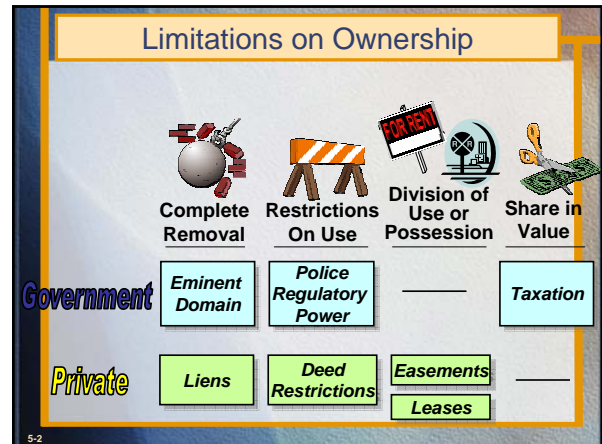


Professor Thomson
Fin 3433
Chapter 5:
Government
Controls and Real
Estate Markets

McGraw-Hill/Irwin
Copyright © 2008 by the McGraw-Hill Companies, Inc. All rights reserved.



- ### Features of Real Estate that Cause Market Distortions
- “Spillover” effects from nearby land uses
 - Uniqueness of location (absolute monopoly)
 - Instability of surrounding land use
 - Unknown quality or condition of existing structures

- ### Resulting Market Failures in Real Estate
- Monopoly
 - Utilities
 - “Holdouts” in land assembly efforts (roads, other public uses)
 - Externalities
 - “Spillover” effects of land use for which initiator is not held accountable (traffic congestion; runoff ; smoke, gases, and particle emissions; noise; urban sprawl; disorderly extension of urban infrastructure)

- ### More Market Failures (continued)
- Incomplete information
 - Construction quality hidden
 - Buyers unaware of structural risks of hurricanes, etc. (maximum wind tolerance of structure; safety of electrical or gas systems; fire dangers)
 - Uncertainty of residential values
 - Effect (“weird” structures; nonresidential land uses; students)

- ### The “Revolution” in Land Use Controls
- Pre-1970: Little interest in land use controls
 - No plans had force of law
 - Zoning very limited in function
 - Focused on protection of single-family homes
 - Did not exist in many areas
 - Environmental movement of late 1960s
 - Rachael Carson: *Silent Spring*
 - Love Canal
 - Notion of “spaceship earth”

Comprehensive Planning as a Solution to Market Failure

- Project future population growth
- Determine requirements for water and waste disposal
- Project needs for public services (utilities, streets, schools, parks and recreation, safety)
- Projected demand for various land uses (public, residential, nonresidential)
- Design compatible arrangement of needed land uses (land use map)

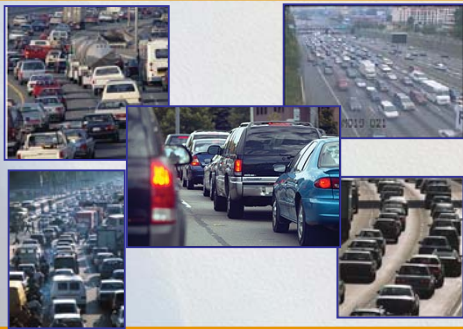
5-7

Urban Planning is Needed for Storm Water Management



5-8

Urban Planning is Needed for Traffic Management



5-9

Urban Planning is Needed for Schools and other Services



5-10

Challenges to Public Land Use Planning

- Changing notion of “best practice”
 - Cul-de-sacs or grid streets?
 - Mixed density and use or containment of nonresidential use?
- Limited actual experience to rely on (less than 30 years)
- Insufficient theory and information
- Inability to foresee the future well

5-11

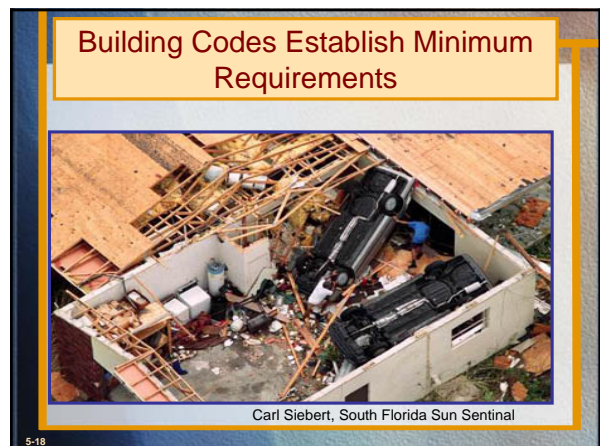
Traditional Planning vs. New Urban Planning

- | Traditional | New Urban |
|--|--|
| ▪ Separated uses | ▪ Mixed use |
| ▪ Automobile oriented <ul style="list-style-type: none"> • Priority placed on easy ingress and egress | ▪ Public transportation |
| ▪ Uniform density | ▪ Pedestrian oriented <ul style="list-style-type: none"> • Sidewalks • Houses close to street • Rear alleys |
| ▪ Cul-de-sac hierarchy in neighborhoods | • Grid streets with restricted traffic flows |

5-12



- ### Traditional Land Use Controls: Building Codes
- Older than zoning (circa 1900)
 - Issues of safety
 - Fire: Materials, alarms, electrical and gas systems
 - Sanitation: Plumbing, water, and HVAC requirements
 - Injury: Design and strength
 - Continue to evolve
 - Effect of Hurricane Andrew (and 2004-5 hurricanes)
 - New technology (e.g., smoke detectors)
 - Changing perception of needs (e.g., bedroom windows large enough to step through)
- 5-17



Traditional Land Use Controls: Zoning

- Features of traditional zoning
 - Use classifications: Residential, commercial, industrial, automotive
 - Use districts (zoning map)
 - Setback requirements
 - “Bulk” or density limits (minimum lot size, height limits, maximum floor area ratios)
 - Special use districts: Service stations, hospitals, churches, private schools, cemeteries

5-19

Traditional Land Use Controls: Subdivision Regulations

- Standards for streets, sewers, and water systems
- Adequate water supply for fire safety
- Adequate drainage and run-off retention
- Open spaces
- Lot layout
- Easements for utilities
- Traffic and pedestrian safety

5-20

Traditional Land Use Controls: Planning and Zoning Administration

- Planning and Zoning Commission created in ordinances
- Requested changes must:
 - Be compatible with a comprehensive plan
 - Be justified if they require change in the comprehensive plan
 - Not have undue effect on surrounding land uses or the community
- Commission ultimately serves as advisory to elected officials

5-21

Traditional Land Use Controls: Board of Adjustment

- Reviews petitions for variances
- Decisions are final rather than advisory to the elected officials
- Only appeal is through the courts

5-22

Traditional Land Use Controls: Site Plan Review

- May be the same as planning and zoning commission
- Review subdivisions and most other building site plans
 - Public review (neighbors and others)
 - Public offices (public safety - fire, police, emergency vehicles; utility officials; school officials)
- Informal procedure allows criteria and rules to change with public pressure
- Most “treacherous” step in development?

5-23

Zoning Issues and Concepts

- Legality of zoning: *Village of Euclid vs. Ambler Realty* - 1926
- Nonconforming use: Use inconsistent with and precedent to zoning map
 - Cannot be substantially changed
 - Must be continuous
 - Can be “amortized” away, (e.g. billboards)

5-24

Zoning Issues and Concepts (continued)

- Variance: Exception to requirements due to hardship
- Exclusionary zoning (unreasonable lot size; inadequate provision for low- and moderate-income housing)

5-25

Do Land Use Controls Solve the Problem of Market Failure?

- Does zoning raise the cost of “threshold” housing unnecessarily?
- Do land use controls interfere with economically efficient land use patterns? (Example: Does zoning make neighborhood services excessively remote)
- Does low density resulting from zoning contribute to urban sprawl?
- Houston: effective land uses without zoning?

5-26

Newer Approaches to Land Use Control

- Planned Unit Development
 - Mixed density
 - No setback requirements
 - Open community spaces
 - Community facilities
 - Mixed uses
 - Negotiated “contract” with land use authorities
- Performance standards
 - Runoff limits
 - Noise and emission limits
 - Traffic limits
 - Tree removal restrictions

5-27

More New Land Use Controls

- Impact fees
 - Favorite of economists (in principle)
 - Despised by many in the building community
- Growth restrictions
 - Temporary moratoriums
 - US Supreme Court refuses to review Petaluma, Ca. limit on the number of new housing units.
 - Also Boulder, Co. and Boca Raton, Fl.

5-28

Power of Eminent Domain

- Eminent domain: Right of government to acquire private land, without the owner’s consent, for public use, with due process and just compensation
- Condemnation: Legal procedure for exercising the right of eminent domain
 - Public use vs. public purpose
 - Just compensation based on highest and best use
 - Problems of excessive use
- Inverse condemnation

5-29

Eminent Domain Controversy

- Concept of “public use” expanded to “public purpose”
 - US Supreme Court in 1954 allowed condemnation of “blighted areas” for redevelopment
 - Michigan Supreme Court in 1981 allowed condemnation to enable GM manufacturing facilities
- Wide-spread subsequent condemnation of “blighted areas” for private redevelopment driven by hunger for an increased property tax base
- US Supreme Court, in *Kelo v. New London Ct.*, 2005, allowed use of eminent domain to obtain non-blighted property for private redevelopment
- Most states have enacted legislation to control such use of eminent domain, and Congress has enacted law to prevent application of Federal monies for such use

5-30

Sample of Environmental Controls since the Late 1960s

- Clean Air Act
- Clean Water Act
- Comprehensive Environmental Response Compensation and Liability Act (CERCLA)
- Occupational Safety and Health Act (OSHA)
- Endangered Species Act

5-31

Hazardous Materials Issues

- Asbestos and fiberglass
- Polychlorinated biphenyls (PCBs)
- Leaking underground storage tanks (LUSTs)
- Lead paint
- Radon
- Mold



5-32

Environmental Assessments

- Phase I EVA (noninvasive)
 - Air and water samples
 - Historical property records
 - Site inspection
- Phase II EVA
 - More invasive tests to confirm indications from Phase I
- Phase III EVA
 - Complete assessment of extent of the problem
 - Determination of remediation needs
 - Estimation of remediation cost
 - Prescriptions for future prevention

5-33

Property Taxes

- Primary source of local government revenue
- Reliable and countercyclical
- Many taxing authorities
 - City
 - County
 - Schools
 - Improvement districts
 - Transportation authorities
 - Water management districts
- Property Tax Exemptions
 - Religious organizations
 - Nonprofit organizations
 - Educational institutions
 - State Property
 - Homestead

5-34

Determination of Tax Rate

$$\text{Tax rate} = \frac{\text{Total budget of Taxing Authority} - \text{Income from other sources}}{\text{Total assessed value} - \text{Total value of property exemptions}}$$

$$\text{or } R_T = \frac{(E_B - I_O)}{(V_T - V_x)}$$

$$R_T = \frac{(65,000,000 - 25,000,000)}{(2,500,000,000 - 500,000,000)}$$

= .020

Or, a tax rate of 2 percent.
Or 20 mills

5-35

Computing Tax Liability

Market value	\$150,000
Assessed value	135,000 = (0.90 x MV)
Less: exemptions	<u>25,000</u>
Taxable value	\$110,000

Property Tax Calculation

Taxing Authority	Millage Rate	Taxes Levied
County	8.58	\$ 943.80
City	3.20	3,520.00
School district	9.86	1,084.60
Water mgt. district	<u>0.05</u>	<u>5.50</u>
Total	21.69	2,385.90

5-36

Special Assessments

- Special assessments: Taxes for specific public improvements affecting a property
 - Street, sewer, etc.
 - Usually charged on a per front foot basis
- Example: Street improvements of \$500 per running foot of street
 - For lot with 100 feet of frontage:
 $100 \times .5 \times \$500 = \$25,000$

5-37

Issues with Property Tax

- Regressive
- Uneven across geographic areas
- Poorly administered

5-38

