid over-delegating public authority over street planning to large private landholders. The marginal question, I fear, will always be whether the voters are capable of selecting statesmen capable of rising to this challenge and laying out streets well. But the alternative is a collection of tracts, company towns, and planned unit developments which will never make a synergistic city, or a democracy either.

With respect to interpersonal equity, once we make efficiency a goal we can reconcile it with most ideas of equity (which are subjective). We should never imagine that partial equity (as for instance by avoiding slum clearance or giving cheap water to favored individuals) could add up to anyone's notion of general equity in the whole economy as a total system. It is better to let efficiency prevail and use taxes to make compensatory equitable payments in money, rather than give in kind specific things to a limited few consumers. Land taxation lets us do this without impairing incentives. Land taxation is, indeed, essential to let cities plan public works efficiently: by recouping the benefits to some landowners through the tax mechanism, we avoid wasting subeconomic services on others who exact this as the price for political support. The alternative is logrolling, pork-barreling, uneconomical public works extension, and corruption.

Land taxation helps reduce urban alienation in three ways: it minimizes the division of haves and have-nots by taxing the haves to support government; it actuates landowners to use their land, thus giving jobs to the landless and rendering services to them; it discourages absentee holding and encourages the resident holder, who participates more in community affairs.

Redistributive payments need not distort efficient location incentives if they are paid directly to individual citizens in cash, rather than being routed through governments and/or paid in kind.

With respect to zoning and land use regulation, the need is minimized by application of the other principles suggested. We should retain zoning but limit it to maximizing joint values, having purified the motives of local officials by distributing social dividends directly to people, not to local governments. Zoning is a poor substitute for direct action against pollution, nuisance, and overuse of the public wealth, all of which are better purged by user charges, direct prohibitions, and regulations. We should minimize edge conflicts among incompatible land uses by encouraging compact sequential expansion. We should also encourage intensification, which is growth without expansion.

We will still not have the City of God on earth. Contradictions and unresolved value questions will always remain. We are dealing, underneath it all, with the most central social dilemma—how to maintain a healthy society in a sick world without being overwhelmed by immigrants. Part of the answer lies in healing the sick world, and part of the cure would be the demonstration effect of our own good example. Show how immigrants can be used to strengthen a society, and others will follow suit. Another part of the answer lies in the increased need to save energy and other resources. The synergistic city is resource-conserving. The rest of the answer, whatever it may be, merits our sustained pursuit in order to secure the enormous advantages of urban civilization in the synergistic city.

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Bank Trust Department Operation of Commingled Real Estate Funds

by Mike Miles and Janelle Langford

INTRODUCTION

Commingled real estate funds are becoming an important vehicle through which money managers offer their clients participation in the real estate market. These commingled funds offer the advantages of real property investment while minimizing certain diversification, liquidity, financing, and transaction cost problems. With the growth in pension and profit-sharing dollars and ERISA's diversification requirements, several commercial banks have initiated such funds. The client commits a portion of his total dollars to real estate and receives these benefits:

1) Higher returns than the stock market.[1]
2) Greater income stability.
3) Specialized personnel to make and manage the investment.
4) Greater investment liquidity than would be individually possible in the real estate area.
5) Participation in large scale projects with minimum investment.
6) Diversification both geographically and by type of property.
7) Inflation protection.[2]
8) Lower overall portfolio risk.[3]

Based on the enumerated advantages and the growth of trust and pension funds generally, these funds should continue to grow and become an integral part of a commercial bank's offerings to pension and profit-sharing clients. Correspondingly, an understanding of the investment perspective of bank trust departments will become increasingly important to all real estate professionals.

Despite rapid growth in the past few years, bank-operated commingled real estate funds are still a relatively new phenomenon. Several major banks are just completing logistical plans for the implementation of such funds with an

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even larger group still in the feasibility stage. Of the nation's 50 largest banks, only these twelve[4] currently have operating commingled real estate funds:

Bank of America
Bankers Trust Co.
Chemical Bank
Citizens and Southern
Continental Illinois National Bank and Trust Company
Crocker National Bank
First National Bank of Boston
First National Bank of Chicago
Morgan Guaranty[5]
North Carolina National Bank
Wachovia Bank and Trust
Wells Fargo Bank

Essentially, commercial banks are a subset of one of five alternatives for pension funds seeking to include real estate investments in their portfolios. The pension funds can:

1) Individually own and manage real estate assets.
2) Individually own and hire outside management for real estate assets.
3) Use group ownership and management of real estate assets.
4) Purchase shares in limited partnerships involved in real estate.
5) Invest in undivided pools managed by banks or insurance companies.

Recent interest in the last alternative stems from the facility with which this vehicle can overcome problems typically associated with real estate investment (as compared to investment in stocks and bonds):

1) Initial investment research in an inefficient market is both difficult and time consuming. At the same time, such a market creates comparative advantage opportunities in valuation which point out a need for "expert" investment advisors.
2) Management of real property assets is messy and costly, yet tremendously important.
3) The scale of real estate investment opportunities often requires investor groups and/or substantial debt financing. The large investment scale further complicates diversification efforts.
4) The investment term is typically rather long and the investment relatively illiquid during the term.

Given the advantages and attendant problems of including real estate investments, option five looks particularly attractive. The interesting questions involve the investment strategy, operation, ideal size, and structure of such pools.

Structurally, commingled pools have several investment alternatives ranging *from* low loan-to-value first mortgage loans on completed, well-located, fully-occupied projects having net leases to Triple A tenants *to* equity positions in heavily leveraged development projects.[6] In between lie numerous intermediate positions paralleling the unfortunate REIT legacy. Essentially, the structure decision involves packing the investment asset to fit the project's riskiness and to meet client objectives. The use of mortgage financing can be viewed as a way to divide a project's cash flow into different risk categories. The well-managed fund will seek an asset structure which will maximize returns consistent with a desired risk exposure.[7] (For example, Chemical Bank has two commingled real estate funds, Mortgage Leaseback and Equity, with each designed to meet a certain set of client needs.)

THE SURVEY

This study deals exclusively with bank trust department sponsored commingled real estate funds.[8] Following a search of the literature,[9] the questionnaire shown in *Exhibit I* was prepared and mailed to the 50 largest U.S. banks as reported in *Fortune* (July, 1977). A draft of this paper with detailed responses was then sent to all 50 banks as an added assurance of accuracy.

EXHIBIT I

COMMINGLED REAL ESTATE FUND QUESTIONNAIRE

Note: If you have more than one fund, please complete a separate questionnaire for each fund.

1. Is the Trust/Investment area of your bank currently managing a commingled real estate fund?

   ______ Yes. In what year was it begun? ______ *Skip to question 4*
   ______ No. *Answer question 2 or 3.*

2. If the Trust/Investment area previously managed a commingled real estate fund but has discontinued it, please give the dates it was operative and explain briefly why the fund was discontinued. Then complete questions 4 through 23 based on your experiences with that fund.

3. If the Trust/Investment area has *never managed* a commingled real estate fund, when would you expect to initiate such a pool? (Please check one answer.)

   ______ 1978-1979 ______ Uncertain
   ______ 1980-1985 ______ Never

   Please complete this questionnaire hypothetically on the basis of your current beliefs about commingled real estate funds.

4. Please check the type of clients that participate in your commingled fund and the percentage that each comprises of the total dollar investment of the fund.

	100%	99-75%	74-50%	49-25%	24-1%
______ Pension	______	______	______	______	______
______ Endowment	______	______	______	______	______
______ Personal Trust	______	______	______	______	______
______ Other (Please explain)	______	______	______	______	______

5. Check the type of properties in which your fund invests and check the percentage of the total dollar investment of the commingled fund which each property type comprises.

	100%	99-75%	74-50%	49-25%	24-1%
______ Office	______	______	______	______	______
______ Commercial Retail	______	______	______	______	______
______ Industrial	______	______	______	______	______
______ Residential	______	______	______	______	______
______ Raw Land	______	______	______	______	______
______ Farm Land	______	______	______	______	______
______ Hotel/Motel	______	______	______	______	______
______ Other (Please explain)	______	______	______	______	______

6. Does your Fund have minimum and/or maximum amount which it will invest in one property?

Minimum	*Maximum*
______ No minimum	______ Less than 500,000
______ 0-$200,000	______ 500,000 to 1,000,000
______ $200,000-499,000	______ 1,000,000 to 5,000,000
______ $500,000-1,000,000	______ 5,000,000 to 10,000,000
______ $1,000,000 or over	______ Greater than 10,000,000
(Please give limit ________)	______ No maximum

7. In regard to geographical diversity, would you characterize your fund's investments as previously

______ Local
______ Regional
______ National
______ International

8. Does your fund invest in mortgaged property?

______ Yes ______ No

9. What is the expected annual cash flow return from the fund's investments?

Current Portfolio Average		*New Investment Expectation*
________	Negative	________
________	0 to 5%	________
________	6 to 8%	________
________	9 to 11%	________
________	12 to 15%	________
________	Greater than 15%	________

10. What is the maximum percentage of the total dollar investment of the commingled fund that each participant may own?

______ 0-5%
______ 6-10%
______ 11-15%
______ 16-20%
______ 21-25%
______ Greater than 25%
______ There is no such requirement

11. Who is responsible for locating properties in which your fund invests?

______ Done internally
By whom? ________________________________
______ Generated externally
By whom? ________________________________

12. Who is responsible for managing the properties in the fund?

______ Done internally
By whom? ________________________________
______ Done externally
By whom? ________________________________

13. How long is a participant required to stay in the commingled fund?

______ No minimum time requirement
______ Less than one year
______ 1-5 years
______ 6-10 years
______ 11-15 years
______ More than 15 years

14. How long does it take for a withdrawal request to be honored?

______ 90 days or less
______ Less than one year but more than 90 days
______ 1-2 years
______ 3-4 years
______ Greater than 4 years

15. Give the total dollar investment of your commingled fund in the years below.

______ 1960
______ 1965
______ 1970
______ 1975
______ 1978 (the present)
______ 1980 (expected)

16. Has the poor performance of the REIT's adversely effected the public acceptance of your fund?
    ______ Yes. Greatly
    ______ Somewhat
    ______ Very little
    ______ Not at all
    ______ Cannot determine

17. Who is your major competition for the type of clients investing in your fund?

18. How are you advertising your fund to potential participants?
    ______ Actively marketing to new participants.
    ______ Marketing through clients whose funds we already manage.
    ______ Waiting for potential participants to come to us.
    ______ We do not want to increase our fund.

19. Why did your bank decide to initiate a commingled real estate fund? Please rank from 1 (most important reason) to 8 (least important reason).
    ______ High potential return on investment
    ______ ERISA's diversification requirement
    ______ Disenchantment with stocks and bonds
    ______ Management fees
    ______ Geographical diversification
    ______ Type of investment diversification
    ______ Customer demand
    ______ Other (Please explain) ______________________________

Survey conducted May-July, 1978.

SURVEY RESPONSES

Number of Banks Operating Funds

The first three questions categorize the respondents. There were 12 trust areas currently managing a fund of which 11 fully completed the questionnaire. Of the 36 respondents who are not currently managing a fund, 12 were able to answer the questionnaire hypothetically.

Fund Origination and Current Size

Date Initiated	Assets in 1978
1 in 1961[10]	400 mil[11]
1 in 1965[10]	44 mil
1 in 1967	50 mil
1 in 1971	50 mil
1 in 1973	130 mil
1 in 1974	3 mil
3 in 1975	27 mil, 15 mil, 20 mil
2 in 1976	14 mil, 4 mil
1 in 1977	1 mil[12]

Three of the respondents never expect to initiate such a fund, 28 have no definite plans, and four plan to begin a fund before 1985. Citibank is already in the process of initiating its new closed-end fund.[13]

Growth of Commingled Funds

Fund Size by Bank[14, 15]

		Morgan Guaranty *	Chemical Bank *	Wachovia Bank and Trust	Continental Illinois National Bank and Trust Company	North Carolina National Bank	Wells Fargo Bank	Bank of America	First National Bank of Boston	First National Bank of Chicago	Crocker National Bank	Citizen and Southern
	1960	35	9									
	1970	365	32	5								
	1975	591	52	35	38	2	11	6				
	1978	330	45	50	50	3	20	27	15	130	14	4
(Exp)	1980	400	—	100	75	15	—	100	35	200	75	15

Among the 50 banks, cluster diagrams and cross tabulations indicate no consistent relationships between the banks' operating funds and the banks' sizes, incomes, or trust incomes. However, the largest five banks all either operate a fund or plan to initiate one in the immediate future.

Type of Client

All of the existing funds have 100% pension and profit-sharing clients. Five of the hypothetical answers (banks planning funds) would split their investment to include personal trust dollars or endowment funds.[17] Moving to individual accounts would involve federal income tax complications as well as increased competition from investment counselors and may involve the banks in investments beyond their traditional scope of expertise.

Investment Size

Only three of the banks' operating funds have a minimum for potential investment size (all $1,000,000), while all but four banks have maximums of 10% of the funds' assets (three banks report no maximums).[18] Of the planned funds, five anticipated no minimum while eight anticipated a maximum varying from 5% to 15% of the funds' assets.

Types of Property

Commercial/retail and industrial/warehouse properties are the most popular form of investment for operating funds with office building investment seemingly on the upsurge. Non-income producing property is included in only three of the funds. Only one fund has "all of its eggs in one basket." Eliminating this 100% response, the average number of property types in each fund is 3.5.

PERCENTAGE INVESTMENT IN TYPES OF PROPERTIES ACQUIRED—OPERATING FUNDS

		Number of Funds Investing the Given Percentage of their Assets in Each Type of Property					
	Number of Funds Investing in This Type of Property	≤20%	21-39	40-59	60-79	80-99	100%
Office	6	3	3				
Commercial Retail	9	2	5			1	1
Industrial/Warehouse	9	3	2	1	3		
Residential	4	3		1			
Raw Land	3	3					
Farm, Forest and Mineral Land	0						
Hotel/Motel	3	3					
Other	4						

Leverage

On the leverage issue, actual fund managers still prefer straight equity investment with eight of the operating funds not investing in mortgaged property (one of these has future plans to include mortgaged property). However, the hypothetical responses were more in favor of mortgaged property with 60% intending to include some mortgaged property in the portfolio.[19] Comparing the growth in operating funds to whether the fund invested in mortgaged property, there was no significant correlation. Only two funds decreased in value: one was a strictly mortgage fund (i.e., no equity) and one invested in equities of mortgaged property.

Returns

Seven of the operating funds have at least a 9-11% current annual cash flow return and eight expect this return to be attainable with new investments. (Hypothetically, three of the respondents planning a fund would expect a 12-15% return on new investments while only one of the existing funds expected such a return.) While four of the existing funds have a current average return of less than 9%, only two expected such a rate on new investments.[20]

Seemingly, several of the funds have not been meeting expectations. Yet, Chemical Bank provides a chart to compare its fund's annual rate of return to returns of alternate investments. This return was figured including capital gains and ordinary income. The compound rate for the life of the fund exceeds the alternative investments by at least 2% as shown in *Exhibit II*.

EXHIBIT II

ANNUAL RATES OF INVESTMENT RETURN INCLUDING CAPITAL GAINS AND INCOME

Year Ending 9/30	Commingled Real Estate and Mortgage Fund	Dow Jones Industrial Average	Standard & Poor's 500	S.P. High Grade Bonds
1969	(6.5)%	(9.0)%	(9.0)%	(7.3)%
1970	6.9	(2.2)	(5.7)	(0.7)
1971	23.3	20.2	19.8	12.1
1972	11.3	10.7	15.2	8.9
1973	9.5	2.9	1.1	2.5
1974	0.9	(29.7)	(35.8)	(2.2)
1975	8.1	37.0	37.7	7.9
1976	0.5	29.5	30.0	15.3
1977	11.8	(10.2)	(4.0)	11.0
COMPOUND RATE				
9 years	7.0	3.5	3.5	5.0

Limitations on Client Participation

The commingled funds offer pension clients a way to invest a portion of their funds in fairly liquid and diversified real estate fund participations. However, the bank operated funds usually have broad limitations on participating interests in terms of the maximum percentage of the fund which any pension client can own and the length of time to which the pension client is committed to the commingled fund. Most of the operating funds allow up to 10% ownership by a single client,[21] and nine have no stated minimum length of investment. In fact, nine of the operating funds try to honor a withdrawal request in 90 days or less making commingled bank trust funds fairly liquid pension investments.[22]

Open Ended

Most of the existing and planned funds are open ended. Citibank's fund is the exception as it is a closed-end fund and has an 11-15 year holding requirement. Other respondents planning a fund felt that any closed-end fund would involve a holding period anywhere from 10 to 30 years. Closed-end funds were seen appealing to large pension clients with possibly a 20% maximum participation of any one client of the total dollar investment of the fund which should exceed $40 million. Correspondingly, open-end funds were seen for smaller pension and tax-exempt clients with a 5% maximum participation in portfolios between $10 and $70 million and one to five-year withdrawal times.

Locations of Investment Properties

Locating quality real estate is a key element of any fund. While four of the existing funds characterize themselves as regional investors (with one intending to become national) and seven as national investors, all of the trust areas use internal means to locate the property with five using supporting external sources. Internally, six of the operating trusts use specially hired personnel, two simply employ existing personnel, and two use both. Of the five that employ supporting external personnel, the following were listed:

Appraisers and counselors	1
Agents and broker/developers	2
Real estate firms (as advisors to the fund)	1
Mortgage brokers	1

The percentage of planned trusts anticipating the assistance of outside-the-bank professionals in locating investments did not vary greatly from the existing funds' responses. Use of outside professionals by planned commingled funds included:

Appraisers and counselors	2
Brokers	7
Developers/builders	4
Industry contacts	1
Mortgage bankers	2

Property Management

All but one of the banks gave the same responses to the internal management of the properties as they did to the internal location of investments. The external management firms, used primarily for on-site assistance by operating funds, were:

Local property management firms	4
Specialized agents	1
General real estate firms	1

Competing Investors

With more dollars seeking investment in the real estate area, the competition for properties is increasing. Insurance companies, with large stable flows of funds and expertise in the area, represent the respondents' greatest source of competition. Foreign investors, other banks, individuals, and syndicates also represent significant competition for quality properties. Due to the level of competition driving down yields on suitable properties, some respondents are starting to look at properties in the construction and development stage. Clearly the risk situation shifts dramatically as funds consider development alternatives. However, as one respondent noted, the banks that have funds may not be able to achieve, in the next five to seven years, what they thought they could and there will be pressure to shift to entrepreneurial activities.

Major Competition for Properties
(respondents marked more than one)

	Planned Funds	Operating Funds
Mortgage Banks	0	0
Insurance Companies	8	11
Foreign Investors	3	5
Other Banks	3	5
Individuals	4	3
Syndicates	4	4

Competition for Clients

In terms of the type of client served, the responding banks clearly saw insurance companies and other banks as their principal competition.

Major Competition for Type of Client

	Planned Funds	Operating Funds
Mortgage Banks	0	0
Insurance Companies	7	11
Other Banks	4	7
Syndicates	4	0
Other		
Investment counselors	2	1
Individuals	1	0

The REIT Legacy

The failure of so many REITs has been seen by many authors to have affected the establishment of other real estate ventures by banks. The majority of the total respondents felt that REITs had *somewhat adversely* affected the acceptance of commingled bank-sponsored funds.

SUMMARY AND RELATED ISSUES

Commingled real estate funds are increasingly becoming a feasible way for commercial bank trust departments to meet the demands of pension clients. Stable return, diversity in property type and location, liquidity, and expertise in management combine with the general advantages of real estate investment to make commingled bank funds attractive. As pension funds grow, so will the potential for bank operated funds. Many banks contacted in the survey, who do not currently manage funds, expressed a strong interest in receiving the survey results. Based on recent growth, expressed interest, and potential, the authors see bank trust departments becoming a much more important influence in certain real estate markets.

As banks and other institutions (both domestic and foreign) move increasingly into the real estate field, they bid up prices and returns drop. This prompts the often heard comment "there just aren't enough *good* properties." As this trend accelerates, the individual investor may be price-risk adjusted into properties not well suited to institutional investors, particularly high-risk development and tax shelter investments whose prices will not be as affected by the market entrance of institutional buyers. If banks learn from the REIT experience, and avoid these types of investments, an interesting interface will emerge with individual investors making development decisions to provide future investment alternatives in a market heavily influenced by institutions.

REFERENCES

1. Returns over the last decade have substantially exceeded common stock returns. (See *Exhibit II*)
2. In fact, through certain combinations of contractual arrangements, such as percentage rents and cost escalation clauses, some real estate investments actually show net annual cash flow improvement due to inflation.
3. Inclusion of real estate assets can improve the risk-return aspect of pension portfolios due to the low correlation of real estate returns with returns evidenced on stocks and bonds.
4. Manufacturers National Bank has a mortgage only fund which is currently being amortized through regular payments. Chase Manhattan had a fund which was liquidated when mortgage yields became less attractive than marketable longer-term bonds.
5. Morgan Guaranty does not purchase operating positions in either of its two funds.
6. For debt financing to be fully effective it must of course involve positive leverage. However, any debt decreases the stability of annual cash flow and should be viewed by the pool manager as a way to divide claims on a property's cash flow rather than enhance risk-adjusted return.
   Refinancing can be a useful way to provide for periodic distribution of price appreciation, but the potential for accounting irregularities is not insignificant when refinancing is combined with "market value" income statements. (Note that the audit opinion on existing commingled funds is typically a "subject to" opinion.)
7. In addition to investment questions, structural issues involving the extent of distributions and closed vs open funds must be settled again mindful of the anticipated client profile.
8. The March 1978 issue of *Pension World* covers a survey of 31 organizations managing large-scale real estate portfolios. Eight of these organizations were commercial banks with the data reported in that survey being generally consistent with the more detailed responses reported in this survey for those eight banks.
9. Academic literature in this area is practically non-existent. A computerized data search of business periodically produced a series of articles citing the importance of the area and discussing several of the issues involved.
10. Three of the banks which had pre-1965 funds are now also managing a second fund.
11. The combined total of both of Morgan Guaranty's strictly mortgage funds.
12. Second Chemical Bank Fund.
13. To summarize, 12 banks have a fund in operation, two have operated a fund, three never plan to have a fund, 28 have no definite plan, four plan to initiate a fund before 1985, and one is beginning currently, for a total of 50 banks.
14. Figures not available for Bankers Trust.
15. Relative sizes are not always good measures of market impact due to variations in use of mortgage financing.
16. Both funds included in total.
17. According to the *Comptroller's Handbook for National Trust Examiners*, funds held by national banks as fiduciary may *currently* be collectively invested (1) in a common trust fund maintained by the bank exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as trustee, executor, administrator or guardian; (2) in a fund consisting solely of assets of retirement, pension, profit sharing, stock bonus, or other trusts which are exempt from federal income taxation under the Internal Revenue Code.
18. National Banks managing collective funds face a 10% maximum under regulation by the Comptroller of the Currency.
19. In terms of risk exposure, a fair generalization would be that strict mortgage funds are least risky, then strict equity funds, then funds which hold equity in mortgaged properties.

20. Funds' reported investment performance must be carefully examined as the funds report annual "appreciation in value" as income according to "Comptroller of the Currency Requirements." Annual revaluation is necessary to unit-value participants' proportionate share on withdrawal.
21. Chemical Bank has a varying percentage requirement depending on the characteristics of the individual account.
22. The time element involved in many of the funds was both flexible and complex. There is often an unwritten understanding about clients being locked-in; at least longer than month to month. For example, a comment from one respondent who checked "no minimum time requirements" was "to gain full benefit, an account would be required to regard its participation as a long-term commitment."

Young Professionals and City Neighborhoods

It may well be, as several investigators have reported, that considerably more of our urban neighborhoods are experiencing decline than revival. But the remarkable thing is that so many have revived over the last few years—both through an influx of new people and returning confidence on the part of long-time residents.

While they were little anticipated even five years ago, major reasons for this rediscovery of the value of urban life are now evident. Chief among them is the enormous influence of demographics. Demographic forces are destiny, someone once said, and we can see intimations of the truth of that remark as America's baby boom generation comes of age, begins to put pressure on housing markets everywhere, and inexorably spills over into at least some undervalued urban areas. Add to that changing lifestyles—people marrying later, divorcing more frequently, having fewer children, newly appreciating older homes and location close to the urban work place—and we can begin to see how even marginal shifts in demand may have profound consequences for central cities quite recently given up for dead.

However real displacement is as the new "hot" urban issue, the very fact that politicians, policy makers, and bureaucrats see it as an emerging issue tells us that times have remarkably changed since the close of the sixties. Seattle declares a moratorium on condominium conversions and Washington considers dampening down its real estate hysteria; Boston now sees some of its bankers genuinely recommitted to city lending while that same city, as well as Kansas City, St. Louis, Cincinnati, Dayton, and others explore the fruitful new world of residential marketing. Even unhappy Cleveland wonders if it might not have opportunities in its wealth of low-priced housing stock.

Are we merely in the midst of a fad, a passing taste for Victoriana on the part of a relative handful of "young professionals"? No one can say with certainty; yet numbers alone argue that urban America has entered a significant new phase—one that has overturned much of the pessimistic conventional wisdom of a decade ago. In its simplest illustrative form, there will be twice *as many people turning 30—shorthand for home buying age—in 1988 as there were in 1968. These people have to live somewhere, and at a time when elevated housing costs, environmental restrictions, and changing social values do not augur a second age of the suburb.*

This paper was published by Boston's Parkman Center for Urban Affairs in August, 1977.

The Parkman Center for Urban Affairs was created by the Mayor of Boston, Kevin White, to serve as a point of contact with the academic and business communities and the federal research establishment. For the last two years, it has concentrated on issues involving local housing markets and neighborhood evolution.

Once again we need only be talking about marginal population shifts to suggest substantial changes in the future fortunes of at least some of our cities. Where demographic trends are at work, the lever effect can upset the most assured of past predictions.

The following Parkman Report, "Young Professionals and City Neighborhoods," *focuses only on the most conspicuous of these trends. It should not be forgotten, however, that bare brick and hanging plants are only a part of the story. As we peer into the nation's urban future, a factor of possibly more importance are those older neighborhoods whose sons and daughters a few years age would inevitably have been migrants out of the city—but who perhaps today will feel that the good life, not to mention the affordable life, may lie where their grandparents found it. In short, and however tentatively, American cities may take hope in positive factors quite different from the programs of urban aid which so often did nothing for them, or worse.*

Robert Fichter, Director
Parkman Center for Urban Affairs

INTRODUCTION

As part of its continuing work on the evolution of city neighborhoods, the Parkman Center has studied patterns of middle class resettlement in the urban core. A recent Parkman House conference brought together a group of young professional newcomers to discuss the reasons for their choice and their feelings about city life. Soon afterward, Parkman Center staff visited a number of other cities to supplement findings in Boston.

The following report is an effort to present issues that emerge from this new migration and to encourage discussion about a trend of apparently increasing significance. Emphasis here falls on Boston, but in its essentials the report should be relevant to developments in several American cities. Numerically the new migrants may be few; in what they may portend for a potentially much greater shift in locational preference, they deserve notice from a national perspective.

THE NEW MIGRANTS

Long-time residents of older urban neighborhoods are sometimes annoyed to hear that their communities have been "discovered" by young professional newcomers. The fact is, however, that such people—whether they are architects, planners, professors, journalists, or whatever else—in a sense can claim to be discoverers, since what is new to them often has a way of seeming new to society at large.

They are sometimes called "trendies." It is not a bad tag. With generous options in where and how they live, with an edge in their ability to communicate tastes and values, they can influence public perceptions of what is desirable simply by talking to one another—and thus in the course of time to the media.

If a "rediscover the city" movement is to amount to much, an adventurous middle class subset of the baby boom generation will be on its leading edge. There are several reasons for this. One is that a tolerance toward or even a desire for a degree of cultural and racial heterogeneity seems most marked among this group. Another reason is that, as trend-setters, such people are alert to city options (a new interest in old houses, for instance), while the bulk of society remains fixed on a suburban ideal. Still another reason is that with relatively high earning power, they can find ways to "live around" such urban difficulties as poor public education; and if they cannot, they have the means to leave them behind rather quickly.

They are much more important in the long run than older and very affluent returnees from the suburbs who will gravitate toward fortress condominiums and luxury rental towers. Young professional urban settlers are more important because of the large household-forming peer group on whom they will exercise a taste-making influence.

Individual cities and metropolitan areas have been conscious of the young professional phenomenon occurring within their own boundaries, in some cases for a decade or more. A national awareness of the phenomenon, however, and its possible consequences for urban evolution, is just developing. That awareness will grow as more instances are noticed. Just a few examples of established or emerging settlements in older cities are Trenton Place in Wilmington, Society Hill in Philadelphia, South Baltimore and Charles Village in Baltimore, Mt. Adams, as well as parts of Hyde Park and Mt. Auburn in Cincinnati, the Central West End and Lafayette Square in St. Louis, Hyde Park in Chicago, Noe Valley in San Francisco, and even a formerly run-down rooming house area of old German mansions in San Antonio.

In Boston, young middle class immigrants no longer live just on Beacon Hill and in the Back Bay (where they are no novelty), or even in Charlestown and the South End, but now also in the 19th century streetcar suburbs of Dorchester and Jamaica Plain and West Roxbury. Several of these neighborhoods, or parts of them, once had but largely lost a professional presence. That presence is now reappearing as a more broadly defined professional class "reclaims" areas of past gentility.

The term "young professional" is obviously imprecise. Neither it nor "intellectual"—a term also used—will do at all for the purposes of a social taxonomy. The possible quibbles over who is or is not a young professional are infinite. However, one can point with confidence to an emerging group whose class characteristics are quite distinguishable, in gross, from those of the majority of their urban neighbors.

While the people at issue have respectable to quite impressive incomes for the most part, income by itself is not the final test of their identity. Many blue-collar workers do as well. While higher education is a common feature, and while values, tastes, and attitudes attributable to prolonged schooling are often conspicuous, a college degree is not the invariable sign. Nevertheless, superior income and education combine to help identify the type.

Although there are exceptions, many of the young professionals are indeed young—that is to say in their twenties and thirties—for the obvious and extremely significant reason that they are a part of the population bulge moving through the age profile of American society.

The great majority are white, with their black counterparts more apt to be migrating toward the suburbs. This appears to be true even in cities with a substantial older black middle class. Single-member households are common, often as a result of separation and divorce. For that matter, the trend toward episodic marriage may be an increasingly important factor as a second or third round of mate selection draws the newly single toward a pool of the unattached. Also common are childless couples, couples with young children, and homosexuals. Homosexuals, it has been observed, may play a part in the "regentrification" of declining urban areas well out of proportion to their numbers.

It is frequently the case that young professional migrants have come from outside the city, the state, or even the region where they are presently living, and the experience of living in a variety of places is a common part of their life histories. Particularly common is prior urban experience, often during college or graduate school years.

How are young professional city dwellers different from suburbanites like them in education, occupation, and income? "We're more interesting," said a young St. Louis woman, quite simply. Or again, "I'd say we were more concerned about intellectual things," remarked a woman in Boston's Back Bay. "We want to have seen the latest films. We want to know what people are reading."

A homeowner in a part of the city still marked by a good deal of blight presented it another way. "I don't go to the movies. I don't even read books much. I work on my house. As for people in the suburbs, I don't know many of them, but probably the difference between us is that I don't care about joining country clubs or things like that. I don't like to feel that I *have* to do anything to claim some kind of status."

"Why didn't I move to the suburbs?" A former New Yorker considered the question. "I don't know. For me, there is more freedom in the variety of the city. I *want* a racially and socially mixed neighborhood. It's the way I think this country has to go. To put it another way, I don't want to live with a collection of people who are just like I am professionally and socially. The friends I have tend to share those feelings."

A woman from Jamaica Plain emphasized escaping from the conventional. "We wanted a house that wasn't like anybody else's house, that wouldn't be Levittown. It could have turned out to be an apartment over a store on Centre Street."

This might be seen as a way of asserting status by denying it, at least according to customary tokens. Somewhat in the same vein is the pleasure new city dwellers get out of having suburban friends hesitate about visiting "the city."

Whether the young professional emphasizes intellect ("the latest films"), or living style (bare brick, butcher block and hanging plants, for instance), or a Thoreauesque standing apart from convention, there are very often feelings of superiority toward his or her suburban counterparts. In this sense, at least for the duration of their time in the core city, young professionals identify themselves as part of an elite within the middle class elite.

Such feelings, at times ambivalent, were expressed by the participants at the Parkman conference. The participants, both couples and single-member households, came from the South End, Roxbury, Dorchester and Jamaica Plain. Among them were an architect, two planners, an anthropologist, a child psychologist, a court officer, a crafts person, an environmentalist, an electrical engineer, and a graduate student working on a combined business and law degree. In age, they ranged from the early twenties through the late thirties. In length of residence, they had lived in their present neighborhoods from two months to seven years. Only two had been born in the Boston area (and had left it for a time), while more than half had come from outside the New England region. With one exception, all were homeowners.*

The first question discussed among them was the deceptively simple one, "Why do you live where you do?" Their answers follow some general observations about the new appeal of urban neighborhoods.

CHOOSING THE CITY

What is it that draws a fraction of the young professional class into the urban core, or holds it there? A certain avant-gardism has been noted. They are people who are self-rewarded by doing that which is not perfectly typical in terms of their education and income. They can be quite pleased when other people seem incredulous about where they have freely chosen to dwell.

Beyond that, they are drawn very often by the character, quality, and often relatively low price of housing. Their taste for "interesting" old houses has already given a new lease on life to a good many thousand examples of 19th century domestic architecture. And while quality is a premium value, even undistinguished stock can be made to serve, if there are compensating features. In the Mt. Adams section of Cincinnati, for instance, which overlooks the Ohio River Valley, quite inferior turn-of-the-century worker housing has been gutted and expensively redone with hardwood floors, sliding glass doors, skylights, and balconies, either for upper-income ownership or luxury rental.

Convenience to jobs and to cultural resources—particularly in cities like Boston, San Francisco, Philadelphia, Washington, Chicago—is another pri-

*The group specifically did not include persons of comparable age, income, and occupation who grew up in Boston and have opted to stay in the city. While they share much with the conference participants, they also tend to be notably different, as for instance in their awareness of "secret" housing markets, their settlement patterns, and their attitudes toward local institutions. Some notes on this group are contained in an earlier unpublished Parkman report.

ority item. Two working members of a household, especially without children, respond sometimes to an overwhelming logic when they look for a near-in location. Yet another reason, akin to the unsuburban or anti-suburban self-image mentioned above, is the allure of people like themselves who have opted for urban neighborhood living. The magnetic effect of urban chic, which needs to be looked at on a neighborhood-by-neighborhood basis, is the overriding factor which carries middle class resettlement toward a point of critical mass.

In the Parkman Center conference, personal circumstances were naturally stressed. Even for those who had gone about the business of choosing a home most rationally, there was an element of impulse in the final decision. And for several, their locational choices coincided with major life changes—a new child or a new job or breaking out of a university orbit, for instance.

A young woman who looked at thirty houses in other communities before choosing Dorchester (the first house she and her husband saw there) downplayed any commitment to the city as opposed to the suburbs. Their mental map of the world was drawn along transportation lines.

"No, I didn't think in terms of strengthening the core city by moving in. There was some sense of responsibility to the city, but it was very much at a second level. Maybe it's because I went to a very political college—we both went to Antioch—and I've gotten *sick* of political stuff. I was just inundated with it. I went through all the flower child business, and now having a house and a little bit of land to make something beautiful in terms of my emotional life is really what I'm looking for."

The compelling attraction for her was one which might hardly occur to a New Englander—hardwood floors and bannisters. "You don't know what that means to someone from California. All that beautiful wood. I just fell in love with it."

For this Californian, a bargain price, architectural features, and access to transportation ranked high in the making of the final quick decision. The existence of nearby stores came as a later pleasant surprise, while the neighborhood was generally perceived as a neutral environment, with a few problems. The bad image of the area shared by many long-time residents as well as suburbanites clearly had little influence on this couple. As her husband said, "There's minor crime around, but that's everywhere. We expected it." And about negative images conveyed by television, he responded with a laugh. "We don't have a television set."

The house itself, along with affordability, appeared to predominate as the basis for the majority of participants' decision to live where they do. The person most explicit in this regard had had a considerable experience of "urban pioneering" in Boston. He and his wife had first renovated a house as non-owners in East Boston and had moved on, both to turn their sweat into equity and to escape some unpleasant cultural conflicts. ("The first day we were there, a little kid came up and told us he was going to slash our tires.") They subsequently spent several years fixing up a house in the South End.

"This Jamaica Plain house is our third in Boston. I'm very into houses, the physical house. I looked all over Brookline at physical houses, and if you're into physical houses, what you look at in Brookline is a $100,000 investment. So finally I discovered this little jewel, the oldest house on its street."

Beyond a quick inspection to establish a sense of compatibility, the neighborhood did not appear to weigh as heavily as one might have expected at the outset. However, neighborhood characteristics did emerge as a factor in the likelihood of the participants' staying on.

Self-perceptions were one way in which the match between neighborhood and newcomer were expressed. As a wife who had reluctantly moved (at her husband's insistence) from Cambridge to Jamaica Plain recalled, "It was traumatic. I came kicking and screaming. I never realized that where I lived was so important to me, had so much to do with my self-image. I think I'm like a lot of people—that although I wouldn't have said I was like that, what is familiar to me is safe and that's where I'm confortable and happy."

In an interesting way, this young woman's feelings became one of the nodes of the evening. Admitting that she had resisted the move and was now trying hard to adapt to it, her very open expression of the need for a "fit" between herself and her surroundings hinted at a key issue for everyone.

In what was perhaps the nearest to an ideological statement, a young Roxbury homeowner remarked that a part of his decision (only a part) was his desire to promote the development of a black professional enclave in Boston. "In my view the future of Roxbury as a black community depends on black professionals moving in."

Yet the evening helped to show that all of these decisions need to be viewed in terms of individual and household life cycles and that, as most of the participants would agree, what might be true of their feelings about where they live this year might not be true a year or five years from now.

THE CONTINGENCY OF CHOICE

From the very first remarks, it became evident that city living (or living in this city as opposed to some other) was very much a contingent situation for all the participants.

A young working mother conveyed the attitude and the effects it has over time. "We used to be in the South End. We'd never made any long-term plans, but it became clear when our child started crawling that we could no longer live there, and a lot of things that had always bothered us began to peak. Just visually it got on our nerves—abandoned storefronts and so on. So I think a lot of things we had been fairly confortable with that hadn't caught up with us as any great anxiety, just one day made us decide we didn't want to put up with them anymore . . . So we moved to Jamaica Plain and the two things that still concern me are, one, the school situation and, two, I feel the area is unstable. In our neighborhood, for instance, nothing particular is happening, but there seem to be a lot of houses for sale. I just don't know about staying in Boston if the neighborhood gets tough to live in. I'll lobby for moving if it does, but if it doesn't, I can also see staying here for a long time. I feel as though I am waiting to see what will happen."

The phenomenon of living with people or in situations that appear to be no bother and then suddenly become an intense bother is an experience familiar to everyone. Job-changing, mate-changing, house-changing are often enough the result of such long accumulated and abruptly perceived shifts in taste, tolerance, and so on.

What seems notable, however, in the present context, is the facility with which the young professional can make those changes in regard to where he or she lives and in regard to the number of other options which may suddenly become both attractive and feasible. Whether the woman is right or wrong about turnover rates and "stability" may be much less important than the ease with which she and her family will make its future housing decisions.

Another perspective came from the Roxbury homeowner. He felt himself comfortably settled and had persuaded relatives to buy adjoining row houses ("to protect my investment"). Nevertheless, he acknowledged that in spite of his wish to see a new black middle class establish itself in the city, he could imagine himself leaving if he felt that he was simply playing the role of a loner, or if his wife's anxieties became too great, or if education became too much of a problem as his young daughter reached school age.

"The dilemma we face is how do you get other people to take the same step we did. Nobody wants to be Jackie Robinson. It's not worth it."

In a follow-up discussion, he speculated that he and his family would probably move to other places eventually in any case, and that from all points of view, it was probably most reasonable to think of young professionals as having a time span of perhaps five years—the years without children or with very young children—when an urban setting may be particularly convenient and attractive.

This is a note which needs to be expanded upon, but in the meantime it should be said that an attitude of "hedged bets" seemed to prevail across the spectrum of conference participants. This was true regardless of age, enthusiasm, tenure in the city, or whatever else. The point to be emphasized is that everyone in the room had the option to live elsewhere (other parts of the metropolitan area or other parts of the country) and the experience of mobility to make that an easy thing to do.

Lacking ideological or philosophical commitments to the city (and these may be the least desirable of impulses to encourage), the kind of younger households in question are constantly going to be totaling up the pluses and minuses of their living situations. So may everyone, but here we are considering the most mobile members of a generally mobile society, capable of disassembling and reassembling their personal "community" with relatively little regard for place.

"Community" is an important and too little analyzed concept that needs to be examined in connection with the mounting interest in core city neighborhoods. The young professional is a fascinating instance since, on one hand, he or she may particularly *want* to establish "community" in terms of a traditional "neighborhood" and a "lived-in" house; yet on the other hand, and even when feeling most attached, may put down fairly shallow roots.

To put it another way, people who tend to behave in ways counter to prevailing taste and expectation are liable either to continue to turn up new living arrangements or are liable to settle into more conventional streams of social behavior as they age. This is to say, simply, that a constellation of factors which might make a row house neighborhood or a neighborhood of mini-Victorian mansions highly desirable at one point in time might make a quite different situation (and idea of "community") just as desirable at a slightly later point in time.

People with large options, relative affluence, wide experiences could be made to look like the spoiled children of our society. They want so many things, they may even want contradictory things, and more than the mass of people, they may well get them—serially if not all at once.

A young South Ender said of her neighborhood, "I like it very much. My husband's had it and wants to get out, so we're in the process of deciding." But she quite frankly described at a later point what a mix of features they ideally wanted: convenience to the heart of the city, a heterogeneous society, open space and woods, well-kept parks, "like the kind you see in Berlin."

It would not be at all inappropriate to suggest that given this kind of yearning for so much, the choice of a city neighborhood can have a good deal of nostalgia about it and may, perhaps only briefly, correspond to a very elusive notion of "the good life."

PASSAGES

The sampling of young professionals gathered at the Parkman House provided a vivid glimpse of individuals and households transiting their life cycles. More than that, one had a sense throughout the Parkman evening of personal evolution, demographic and "lifestyle" evolution, and the evolution of the city going on together, passing in and out of phase.

In these terms, the choice of a city neighborhood clearly did not represent any kind of a final decision, but rather one decision in a lifetime of choosing where and how to live. As one said, "I think the time horizon is important. If you feel you can sell at a reasonable price in a reasonable time, maybe you don't go much beyond the physical house, but maybe when school becomes important, you begin to rethink the future." Or another: "Children complicate your decisions enormously."

A couple phrased their possible departure from their neighborhood (and the region) simply in terms of growing older. "If anything, I'd say our neighborhood is improving, but we're in our late thirties, we've been struggling for a long time to make the city do what it's supposed to do—to make the policemen police and the building inspectors inspect. And, you know, when parents get older and die, when even some of your friends begin to die, your resilience goes a little. You get worn down."

A lesson to be drawn from the quite obvious fact that young professionals, as much or more than any other population group, will be in a continual process of household formation or dissolution, job-changing, and taste-changing—all with consequences for where they dwell—is that replacement trends rather than individual decisions are the thing to look for. That a few young professional households discover some forgotten trove of row houses or 19th century cottages may indicate relatively little for the future of the area if—in their passage—they are not followed by others like them. Are so-called "pioneers" succeeded by "colonists"? Have new real estate actors come on the scene? Has media treatment changed and begun to stamp a fresh image on the neighborhood? Has a sub-neighborhood even acquired a new name? These count for much more, in terms of neighborhood evolution, than any few individual decisions.

PROBLEMS OF URBAN LIVING

Among the negative aspects of city residence most talked about during the evening, these predominated, roughly in order of the time given to them: security of persons and property; the quality of public education and, more generally, the responsiveness of the city and other public institutions; and finally, the "civility" of Boston as a place to live.

The question of safety was a curious mix on conflicting feelings and assessments. On one hand, almost everyone expressed nervous humor about the experienced or potential dangers of the city. "I feel safe walking at night in the South End," one woman said, "maybe I shouldn't." And another described herself as "perhaps the product of reading in the newspaper that I'm supposed to be afraid."

One participant recalled that a local storekeeper was shot the day he moved in, and several remarked that older residents welcomed them by telling about the latest crimes on the block. Yet mixed into the conversation were vigorous reassurances.

At least four people mentioned that when they first stopped to look at their prospective homes, the police appeared, called by watchful neighbors. It was also noted as a positive feature that people in many areas really do seem to look after one another's homes. "There's a wonderful spirit of mutual protectiveness. I certainly don't find it in the wealthy suburb where my parents live," said one.

What emerged here were views that oddly co-exist with one another. One set of attitudes seems to be that the city is an adventure and that in taking certain risks, or at least living with them, one is more in touch with reality than people in the suburbs. (The suburbs, incidentally, were often described as being *less* safe than we are told.)

Another set of attitudes, often expressed by the same people, goes something like this: "The city is actually much *more* safe than presumed and (knock wood) we personally haven't had any trouble because of protective neighbors, good luck, etc."

In any case, it seemed clear that physical and household integrity were of paramount concern. Yet as the evening went on, this concern evolved into a considerably more general preoccupation with unpleasant human contacts and even non-personally directed acts of incivility.

In fact, reviewing the record of the evening, physical attack was only the most threatening (and not the most obsessive) end of a spectrum that shaded into abusive kids on a tennis court, smashed beer bottles, belligerent drivers, venal public officials, an ill-kept environment—in sum, all the "ungracious" aspects of city life. As one person put it, "Sometimes, when you've come home from Lexington—and believe me, I don't want to live in Lexington—you just wish, for once, you'd look down and the streets would be *clean*."

CHALLENGES AND HASSLES

During the course of the evening, a participant-observer made a distinction which seems to be a useful one. What he heard around him were two kinds of complaints—quite apart from the positive claims people were making for their housing choices and their neighborhoods.

One kind of complaint seemed almost like an expression of pride in challenges successfully met. Heating a large old house with a wood-burning stove was a feat one could boast about. Carrying out repairs on a house beyond its economic life (according to the appraisal handbook) was a feat one could boast about.

But there are other things in the environment—they could be called "hassles" —that wear people down. (And young professionals are by no means alone in feeling the effects of such difficulties.) All of the hassles discussed at the meeting clumped around the quality of life in the region and particularly focused on Boston as an epitome of the performance (or non-performance) of public institutions, at all levels.

Although none of the participants had children in the public schools, the public school system was frequently offered as *the* outstanding instance of an alienating failure in both the public sector and the society it mirrors. As one resident put it: "There is no question, in my mind, that the schools of Boston are the schools most people of Boston want to have. And that really makes me feel out of place. You wouldn't have an elected School Committee with the characters who sit on that committee if it weren't for the voters. It indicates, I think, that here there are broad differences of interest between newcomers such as ourselves and the resident population."

"I'm sorry," he went on, "but the fact remains that the schools in this town are an unbelievable scandal. I don't care how you measure it. Five times as much central administration as other cities, for instance. Finally you say, 'I can't live with that kind of incompetence.' It's been twelve years now for us in Boston—seven in a neighborhood we love and admire—but now we'd like to try living in another city, another part of the country where people have higher expectations of one another."

Another person turned the criticism back on the young professionals themselves. "To me it indicates that we are not demanding enough. Frankly I think it's debilitating to have somebody send their kid to a bad school to make a point of principle when the issue is demanding more and getting it. For instance in Newton," he continued, "one of the things is people have no qualms about their dealings with that system. God damn it, they pay a lot of money for it and they're not going to let it rip them off. We don't have that attitude. We have the attitude, 'Oh, is it right, is it wrong? Are we good, are we bad?' And the issue about what happens in the schools doesn't really get raised by people like us. I think it's all a direct result—and this is what makes Boston so different from Houston—of the fact that so many of us are in government and education and these other tertiary (or worse) industries. It makes us too soft, too undemanding, not nearly self-interested or 'hedonistic' enough. It's the handicap of being a liberal."

When asked whether it bothered her not to have her children in the system and by that means to exert pressure, a mother admitted that of course it bothered her. "But you only have so many hours to fight so many battles, and while you are fighting the educational system, your kids will be going through it."

At the same time, she said that she did not envy suburban friends, even with their access to presumably better suburban schools. "We truly do feel our kids, living in the city, have had things that suburban kids don't have."

It should be added that while not present at the session, there are other young professional parents who have vehemently committed themselves and their children to the public schools (at least at the elementary level). Differences in the quality of the particular schools concerned may be a factor, but so may be the factor of "critical mass" which makes a group of parents feel that they have sufficient numbers or influence to alter a school environment.

Public education was only one example of a syndrome of unresponsiveness and inefficiency that a number of participants cited as negatively influencing their feelings and their long-term prospects. Without doubt the quality of public institutions is a differential affecting the competitive attraction of various cities. A Dorchester resident who expressed himself as quite happy with his home and his neighborhood was quite candid in this regard.

"Government generally here, for an outsider like myself, is just incomprehensible. My sense of outrage may be because it is all so new and sudden, but it is a constraint on a commitment to Boston as a permanent home. The nature of government—its unresponsiveness, the lack of professionalism I see in it—makes me rethink the future."

The Jamaica Plain architect restated the problem in terms of regional attitudes, the regional economy, and the opportunities open to professionals in that economy.

"Right now, for someone like myself, the possibility of growing here is small, and also life is difficult in the Northeast. It's a problem that Boston is going to have to face at some time—life here is simply more difficult than it needs to be. I experience it in trying to get things done with our local bureaucracies, but the issue is larger than that."

At this point the moderator broke in with a thought of his own. It seemed to him, he said, that some of the appeal of Boston and the New England region is akin to the appeal that old England has for a certain kind of foreigner. England sometimes can charm exactly because it muddles along, because it can be so ludicrously inefficient and at the same time quaint. As another participant remarked, "This city is so much more humane than Washington, where I used to live. I think I'll take my funny little Boston."

In that remark she may have begun to capture the answer to a question posed later on by an expert on population studies. "There are so many negatives you can point to," he said, "like taxes, an eroding economic base, the weather—and yet it doesn't add up. More people want to live here than, by rights, ought to want to live here."

There was some agreement that Boston's attractions and irritations are related. The young woman from California praised public services in the West as being far superior, but preferred Boston as an older city with a human scale that a pedestrian can love. Others admitted that even while Boston's political folkways might be deplorable, they also made a wonderful "theatre of the absurd."

"There is one politician here—I won't mention his name," a participant remarked, "who used to make my skin crawl. Absolutely crawl. Now I get a kick out of him. That's a terrible thing to say, but it's true."

AFFINITY AND PROPRIETORSHIP

As noted earlier, the discussion of "hassles" went through an interesting evolution in the course of the evening. Hassles—defined as problems which young professional residents view as seriously undermining their commitment to the city—began with personal safety, enlarged to include the unresponsiveness of public institutions, enlarged even beyond that to address the economic and psychological climate of the region, and then settled on the theme of civility.

At times there was almost a plaintiveness about this subject. The group clearly felt itself composed of people who do no harm to others and wish others would behave with the same kind of decorum. The remark, "if just once in a while you could look down and see the streets *clean,* "expressed the modesty of what they were asking for.

On the face of it, this and similar requests do not seem excessive. Intelligent and honest politics, competent public services, an unlittered, unabused cityscape, and decent neighbors appear to be no more than what a reasonable person should expect.

One might reply that it is and it isn't.

In the context of city neighborhoods, in the larger political and social climate of this and other cities, complaints and demands of the sort heard at the Parkman conference inevitably take on class connotations. To put it another way, values which collectively define the more affluent suburbs tend to become latent with challenge when they locate in the often socially foreign territory of urban neighborhoods.

In Boston's South End such conflict has been easily observable for years, though it often goes by other names. In other neighborhoods, the conflict may or may not emerge so sharply. Nevertheless, class differences and all that such differences can imply in terms of acceptable street behavior, child-rearing practices, politics, religion, and even cooking smells are probably the fundamental issue in a "back to the city" movement—wherever it takes place.

Interestingly, class differences are often a more taboo subject than race. An example during the Parkman evening was a situation described by a Jamaica Plain woman. An enthusiastic tennis player, she had been very pleased when the city built a set of courts near her home, until she discovered how difficult it could be to use them.

"There is a certain element, there are certain adolescents who will stand on the court while you try to play. They will stand there, they will throw things, they will say terrible things, they will take your ball and make it absolutely impossible to go on. Eventually you are so angry, you just give up."

At first glance, this is simply a case of good and reasonable adult being harassed by bad kids. All the right seems to be, at first, on one side. But then questions occur. Was the site of the tennis court a traditional place to "hang" before the courts were built? Is there a turf question involved? Would a majority of residents whole-heartedly agree that these are "bad" kids, or would there be some ambivalence? Is it part of the local folkways that people have to win respect, have to learn how to deal with situations like this situation of harassment?

No answers will be offered here to the specific case, but what it does introduce are questions of class, culture, and proprietorship. Who is the neighborhood for? Who has the right of way? Who stands down for whom? At what point, on a block or in an entire area, do newcomers challenge the hegemony of those who were there before them?

This is no small consideration where politics and government in this city are concerned. Without much personal malice, young professional newcomers can make remarks about the indigenous political leadership that would seem shocking to them if they were made by whites about blacks. Quite apart from questions of competence, honesty, or high-mindedness, there are almost always hints of cultural and class prejudice.

And negative feelings are reciprocated. The "liberal" young professional newcomers—particularly, perhaps, those who have arrived later, paid higher prices and expect a great deal of their adopted neighborhoods—are apt to be looked on with deep suspicion by the existing political elite. They are often seen as fickle, insatiably demanding, ungrateful, and politically undependable. These two, the indigenous leadership (some of which has migrated to the suburbs) and the new middle class, can have sharply different notions of what the city should be, and for whom.

In most communities most of the time, proprietorship never comes into question. In a small town, despite income differences and personal animosities, no one as a rule thinks to ask who the town "belongs to." Obviously it belongs to everyone who lives there. Everyone has a recognized place. When change occurs, it occurs gradually. Even eccentric behavior passes so long as it has been of long standing.

If a definable area is occupied by 95 people typed as A and 5 typed as B, there will be no question of hegemony. A's and B's both know perfectly well where dominance lies, whose values prevail, what the future will probably hold. It is when the proportion of one culture or class or race threatens the dominant population's sense of control that uncertainty rises, destabilization occurs, and readjustment is under way. When this process happens quickly over time in an urban setting, the costs can be high on both the down and the upside so far as property values are concerned. On the downside, rapid destabilization can lead to loss of housing stock and possibly an anarchic social situation; on the upside, loss of affordable stock for lower-income residents, along with their sense of community.

And here the presence of young professionals on the urban scene provides some excellent matter for thought. Because they tend to be less race sensitive (or at least negatively so) than many native residents, they help to demonstrate that race is not necessarily the key issue that has to be attended to in the dynamics of neighborhood change. Because their presence raises property values rather than lowering them, they are a proof that transition—with respect to value—need not be one-directional. And finally, because as they cluster they will invariably begin to impose their culture—however benign and constructive it seems to them—they should remind everyone that the tendency for affinity groups to want to establish themselves, to create a congenial environment for themselves, and if possible to dominate their surroundings is prodigious.

A white professional household and a black professional household may be happy to have each other next door—may, in fact, feel that having each other next door is a big step toward racial harmony. Both households, on the other hand, may be very unhappy about the presence of dubious lower class households and especially adolescent members of such households in their vicinity. This is simply to say that people appear to have an incorrigible desire to live with others sufficiently like them (and the range of tolerance varies) to contribute to feelings of stability and well-being.

There are tensions even where race and income and ostensible class are not at issue. The young New Yorker now settled in Dorchester comments, with a little bitterness, that one of the first things he encountered in Boston was the prejudice against people born elsewhere, anywhere else. "Professionally I feel it. As soon as they find out you aren't from Boston, that's it so far as a lot of people are concerned. They aren't interested anymore. You're a non-person."

This, however, is social selection at a rather fine remove. Let us take instead a composite case which attempts to describe the dynamic of change that young professional newcomers can introduce into an older urban neighborhood.

A MODEL

A "pioneer"—so far in the vanguard that "lifestyle" editors are unaware of him—restores an old building in an area of rooming houses and bars, with a street population frequently alcoholic. Nearby, little ethnic enclaves look out for themselves, ignored by the world.

As long as he is not personally threatened, the "pioneer" may well enjoy his architectural treasure, quite oblivious to the surroundings. Since a lower class culture utterly dominates, he probably will not even think of asking for help from public officials, and he may even rather like the "gaminess" of his new environment.

Those who follow him, the "early settlers," will pay a bit more for the homes they set out to rehabilitate. They will also be somewhat more aware of negative features in their surroundings and feel the need (in order to protect their investment) of establishing a middle class foothold. Because their eagerness to see stable adjacent households is so great, they may be quite happy to have an ethnic family across the street put money into a dilapidated building—even if this means aluminum awnings and asphalt siding.

A still later wave of upper middle class migrants, now paying substantial prices for run-down housing (as speculation has increased), may have their rehab work done for them. They will also tend to be very demanding of improved public services and may well complain about "inauthentic" restoration. (In fact at this point they may call for historic district designation.) While their immediate predecessors, the "early settlers," who may now be gone, will have realized a major appreciation on investment, these "late comers" will be more prone to worry about the future of the neighborhood and about resale. Nevertheless, if the progression continues, the house across the street may go to a more "acceptable" purchaser who will remove the aluminum awnings, strip off the asphalt siding and convert the building into a home for himself, along with two expensive apartments for young singles.

Over a period of a few years, real property will have trebled or quadrupled or more in value. In the course of this evolution, a taste for heterogeneity will shift toward a new homogeneity—even though the spice of urban life, such as the little Lebanese grocery on the corner, will still be cited as one of the great attractions.

And what about the new residents? A "liberal" young professional may feel that he is an inoffensive positive addition, or he may be an advocate and activist who gets involved in "issues" and even deplores late arrivals "who are changing the character of the neighborhood." His more "conservative" young professional counterpart hasn't so much social conscience. There are people less well-off, with different cultures and habits, whom he detests as much as they are apt to detest him. No matter. The more affluent the area becomes, the happier he will be. To take a Parkman participant's remark out of context, he would be "delighted to have someone like me move in next door."

In the long run, these differences of personality and philosophy may not be of much relevance, or may even be historical functions of the settlement process itself. What will matter is numbers—the number of newcomers to the existing population and their influence on housing values and costs.

The scenario above is only one of several possible scenarios, but it is indicative of the key issue. A growing young professional population, no more nor less than any other, will, over time, seek to assert itself; and if circumstances concentrate demand, it will tend to squeeze out those who cannot keep up financially or who do not "fit in." In a sense, this kind of middle-class recolonization represents a "looking glass" version of what happens when poor minorities filter rapidly into weakened working class communities.

From a social policy point of view, enhanced value is a benefit to a neighborhood; but greatly enhanced value, from the same perspective, may be a diminished benefit. The unquantifiable costs include dislocation and a ripple resettlement effect which may undercut social stability and property values elsewhere. This was one of the externalities of urban renewal which should not be forgotten.

THE FUTURE

No one who has looked into the young professional phenomenon can help but notice that public policies and public sector activity have had relatively little to do with it. While redevelopment has been a factor in some cases, in many others settlement has occurred in areas untouched by urban renewal. This would suggest that fairly powerful forces are at work. Furthermore, these forces may be only marginally susceptible to conscious public action, whatever its social goals.

With that said—and before recommending some modest policy initiatives—one can suggest things to think about and look for.

First of all, while cities vary in their appeal to a young professional clientele, it would be a mistake to assume that each city has a finite pool of potential young professional migrants to draw on. While middle class resettlement in cities may or may not become a significant force in the urban equation, it is in theory quite possible that a middle class taste for city living could become an appetite that grows by what it feeds on. The more popular such a movement, the broader its potential base; the broader the base, the more likelihood of changed conditions (reduced crime, improved public education, enhanced civic amenity) which would further tend to enlarge the migrant pool. (This is at least true until the number of household formations falls off in the next decade.) The sharpest observation one can make is that the migrants at issue occupy self-appointed places in a settlement cycle, the more numerous and often more affluent arriving only after a beachhead has been secured.

The frontier rather than the war zone is perhaps a better analogy. Or the world of fashion. Pioneers, trend-setters are followed by colonists, by consumers who have been educated through the example of others about what is desirable. If a settlement "takes," it will invariably be because of the presence of "followers" who make up the bulk of demand for any commodity or fashion, whether it happens to be Victorian mini-mansions or flared trousers or whatever else. However, these trends in living choices do not advertise themselves until a late stage. The critical period has typically occurred when planners and policy makers were hardly watching, or unaware of what to watch for. Once again there is a parallel to the subtle early processes of decay.

One among the trends to follow just now might be a growing popularity of a city home with a second home far out in the country. This living arrangement, which leaps the suburbs altogether and radically alters the role of the automobile, could make eminent sense if energy costs continue to escalate. Even at the present time, one can find many working couples who will argue the logic of the nearby weekday work place, with weekend access to an "unspoiled" environment. It is a formula quite familiar to Europeans.

Other trends which now have become matters of national interest are marital and child bearing patterns. In the last year or so, absolute population decline has become less ominous to city officials as they have been taught to think in terms of households. "Fewer people, more households," appears potentially a message of good news—*if* those households are so-called "net-payers," which is to say residents affluent enough to contribute more than they require in services. One cannot generalize for all older American cities; yet as marriages grow shorter, as mate-catching becomes a cycle of middle age as well as young adulthood, as children are fewer and providing for them easier, a central living location might enjoy new appeal to some "net-payers" who before would automatically have settled in the suburbs. This is not guaranteed by any means; but as one young professional put it, "When you think of it, everybody who is not part of a conventional nuclear family—and we are seeing fewer and fewer of them—becomes a possible candidate for city living."

A phenomenon observable in a number of cities right now is the middle class reclamation of certain neighborhoods or sub-neighborhoods, favored because of architecture or location, and the simultaneous erosion around them of less desirable stock. In one case, housing will be treated as a precious durable good (more precious because of its age); in the other, as a consumable. Where housing is treated as a consumable (by exploitative landlords, abusive tenants, or incapable owner-occupants), the helpless poor will inevitably have to migrate along paths of weakening demand, leaving behind cleared areas which may become ripe for future upper-income development in proximity to islands of preserved older housing.

It is perfectly possible to imagine that this process, in some cases, will march urban development time briefly backward, removing from the landscape cheaper stock that grew up in the wake of more substantial housing constructed in the middle or late 19th century. It is also not only imaginable but in some cases now evident that where housing is cleared by abandonment, arson, and demolition and as its previous occupants flow into areas of rapidly declining status or social cohesion, today's central city problems can be carried into the inner ring of suburbs.

Should a central city retain its strengths as an economic, cultural and transportation core (and not all of them will), large cleared zones combined with islands and archipelagoes of middle class resettlement could set the stage for a shift in the way this country locates its more intractable social problems.

Generalization, once again, is impossible. Cities vary a great deal in their residual advantages. Furthermore, energy costs, the cost of new construction, transportation policy, federally influenced financing arrangements for home ownership are all problematic factors, as are federal policies toward the least advantaged.

All these things make prediction hazardous. That some American cities may be socially reorganized on European lines is no more than a speculation. Nevertheless, negative trends which seemed quite inevitable as little as five years ago now have, for some core areas, gone into remission. The presence of a growing young professional class is both a small sign and cause of this watershed.

Middle class resettlement can be a very encouraging or alarming development, depending on one's point of view. It can be seen as a potential good in terms of stabilizing the tax base, preserving housing stock, improving public institutions, amenity and decorum. It can equally be seen—in a period of tighter and tighter housing markets—as intensifying the housing problems of the poor and squeezing even moderate income residents who may find themselves, in the end, dispossessed by affluence rather than blight.

The pattern in this country—it is seldom stated as baldly as it needs to be—is that the more well-to-do and influential have first choice and that all the rest, down the ladder of prosperity and status, in general have access to less, according to their degree. If significant numbers of the middle class decide, for whatever reasons, that a core area living situation is desirable, poorer people will be displaced, short of very concerted moves to make provision for them where they are. And some would argue that institutionalizing cities as reservations for the poor would be a final irony for urban centers which may now at last be enjoying spontaneous regeneration. Helping people and helping places, they will point out, are sometimes quite different objectives.

Nevertheless, and assuming that middle class resettlement has reached consequential proportions in some cities, it might be timely to ask what measure, if any, can be taken to cushion the less desirable effects of "urban chic."

MARKETING CITY OPTIONS

One might begin with an ideal. The role one would ideally like to see young professionals playing is that of an evenly dispersed leaven of energy and money into neighborhoods of spongy demand and flagging self-confidence. This is obviously unrealistic. No matter what new tastes emerge, young professionals, like any other population segment, will never be drawn to more than a limited set of housing types or kinds of neighborhoods at any point in time. Furthermore, the rule of affinity makes it plain that a significant young professional presence will mean clustering.

A question, then, is how to keep the tendency to cluster from resulting in a severe inflation of housing prices and costs and a consequent dislocation of responsible residents who want to stay in their neighborhoods. Relatively poorer people can fare badly in an area "discovered" by young professionals. Self-sustaining as they might otherwise be and valuable as they may be in a city's social mosaic, they may be expelled by forces over which they have no control.

If provision is to be made for them, it must be made at an early point. A population particularly deserving of attention are renters who could, with the proper incentives and aid, become solid homeowners. This has been the approach energetically followed by the Neighborhood Housing Services program in Baltimore.

The key policy considerations are two: rooting willing and capable existing residents *before* new social and economic forces overwhelm them, while mitigating (so far as that may be feasible) the "gold rush" effect where speculation can become rampant.

A little tried strategy would be a marketing effort designed to siphon escalating demand into plausibly saleable areas where fresh demand is needed. The product—neighborhood housing resources—and the potential client group need to be analyzed, along with the modes of communication most effective in reaching them. In the Boston instance, so simple a thing as house tours organized by neighborhood associations have been an inexpensive and effective way of creating "awareness."

Some neighborhood associations, tired of the "fight or flight" set of reflexes and feeling badly served by real estate brokers, have established informal house banks (listings of available properties). These could well be supported with public aid in the form of informational materials. Where an urban-suburban real estate referral network has broken down, the public sector may have a catalytic role to play, as it may have in the behavior of lending institutions. (The Reinvestment Task Force in Seattle is an example.) Public service television represents another potential resource which the public sector might help to direct toward the rediscovery of a variety of city options—thus countering some of the devastating impact of routine media coverage of "urban calamities." Whatever the precise arrangements, improved public sector-private sector relationships are critical.

If a young professional market exists—and it may not for all cities—a goal would be to stay a step ahead of demand. One would like to see dispersed nodes of new middle class settlement, rather than a few "golden ghettoes." At the best, such nodes could buffer change for adjacent communities and create a more favorable climate than one might otherwise hope for in terms of a degree of orderly racial integration, where the class factor soothes rather than exacerbates transition.

Above all, it is in the interests of policy makers to attune themselves to demographic and lifestyle shifts in regional and metropolitan markets. Households considered rare or freakish a few years ago may well represent new home-buying potential, ready to respond to fresh incentives. Boston has become aware, for instance, of young singles quite willing and able to take on large old houses. Novel kinds of encouragement may guide their choices and thus help to shore up weak markets.

Free from concerns about educating children, homosexuals might similarly be thought about with a new seriousness as a segment of the home buying public. And given the number of young families earnestly interested in communal life on something better than the terms of post-adolescent communes, an interesting possibility is that of small group settlements in adjacent dwellings.

These are speculations, not fantasies. From a city's point of view, even marginally increased demand on a street or in a block may significantly increase the confidence of existing residents, if the newcomers are at all compatible. This will happen and is happening spontaneously here and there. Some of the most positive developments, on a small area basis, are occuring without help from or even the awareness of public officials and agencies. A libertarian might cite this as evidence that the best hope exists where government is least; but less pessimistically, cities—at least some cities—have new possibilities to consider at a time when the funds available for conventional kinds of neighborhood improvement have diminished, and at a time when faith in conventional neighborhood investment strategies is rather on the wane.

SUMMARY

Boston has attracted and continues to attract numbers of "young professional" home buyers. They are to be found not only in the "city chic" areas of Charlestown, the Waterfront, and the South End, but now also increasingly in neighborhoods such as Dorchester and Jamaica Plain, where houses continue to sell at comparatively modest prices.

At the present time, young professional home buyers appear to be attracted chiefly by the kind and quality of housing available in the city, with the Victorian mansion or mini-Victorian mansion "cottage" enjoying new status. In fact, there appears to be a newly emerging taste for a semi-suburban environment *within* the city.

Other attractions are affordability, location, a sense of community, and the phenomenon of urban chic itself. A mix of people in the area is also often mentioned as a desirable feature. An ideological commitment to the city is of some importance, but much secondary to personal goals and probably also less a factor than among young professional newcomers of a few years ago.

Negative influences on this group's longer term decisions are crime, the adequacy and responsiveness of public institutions, particularly the schools, and less specific elements which can be characterized as the "civility" of the urban environment and uncertainty about the future. There are both similarities and striking dissimilarities in the way young professionals view these concerns as opposed to blue-collar residents, with racial attitudes a key variable.

Young professionals who choose the city tend to be trend-setters and therefore are apt to be quite migratory as they seek the good life. They are also mobile because income and relatively large experience of options encourages mobility. Even at the height of enthusiasm for a new urban home, therefore, young professionals tend to have made choices which are highly contingent on job opportunities, on marital and other living situations, and on tastes which can alter fairly suddenly. In this they are distinguished from the mass of the population more in degree than kind.

Great mobility makes young professional settlers in older urban areas a problematic population group in terms of neighborhood development, despite the fact that they can contribute valuable doses of optimism, energy, rehabilitation investment, and enhanced property value in sections which may need all these things quite badly. It may be more appropriate to think of them, individually, as transients with a few years to invest than as "permanent" residents. This approach to young professionals will call more general attention to the replacement process in neighborhood housing markets—a process too little observed or understood at the present time.

Other factors deserving attention are the social and economic strains which young professionals can introduce, particularly when limited geographic areas or kinds of housing stock become too chic too quickly.

It has frequently happened that the first comers among this group ("the pioneers") value heterogeneity, accepting the existing environment much as it is. But as colonization takes place and as property values rise due to a new middle class presence, subsequent young professional migrants become more conscious of their surroundings and the effect those surroundings may have on resale possibilities. They will similarly be more class conscious than their predecessors. They may well, therefore, exert considerable pressure for conformity based on a new middle class homogeneity (the "suburbanization" of the city). Late comers still may be racially quite tolerant but will tend to be increasingly intolerant of "undesirable" lower-class lifestyles.

From a public policy point of view, therefore, a young professional in-migration is a plus, but by no means an uncomplicated plus, for the city; and a campaign to attract this group deserves some careful thinking through.

Young professional complaints about public services and the quality of such institutions as schools ought to be heard and earnestly responded to, since inadequate services and institutions may silently be undermining the confidence of the existing (and perhaps less vocal) population. This "gadfly" role can be an irritant to officialdom, but such gadflies are ignored at a certain peril. If the gadflies drift away, an erosion of confidence in an existing community may continue to an end-game situation; if the gadflies colonize, new political forces may develop around themes of dissatisfaction.

One approach which the existence of young professional buyers does recommend is a marketing role for city government. Through marketing activities (marketing as opposed to simple advertising), local government could attempt to channel interest away from areas of skyrocketing demand and into areas in need of more buyers. While there are obvious risks and limitations here, this relatively untried approach could help to minimize the "Georgetown" of "Gold Coast" effect on one hand, while infusing precious new blood and money into "forgotten" areas with plausible housing options on the other.

In both instances, primary attention would remain where it properly belongs: on the existing population, its collective economic and social strength, and on its confidence in the future. While dense young professional enclaves may in the majority of cases be inevitable, while they may in a few cases be desirable, it is a diffusion of the strengths young professionals bring with them that policy makers ought to look for.

More generally, a marketing component in an overall neighborhood strategy would address an often ignored issue for city governments: the competitive position of city neighborhoods in the larger metropolitan housing market picture. Public officials can be among the least sensitive in this regard. Problem and crisis-oriented, they sometimes lose track of what city neighborhoods may have to offer and to whom.

While no one can predict with assurance the extent of a young professional migration to older urban neighborhoods, let alone the possibility of a more broadly based middle class resettlement, there are at least signs now, in some cities, that significant shifts may be underway. Such shifts could, over time, considerably rearrange the social composition of the city, with the options of the poor increasingly narrowed. This will lead to a vehement debate between those whose chief concern is helping to preserve the city as a physically, socially and economically viable place and those whose chief concern is the plight of the poor.

As the debate intensifies, one might look at its remarkable context. A conjunction of trends is at work. Among the most powerful is the surge of home-seekers now in the market as the baby boom generation comes to full maturity. This factor, along with a number of others, suggest that certain older urban centers have a better chance to reinvigorate themselves than they have had for thirty years or more. While "now or never" may be too dramatic a way to put it, the period of greatest opportunity appears to lie in the years immediately ahead.