WILL NEW COMMUNITIES SELL? SELECTED FISCAL AND ECONOMIC IMPLICATIONS OF NEW COMMUNITY DEVELOPMENT

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The promise of the new community development idea has held great expectations for legislators, administrators, developers, technicians and residents alike since its resurgence in the 1960s. A small number of privately financed new communities were started at that time and followed shortly thereafter by federal legislation and participation of additional projects in the new community movement. Sufficient experience has been gained with the "does" and "don'ts" for us to learn from the successes and mistakes of others in advance of public and private commitments to beginning a new community or expanding and existing one.

The purpose of this paper is to share with you some of the experiences that I and my firm have had as real estate economists in the assessment of the development potential of several new communities and as a resident of Reston. It is my intention to establish a discussion framework will enable you to focus on some of the fiscal and economic implications of new community development projects. It is not my intent to give you definitive answers with respect to revenues, public services costs, land use decisions or market potentials. Answers to those questions require analysis of a wide range of locally unique factors which makes it impossible to replicate the experience of any given new community in another geographic area, at another time, and with different fiscal and economic characteristics.

Illustrative New Communities

For the purposes of this paper I have gone back and looked again at two new town projects whose residents often compare to each other: Columbia, (Howard County) Maryland; and Reston. The construction of Columbia and Reston commenced in advance of federal new community legislation and they are being developed by private interests which are not directly assisted by the Federal Government.

The Development Framework

The development framework for these and for all new communities is founded on the physical, economic, and social environments within which they are built. These environments together with the political environment define a new community's potential and the amount, type, and location of development which occurs within its borders.

The most important factor for the success of a new community is support in the marketplace for the full range of land uses which together distinguish a new community from other large-scale developments. That is to say, a sufficient regional or "market area" demand must exist or be anticipated as a prelude to beginning construction of a new community. There is no substitute for a vigorous economic environment if a new community is to eventually become financially viable. The pace of development must be commensurate with the substantial front-end investments required of the developer. Optimistic development forecasts relative to required front-end investments has been the Achilles' heel of new communities throughout the country. In general across the country, the new community marketplace has been unable to absorb land and buildings fast enough to put developers on sound financial footings. Results of this phenomenon have included a slower pace of development, greater federal participation than ever anticipated, and financial reorganization to achieve financial objectives.

The extent to which market forecasts have been optimistic is directly related to economic factors with which you are familiar. The worst recession in 40 years began in 1973, causing the virtual collapse of the nation's real estate industry. At the same time, the country's financial markets became disastrously disorganized. Widespread consumer income and job uncertainty reduced the market for housing. Developers had difficulty delivering their product and sales slowed commensurately. This series of events was followed by a severe economic slowdown in 1981-1982 with high unemployment and continuing high interest rates. All of these factors affected virtually every large-size real estate project in the country.

Among the critical factors necessary for the realization of the financial break-even point, new community investors look for markets that are especially large in relationship to the size of the proposed community and for competitive advantages that will permit the project to penetrate that market even at times other developers are unable to do so. Well-designed, effectively merchandised and, above all, highly competitive rents and sales prices are prerequisites to the fiscal and economic success -- selling the new community. Experience suggest that the typical development trend includes below-average absorption in the early years and above-average absorption during the peak years of development. Thus, the developer must be prepared to finance substantial losses and negative cash flows until such time as the marketplace responds adequately to what the new community has to offer.

Forecasting the pace of new community development is as complex as the marketplace itself. Two important underlying objectives of new communities are to provide a variety of jobs and of housing choices within their borders. These objectives tend to reinforce each other as more jobs increase the demand for housing and greater housing choices attract and accommodate employees in nearby industries. Together, the jobs and housing structure of a community tend to dictate its institutional and commercial development. Success in attracting jobs and residents will result in the development of other land uses which in turn make their contribution to building a full-fledged community. This goal has already been realized by Columbia and Reston.

Development Setting Overview

Columbia and Reston were each begun with the threads of a similar idea: to build a community that was so much better than nearby competitive developments that it would be a superior place to live and work and return a profit on the required investment at the same time. Nonetheless, the circumstances surrounding their development were greatly different as reflected in their relative success in the marketplace.

Columbia

In October 1963, the Rouse Company announced to the citizens of Howard County that it had acquired some 14,000 acres -- about 10 percent of the County's land area -- for the purpose of building a new city. Within a nine-month period the company and purchased 140 farms and other parcels of land at an average price of $1,490 per acre. The new city would provide jobs, housing, and a full-range of urban activities while avoiding both the sprawl and the lack of services that had come to typify small-scale development. Columbia, it was said, would not only pay its own way for county services but would contribute excess tax revenues to benefit the entire county.

In November 1964, the Columbia Plan was presented to Howard County in support of its request for a new kind of zoning that would permit higher residential densities and greater flexibility in mixing land uses than had been the case in this county of only some 40,000 residents. The following year the county passed a new town district zoning classification and approved its use for Columbia's development. By July 1967, four years after land acquisition, the first residents moved in.

Reston

Like Columbia, Reston began as one man's idea of what urban development should be like. Bob Simon began with a core tract of land for which $18.1 million was paid in 1961. Several other small parcels were added to fill out the 7,418 acres that were to become what you see here today. Since the county's zoning ordinance did not permit mixed-use or high density development, it became necessary to seek an amendment to the zoning ordinance. In 1962, the Residential Planned Community (RPC) zone was approved by the Fairfax County Board of Supervisors for the Reston land area. This zone requires the maintenance of large areas of open space and permitted, for the first time in the County, the use of cluster development based on average densities. It also implied a partnership between the developer and the county to invest in a rural area having few public services. By December 1964 residents began moving into the new community.

Development Prerequisites

Once the development concepts for these new communities moved closer to realty, it became necessary to look hard at the characteristics of the markets in which they would operate. Four prerequisites for successful development had to be established. The first of these was the metropolitan area growth potential which would lay the foundation for marketing in each of the new communities. The second was the formulation of a long-term financing package to not only provide font-end funds for construction but also to finance losses during the initial period of development. The third important prerequisite was what may be characterized as "responsive" local governments from the perspective of the developer. This implies not only a partnership but also a commitment of the local government to the development plan and to public capital improvements projects once the plan was approved. The fourth prerequisite was a relatively sophisticated planning and development process by both the developer and the local government.

Metropolitan Market Growth. Reston and Columbia depend on what has been one of the fastest growing metropolitan areas in the nation: Washington, D.C. Both projects are approximately the same distance -- 20 to 24 miles -- from federal employment centers in downtown Washington. The area's economy is undergirded by the Federal Government with over 340,000 employees. A large portion of the balance of the employment is in professional and business services whose location in and around the nation's capital is attributable to the federal presence. Job growth during the 1960s played and important role in alerting developers to the Metropolitan Washington Area's market potential. From 1960 to 1970, employment increased by more than 370,000 jobs, and brought with it a population increase of some 800,000 persons. This growth established a firm market foundation for large-scale development in all geographic sectors of the region.

Analysts had only to look to employment and population forecasts to satisfy themselves that the longer-term outlook for growth to support community development investments was favorable. However, the 37,000 jobs-per-year growth of 1960's has not been sustained. During the 1970s, job growth in the metropolitan area was cut to about 13,000 annually and in the 1980s it more than doubled to 26,980 new jobs annually. Population growth, the foundation of household formation and the critical component in new housing starts, grew at even a lower rate. In the 1970s the population has grew less than one-third the rate of the 1960s. In the 1980s, the population growth of 7,680 persons per year, was only 28 percent of the growth of jobs. This indicates that the population is also growing in the outlying counties to service jobs located within the metropolitan area.

Columbia derives a major part of its market support from the Metropolitan Baltimore Area in which it is located and which has also experienced significant growth in recent years. In the 1970s, Metropolitan Baltimore employment grew 14,500 but during the 1980s employment only grew by 6,400 jobs. This increase, along with employment growth in Metropolitan Washington, has resulted in an annual increase in the bi-metropolitan population of more than 70,000 in the 1980s. Howard County is one of the two counties in the Baltimore SMSA with substantial numbers of residents who commute to Washington for employment. Each of the new communities depends on the stability and growth of those employment centers as an important part of their respective marketing programs.

Long-Term Finance. A critical factor in the viability of both projects has been the ability of the developers to put together long-term financial packages. Major sources of funds are critical not only for the provision of front-end capital investments during the early states of development, but also to carry the projects during downturns in cyclical real estate markets. Slow marketing and other problems they have run into have resulted in significant changes in the capitalization of each since the projects began.

Long-term financing for Columbia was provided by Connecticut General Life Insurance Company which, in return, acquired a major equity position in the project. In December 1965, additional private financial was provided by Chase Manhattan Bank and the Teachers Insurance and Annuity Association of America. Two additional lenders -- Morgan Guaranty and Manufacturers Hanover Trust -- were added to the lender group in 1970. As a result of financial problems stemming from post 1973 economic conditions, Connecticut General assumed effective control over major investment decision in the project and began playing a more active role in day-to-day operations.

Simon Enterprises conceived the idea for Reston in the early 1960s. Its partners included the John Hancock Mutual Life Insurance Company as owner of the land and Gulf Oil as a major equity partner. In 1967 the project encountered serious marketing and financial problems and controlling interest was purchased from Simon Enterprises by Gulf. In 1978 Mobil Oil acquired Gulf Oil's 3,000-acre interest in the project. Mobil continue today as the developer of the remaining 1,000 acres of vacant property in Reston.

We see then that two of the most successful new town projects in the country have had financial difficulties.

Responsive Local Government. From the developer's perspective, a responsive local government must be able to make land use control and public services commitments and stick by them. These critical local government roles clearly place them in a partnership position *vis a vis* the conception, development, and sales success of new communities. Typically, private businesses, such as developers, have a quick and clear-cut decision-making process. This process must be sensitive to unforeseen and rapidly changing market conditions and often carries with it long-term irrevocable commitments from the company's perspective. The public's business is not carried on it the same manner and local government is slower to respond to the existencies of the marketplace. These factors serve to establish creative tensions between the developer and the local government to achieve mutually agreed upon objectives.

Large-scale development usually takes 20 years, or more, to complete. Market factors, local ordinances and development policies, the availability of funding, ordinances, development policies, and personnel all are likely to change frequently during such a long period. Each can have a significant effect on the "responsiveness" of local government to past commitments to new community projects. It is imperative, therefore, to establish and maintain strong and effective lines of communication among the developer, local government and affected residents.

Development Plan and Process. The fourth prerequisite of selling a new community venture is a good land development plan and, commensurately, a relatively sophisticated public planning process able to review, evaluate, and modify it. Perhaps the most sophisticated planning prelude to the development process of any new community project occurred in Columbia in 1964 and 1965. More than 130 experts and consultants were assembled to advise the developer of Columbia on how to build the best new community possible. Included among these experts were economists to forecast impacts of the community on Howard County.

Experts were also brought in on all aspects of the development plans of Reston. The expertise of these consultants predictably overwhelmed the public planning staffs. The market forecasts and cost revenue analyses presented to the counties were the most sophisticated documentation that had ever been brought forward in support of a development proposal in their respective jurisdictions. The counties were neither technically nor politically prepared to deal with the implications of these data over the lengthy build-out period which they represented.

Subsequently, each of the counties has increased its technical capabilities to evaluate sophisticated development proposals and identify the issues they represent. They are much better prepared to deal with developers at the technical level and to assess the economic and fiscal implications of large-scale developments proposed for their jurisdictions. They can negotiate with greater confidence the cooperative agreements necessary to ensure the equitable sharing of the required capital and services costs between the developer and the jurisdictions.

Fiscal and Economic Growth Attributable to New Communities

Determining the impact of any existing or proposed development is difficult and requires a background of experience gained through analyses of other projects. At the same time, the importance of preparing sound fiscal and economic analyses as foundations for investments decisions by developers and local elected officials alike cannot be overemphasized.

Key Measures of Revenue

Let's talk first of all at the revenue side of the fiscal impact equation. The first and foremost public revenue producer is the real property tax which remains a bulwark of local tax structures. A second indicator is personal income which can be translated into estimates of personal property, sales, business and professional, utility and other tax revenues. The third important measure to local officials is the job-generating potential a new community represents. Applying these three indicators to Reston and Columbia provides a general indication of their fiscal and economic importance to the local jurisdiction in which they are located.

Real Property Tax Yields. The Fairfax County general fund is highly dependent upon the real property tax to yield revenues sufficient to cover the more than $678.3 million of general operating, library and school expenditures. In fiscal year 1985, it is anticipated that 58 percent of the revenue to cover these expenditures will be raised from the real property tax. As of last month, Reston was assessed at about $1.53 billion. At the current tax rate of $1.39 per $100 of assessed valuation, Reston will yield approximately $21.3 million in real property taxes. This represents about 1.9 percent of the real property taxes that will be raised in fiscal year 1985. At the same time, Reston represents 4.9 percent of the county's population. Therefore, the real property tax yield from Reston is 38 percent of the project's share of the population.

Similarly, Columbia accounts for a disproportionate share of the real property revenue raised by Howard County. Investment in Columbia is about $1.78 billion. Applying the tax rate of $2.54 per $100 of assessed valuation yields about $45.3 million in real property taxes. This represents about 37 percent of the real property tax revenue raised last fiscal year. At the same time, Columbia accounts for about 43 percent of the population in the county. Therefore, the new community contributes less in real property tax revenue than the population that has to be served by the county because large property tax generators like General Electric are outside its boundaries.

Average Household Income. Personal expenditure patterns vary directly with the income levels of the consumer spending unit. Higher average household incomes translate into more and higher valued personal property, more sales tax, more utility taxes, and more expenditures for business and professional services which, in turn, pay local taxes.

Residents of new communities in the Washington and Baltimore metropolitan areas have significantly higher average households incomes than other residents of the counties in which they are located. In 1984, Fairfax County residents have an average household income of about $51,100. Reston residents had an average household income of about $52,700, or three percent higher than residents elsewhere in the county.

From the higher average incomes recorded in each new community, it may be inferred that each contributes to its respective county substantially more than its proportionate share, on a per capita basis, of personal property, sales, utility, and other non-property taxes.

Job-Generating Development. By definition, a new community includes a broad mix of land uses. Residential, industrial, retail, offices, recreation and institutional uses are all part of the "balanced development" which helps distinguish the new community from the typical subdivision. This broad mix of uses and the prevailing densities in which development is permitted to occur has an important effect on the cost-revenue picture from the perspective of the county. That is, the high public service demand of residential land uses are balanced by the lower public service demands of industrial and commercial job-based land uses.

There are, however, major differences in the proportion of job-generating land uses in Columbia and Reston. Of the developed land in Reston Approximately 75 percent is devoted to residential uses. For Columbia, this figure is 57 percent. One of the major reasons for this difference is that Columbia has set aside land for a number of relatively low-density industrial parks.

Columbia also has much higher jobs-to-population ratio which currently is approximately 65 jobs for each 100 residents when General Electric is included. In Reston there are about 34 jobs for each 100 residents. In spite of these relatively favorable labor force participation rates, many new community job holders do not live near their jobs. The largest employers in Columbia and Reston, GE's Appliance Park and a Federal Government agency, respectively, still have many more employees who commute from outside the new community than they have who are residents.

By the same token, significant numbers of new community residents are employed outside the new community, particularly in Washington, D.C. More than one-third of the employed residents in Reston work in or immediately adjacent to Washington. Columbia's location permits commutation to jobs not only in Washington, D.C. but also to Baltimore. Of Columbia's residents, 16 percent work in Washington, D.C., 12 percent in Baltimore, and another 10 percent in the Fort Meade-Silver Spring corridor.

Each of the new communities has been successful in establishing a substantial and growing employment base. The degree to which the presence of the new community played a role in individual industry's decisions to locate in them is difficult to assess. The available evidence indicates that the amenities available in the new communities have played a mixed role in the industrial location decisions that have benefited them. Few if any decisions to locate in the general area of Washington and Baltimore have been influenced by the existence of the new community projects. Most important in the basic locational decisions have been market-related factors. However, once the basic decision to locate in the Washington-Baltimore region has been made, the amenities, image, and environmental values offered by the new communities have been extremely important in weighing one location against another. It is clear that Reston and Columbia have major advantages over more traditional alternatives in competing for employers seeking sites within the region.

This point is illustrated by a federal decision to locate a major governmental facility in Reston. In 1961, a Federal Government policy decision was made to locate a share of Washington's new federal office buildings in the suburbs in accordance with a regional plan for the National Capital Area. When the U.S. Geological Survey required additional space and the consolidation of 17 separate offices, Reston was selected as the site for the new headquarters building because of the amenities provided by the project as a place to work and live and of the cost of space negotiated with Reston. The 2,600 U.G.G.S employees represent 16 percent of Reston's current employment and the privately owned building is a major source of taxes for the county. It is unlikely that this facility would have been located in Fairfax County without Reston.

In terms of overall impact, the job-generating capacity of Columbia has proven to be spectacular. Columbia lists some 38,500 employees including those at General Electric's Appliance Park, representing some 56 percent of Howard County's total employment. Columbia's industrial and commercial development represent over 63 percent of the industrial and commercial assessable property in Howard County. According to Howard Research and Development Corporation, many industries have located in Columbia that would not otherwise have located in Howard County had it not been for the new community.

Reston currently has approximately 15,400 employees representing 6.3 percent of all employees in Fairfax County. The heavy emphasis is clearly on research and development firms and on office space for a broad variety of tenants including trade associations and business services. Like U.S.G.S., some of these firms would not have located in Fairfax County were it not for Reston.

Public Service Cost Implications

As with the revenue-producing characteristics, the public service costs implications of new communities must be evaluated on a case-by-case basis. Cost variables such as land development design, applicable public service standards, the amount and distribution of the daytime and nighttime population to be served, construction cost indexes, and other factors will contribute to making the cost side of the cost-revenue equation unique to a given community.

In the euphoria that often accompanies development proposals, the importance of the cost side of the public services equation is sometimes minimized or overlooked. Absent local fiscal impact study requirements potential cost-revenue relationships are typically glossed over. Local governments, now more than ever before, are insisting on public service cost analyses as a prerequisite to large-scale development approvals of all types. These analyses have tended to blaze new trials of sophistication in the land development proposal review and evaluation processes among local governments.

There are many types of indexes available for evaluating the public service cost implications of new community development. General government support costs are frequently assigned on a per capita basis since there is no clear-cut method of otherwise distinguishing them. Similarly, police, health and welfare, social services, recreation, library, and other public services costs may be assigned on a per capita basis when better data are not available. If data on the cost of fire department calls, school-age children for both regular and special education, road construction and maintenance, and capital debt service are available, these indexes can be appropriately assigned to existing and forecast new community development to more accurately reflect their respective impacts on the county treasury.

Pace of Development. While the amount of public services is the most important set of measures in evaluating their cost implications, the pace of development itself can also have an important bearing on these costs. Experience with the rapid development of Columbia and Reston and its implications to the availability of public services are instructive to communities that have not yet experienced the full impact of new community construction.

Once the Fairfax and Howard County governments became, in effect, partners in the development of Reston and Columbia respectively, they accepted, by implication, responsibility for providing public services at a scale and pace commensurate with the developers' implementation schedule. However, in the developer's eyes both local and state governments were also to respond to public services demands being placed on them by rapidly increasing populations. Many public service issues have resulted.

Examples of these issues include those revolving around transportation and public education. Reston and Columbia have invested their own funds in transportation facility construction which, under typical development circumstances, would have been taken care of through existing priority-setting mechanisms and funding formulae. In each case, the developer decided that the need for the transportation facility was so important that imminent construction was necessary. In Reston, and in Columbia, until 1973 when the state government assumed responsibility for the construction of public school buildings, the availability of classrooms has not kept abreast of new community resident demands for them. As a result, alternative financing arrangements have been explored, overcrowding exists and longer bus trips prevail than would be the case if population growth and standard classroom availability were kept in proper balance.

Public School Expenditures. By far the biggest financial demand on each of the county governments is the cost of public education. This is no different than local government expenditure patterns elsewhere in the country. Nearly all communities face the question of education expenditure priorities every year.

The Fairfax County school system is responsible for spending about 51 percent of the county's operating budget. Reston's population growth is placing unusual demands on the school system for capital and operating expenditures. Approximately 11 classrooms are needed to educate the 300, or more, annual increment in Reston's public school student population. The operating and capital expenditures necessary to educate Reston's public school students amount to over $30 million per year.

The Howard County school system has been even more severely impacted by Columbia because Columbia represents a much greater share (43 percent) of its county's population than Reston does (6.2 percent). The more than 2,700-person annual growth in Columbia has resulted in the need for about 20 classrooms each year to accommodate the 500 public schools students increase. It is estimated that the Howard County school system spends about $29 million per year, exclusive of the Community College located in Columbia, on educating public school students living there. The developer of Columbia claims to have saved the county several hundred thousand dollars annually in school bussing costs since about 85 percent of the students walk to school.

Other Public Services Cost. Determination of the precise cost of public services attributable to new communities will differ from one to the next. It is important to evaluate each type of cost based on available indexes which change by community and over time. No attempt is made here to develop a methodology suitable for your new community's circumstances nor is it suggested that the experiences of the new communities evaluated in this paper necessarily apply to yours. It is important to note, however, that there are ways to help assure public play in providing services and the rapid increase in these services required at new community locations. Opposing positions on these issues may harden rapidly when local government services do not keep up with new community resident and developer demands for them.

4. The "old saw" about development occurring on a major road at the end of a sewer pipe is as true in the new communities setting as it is elsewhere. The availability of highways and sewer taps paid for by the developer has been a key to the rate of land absorption in Reston and Columbia. The ability of the developer to invest large sums of money in capital facilities has played an important role in the success of the Washington area's new communities.

5. If public services decisions were made by new community residents, it is highly possible that their target populations would not be reached. If, for example, Reston and Columbia were incorporated cities, the residents' elected representatives would play an important role in controlling the location, size, and timing of the availability of public services. It is entirely possible that they would choose to slow growth down to maintain small-sized communities more suitable to their interests than permitting the communities to grow into full-fledged cities.

6. A part of the developer-county partnership in new community construction should include land development policy understandings for the areas adjacent to and outside the new community. In the cases of Reston and Columbia, new and untried land development control ordinances were passed in advance of development. Unfortunately, implementation of these devices does not necessarily extend to the development process outside new community boundaries. For example, there has been intense pressure for commercial development on highways leading to and from these new communities. Since there is a definite amount of retail space required to serve new community residents, any strip commercial development that occurs has the tendency to reduce the viability of proposed commercial centers in the new community itself. While Columbia has been successful in dealing with this problem, Reston has not. Construction of the Reston town center has been delayed partly because of commercial development outside, but close to, their borders.

7. While a full-range of housing choices is desirable and necessary in a new community, priorities must be established at an early date regarding the most marketable housing. In spite of the desirability of providing low- and moderate-income housing in new communities, from the marketing perspective its availability should be delayed until the market position of the new community's unassisted housing offerings is well established. The low- and moderate-income housing image remains a marketing stumbling block in even the most sophisticated communities.

8. Land carrying costs are high in any urban development venture and especially high in large-scale ventures such as new communities. To illustrate this point I might draw on a few figures from the Reston experience. In 1976, the developer was paying approximately $1.6 million in interest annually and $1.6 million in real property taxes to the county each year. In order to break even, a gross annual sales volume of some $30 million dollars is required. In today's market this represents a clear and present burden that must be overcome if development targets are to be met. These facts of real estate investment life are important to those of us concerned for the saleability of the new community concept.

Overall Summary

To briefly summarize, the key message here is that both the county government's and the developer's financial viability depends upon the timely marketing of land and buildings in relation to expenditures. Market absorption in the project and the timing of required public investments must be realistic in order that the project will sell and local government revenue and cash flow projections will be realistic. There are many examples of public investments in infrastructure~~s~~ whose carrying costs are not being covered by increased tax revenues from projects they were designed to serve -- and if properly accounted for, the investments may never be recovered. Local government administrative delays and failure to meet commitments contribute to developer delays in the construction and selling the new town product. It has been exciting to live in Reston and participate in the evolution of the processes I have described to you today.

Thank you.

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