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Value Capture and Community Benefits

By Nico Calavita

Market-based regulatory strategies have become relatively common, though far from universal, in communities across the country.

It has been almost a quarter of a century since Jerold Kayden alerted planners to the momentous change occurring in land-use planning—"the movement from command-and-control to market-based regulatory strategies"—when public and private interests would "join forces for the common good" by harnessing mechanisms such as transfer of development rights and incentive zoning (1992, 565).

As planners seek to promote higher-density compact development in a climate of declining public revenues, it is imperative for them to help cities and counties capture a portion of the increases in land and development value resulting from granting additional development rights to provide public amenities.

To that end, this article highlights a number of promising approaches for capturing value created from land-use and other regulatory changes. Specifically, it focuses on the new ways in which incentive zoning is being shaped and implemented in California. Throughout, I will use the term "value capture" to encapsulate mechanisms like public benefit zoning, floor area ratio (FAR) acquisition programs, amenity bonus programs and community benefits programs. All of these techniques seek to capture some of the value increases—both land and development value—resulting from entitlements.

While beyond the scope of this article, it should be noted, however, that the value of real estate also increases as a result of the building of infrastructure and public facilities. The main tool to capture those increases is a special assessment district, and in some contexts, tax-increment financing (TIF) is also seen as a value capture mechanism (Huxley 2009). It should be noted, however, that with TIF the value captured is from increases in real estate taxes resulting, at least in part, from public investments in redevelopment areas, and not from landowners and developers.

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ORIGINS AND PROBLEMS

Incentive zoning (IZ) encourages developers, usually through additional densities, to provide community benefits or amenities. (In this article I will use the two terms interchangeably). It has a dual origin: In cities like New York and Chicago, where IZ was initially attempted in the 1960s, the benefits sought from developers tended to emphasize ways in which to improve the public realm, such as encouraging the creation of public plazas or theaters. In Fairfax County, Virginia, on the other hand, density bonus systems were introduced to circumvent court decisions that prohibited inclusionary zoning.

Concerns about IZ are many, including the charge that it undermines planning. After all, if planning rationale has established a maximum density, what makes certain community benefits worthy enough to trump the benefits gained from plan-established densities? Similarly, if amenities are so important that plans can be undermined for them, why should not they be required without incentives?

Studies that compared the benefits and costs of IZ found that developers benefited disproportionally. A case study that analyzed public plazas and arcades provided under the IZ program in New York City found that developers enjoyed huge windfalls while providing, in many cases, poorly designed public spaces at a relative low cost (Kayden 1978).

As experiences with IZ grew, changes and improvements were made. For example, in a few cities—such as San Francisco and Santa Monica, California—the amenities were obtained through mandatory incentives; the cities are now utilizing IZ to obtain additional benefits. It should

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About the Author

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be pointed out that development value is not only created by zoning changes to individual parcels, but also through plan changes, especially in states like California where zoning ordinances must be in conformance with land-use plans, and value capture can be "plan based."

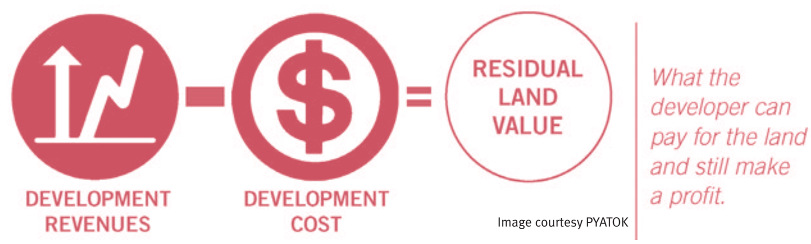
Now a new wave of IZ is emerging, characterized by three elements: 1) reliance on economic analysis; 2) particular attention paid to the effects of value capture on land values; and 3) utilization of extensive public participation processes.

ECONOMIC ANALYSES AND VALUE CAPTURE

According to Cameron Gray, former director of Vancouver, British Columbia's Housing Centre, community benefits contributions "cannot be calculated or negotiated without using development economics and real estate analysis, and the question is not whether but how" (n.d., 1).

Economic Analyses

In order to calculate what it is economically feasible under a value capture scheme, it is necessary to compare the value of a project under existing zoning and its value after the plan change or upzoning. This is done through economic analyses that establish the costs and revenues of a project. For example, in a residual land value analysis, costs are subtracted from the revenues, providing information about how much the developer can pay for the land and still make a profit. Comparing the residual land value before and after a rezoning, a city can determine the "uplift" or "enhanced value." Such determination provides the basis for the level of amenities that can be required while maintaining the development's financial feasibility. Other methodologies may assign a particular cost to the land and calculate the developer's profit.



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Reminders

For value capture to work, there needs to be market demand for additional development. Many communities, especially those that are struggling economically, will amend their plans to allow greater densities in the hope of luring new development. Unfortunately, once additional benefits have been granted (for free), no community benefits will be forthcoming when a city experiences a market revival. This is happening in Oakland, California, for example, where large parts of the city, including downtown, were upzoned a few years ago when the market was relatively weak. Now the market is quite strong, but city planners are still reluctant to secure community benefits from developers, and community groups are having difficulties getting them.

Decisions about the levels of amenities and incentives to be established are ultimately political ones, but they need to be based on economic analyses that establish the value of both. For planners the goal should be to seek the highest possible level of amenities without making the proposed development financially unfeasible. Past experiences indicate that political decisions might have been biased in favor of the developer because of their exclusive accessibility to development information and the political sway they enjoy in certain communities. For example, in the 1980s in New York, "anticipation of bonuses fed back into higher land prices"(Cullingworth and Caves 2003, 116), probably the result of developers' intuition that the value of the density bonuses would be much higher than the cost of community benefits.

Higher densities generally come at a public cost. From shadows cast by tall buildings to increased street congestion, development exceeding plan-established densities is likely to lower the quality of life in a particular community. Since positive externalities are also possible, planners should determine whether the value of the amenities to be gained is significantly higher than the public cost of the additional densities.

Case in point: The developer of a proposed high rise in downtown Berkeley, California, claims that he is providing a community benefit by subsidizing the continued operations of a multiplex movie theater and a children's museum that will be displaced by the new development. While the subsidies may represent an additional cost to the developer, they do not constitute an *additional* community benefit.

VALUE CAPTURE AND LAND VALUES

Upzonings or plan changes that allow higher densities are likely to increase land values. It has been argued that when public action raises the value of land, the public should "recapture" at least a portion of that increase through the provision of community benefits. This understanding shapes planning approaches in many European and South American countries, as well as in a few American and Canadian cities.

Who pays and who benefits from value capture? In order to determine the effect of value capture on land values, we need to consider two scenarios: “base density plus” and “rezonings.”

Base Density Plus

Under this scenario developers have the choice of building at an established base density for which they pay prescribed exactions (or not, depending on the locality), or of trading additional densities (or other incentives such as greater height or reduced parking requirements) for amenities. Under the scenario of a fair economic trade-off between incentives and amenities, land prices should be unaffected. If—as was the case in New York in the 1980s—the value of the incentives is much higher than the cost of the amenities, the value of the land is likely to rise. In the opposite case, the developer will not choose to use the incentive zoning option, and the city will have to reduce the level of amenities.

To summarize, the consumer benefits because of the increase in market choices and the amenities provided, while the developer also benefits from the amenities as well as from higher profits. The landowner still profits from selling the land, but at a price that reflects the base density only or slightly more.

Rezonings

Localities have the discretionary power to rezone properties to allow higher densities or change land-use designations. These changes, under appropriate market conditions, will lead to higher land prices. Under the “rezoning” scenario, for example, developers might acquire land zoned industrial—a use for which there is no demand—and initiate the process of rezoning the land to medium-density residential. Presumably developers will pay less for industrially zoned land than residentially zoned property, allowing them to provide community benefits, cover the cost of the rezoning, and gain a portion of the “enhanced value” resulting from the rezoning as additional profit.

How this scenario plays in real life will depend on the market and circumstances in a given locale. It could be argued, for example, that landowners, anticipating the likelihood of a rezoning to a more valuable use, will seek a higher return over industrial land value, in effect withdrawing their property from the market. But if the rezoning is part of an overall plan to change land uses or increase densities, thus increasing the supply of land available on the market, the levy should not cause land prices to rise significantly.

In conclusion, both developers (who get the rezoning) and the community win. Landowners will win because they will be able to sell their land, but not at a price that reflects the higher-level use.

Could “density plus” and “rezonings” be likened to selling zoning? That depends on whether the value capture scheme is based on a plan and how good the plan is. Key questions: Is the additional density based on good planning principles? In the trade-off between the public costs of additional density and the benefits of public amenities, is the public interest clearly the winner? Was the trade-off system openly based on economic analysis and extensive public participation? Were accountability and transparency an integral part of the process?

KEY QUESTIONS

1. Is the additional density based on good planning principles?
2. In the trade-off between the public costs of additional density and the benefits of public amenities, is the public interest clearly the winner?
3. Was the trade-off system openly based on economic analysis and extensive public participation?
4. Were accountability and transparency an integral part of the process?

PUBLIC PARTICIPATION AND COMMUNITY BENEFITS

In changing from a top-down, command-and-control approach to a market-based approach, planning has also embraced a more participatory, community-empowering planning process. The fact that value capture is wedded to an engaged citizenry is in large part due to this shift. However, when public benefits that are part of the status quo are exchanged for other public benefits in a value capture context that enhances developers’ profits, it behooves planners to provide ample opportunities for transparency and accountability and for citizens to demand the same. As we shall see from the Santa Monica and San Francisco, California, case studies, value capture originated from citizen demands and was enacted

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An April 15, 2015, public meeting on community benefits to be generated from five skyscrapers proposed by Berkeley, California’s *Downtown Area Plan*.

under their careful watch. Citizen participation is especially appropriate for expressing preferences for possible amenities, and online participation is becoming common. Redwood City, California, for example, is making use of an online forum, in addition to community workshops, to define desired benefits and identify top priorities. The list of amenities identified in cities with value capture includes affordable and workforce housing (usually on top of the list), open space and parks, bikeways, public right-of-way improvements, public art and art programs, and funding for mass transit services.

CASE STUDIES

The following case studies are based on plans prepared with extensive public participation, but with different value capture mechanisms. In downtown San Diego developers pay cash for FARs. In the Eastern Neighborhoods in San Francisco they pay fees for additional height and provide more affordable housing for land-use changes from industrial to mixed use. The same is true in Santa Monica. But in Santa Monica the approval process varies depending on the type of development and incentive: negotiation-based for large developments and ministerial for smaller ones. In all cities the level of cash, fees, and affordable housing requirements were based on economic analyses.

San Diego FAR Incentive and Bonus Payment Program

In 2005 the San Diego's Centre City Development Corporation (CCDC) released a draft plan for downtown San Diego. It proposed to double its development potential, both for residential and commercial uses, from 53 million square feet to 106 million square feet. The draft included increases of two FARs over the earlier (1992) downtown plan for the majority of downtown. In addition, CCDC proposed a system of FAR incentives and transfer of development rights to provide parks, preserve historic sites, and develop inclusionary units on-site.

Citizen groups, notably Citizens Coordinate for Century Three (C-3), pointed out that additional FAR should not be handed out for free. Since they would increase land value considerably, they argued, some of the increases in value should be recaptured for downtown's benefit. C-3 also predicted that additional FAR would probably make the utilization of incentives by developers less desirable. Heeding these criticisms, the plan was changed to maintain the lower FARs of the 1992 plan as the base maximum density. Developers could receive increases in FARs if they provided benefits that included affordable housing, urban open space, three-bedroom units, eco-roofs, and employment uses.

Additionally, a few weeks before the approval of the plan in March 2006, the mayor and the council member for the downtown announced a FAR bonus payment program

Image courtesy PYATOK

that would help pay for parks and open space: Builders wishing to build above and beyond the levels allowed in the 1992 plan could do so at a cost of $15 per square foot. In May 2007, CCDC approved this FAR bonus program for certain geographic areas of downtown.

In 2011, the state of California eliminated redevelopment agencies, increasing the need to identify additional funding sources in redevelopment areas. In downtown San Diego, the elimination of funding for the implementation of the open space system especially worried city officials. In 2012, Civic San Diego (CCDC's successor organization) proposed, and the city council approved, an amendment to the FAR acquisition bonus program to expand the areas where FAR could be purchased, as well as an increase of about 50 percent in the number of FARs that could be purchased through the program to help implement the open space and park system in downtown.

According to a Civic San Diego document, the bonus programs "have been attractive to developers and have been successful in increasing densities and have resulted in the provision of public amenities and benefits," with the FAR payment bonus program resulting in $1.7 million in funds for the potential implementation of public parks and enhanced public right-of-way improvements (Civic San Diego 2012, 12).

San Francisco—Eastern Neighborhoods Plan

The plan for San Francisco's Eastern Neighborhoods (ENs) came about as a result of the need for the city to plan for areas containing underutilized industrial areas and the conflicts that arose from the dotcom boom of the late 20th century. During the boom, certain areas east of Market Street—primarily in the mostly Latino Mission District—experienced rapid increases in real estate values, gentrification, and the displacement of families and businesses.

The coalition that formed to fight the changes occurring in their neighborhoods (the Mission Anti-Displacement Coalition, or MAC) decided—when the city initiated a planning process for those areas—that they would create their own plan, called the *People's Plan for Jobs, Housing, and Community*. As part of the *People's Plan* preparation, the leaders of MAC came up with the idea of "Public Benefit Incentive Zoning" (PBIZ). They argued that increases in density create greater value for land owners and developers and that, through PBIZ, a portion of this increase could be captured in the form of public benefits that would mitigate the impact of the additional development. The plan included a menu of public benefits, with affordable housing on top of the list. Eventually the city embraced the concept of PBIZ as part of the planning process for the ENs.

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Twenty percent of the 196 loft units at Potrero Launch in San Francisco are affordable to households making between 30 and 50 percent of the area median income. The higher affordability levels were in part the result of the rezoning change from industrial to mixed use, which, under the city's *Eastern Neighborhoods Plan*, calls for higher inclusionary requirements.

The EN plan's main task was to identify the areas that could be changed from "gray" industrial areas to mixed use or residential, and those areas where industrial uses, mainly production, distribution, and repair uses (PDR) would remain.

The plan provided additional benefits to land owners and developers, including height increases and removal of conditional use permits for residential uses in all areas—except for PDR preservation districts—and changes in land-use designations from industrial in some areas to residential uses. In order to learn more about how much these changes enhanced land values, the city hired a consultant to prepare a residual land value analysis to estimate the enhanced value from height increases and land-use changes. The analysis showed that residual land values and profitability were generally higher under proposed zonings and requirements than under current zoning. The question remained as to how, and how much of, this value could be recaptured for public benefits.

The city had two choices: (1) to recapture land values through individual project "deals," utilizing development agreements or similar instruments or (2) to establish *a priori* the level of public benefit to be expected, proportional to the benefit received, exercised through a system of fees on top of baseline impact fees. To reflect the relationship between higher densities and increased value for land and development, the city established a tiered approach to baseline and public benefit fees (Table 1).

To fulfill the goal of increased affordable housing production in the ENs, the plan also requires more affordable housing than is required under the city's inclusionary program.

Santa Monica—A Flexible, Tiered Approach

Santa Monica has a long-standing tradition of achieving community benefits through development agreements, including parks and park improvements, and child care centers with subsidies for low-income families. In 2010, after many years of extensive community engagement, the city adopted the *Land Use and Circulation Element (LUCE)*. A fundamental tenet of the *LUCE* program was that future development should fund a range of measurable public benefits, from open spaces and parks to affordable housing.

As part of the *LUCE* preparation, preliminary economic studies analyzed the extent of "enhanced land value" resulting from higher densities.

These analyses indicated that projects that would provide community benefits under *LUCE* were able to achieve financial feasibility. For individual projects the enhanced value is arrived at through economic analyses and pro formas that identify developers' profit. Consultants employed by the developer prepare this analysis, which is then reviewed by consultants to the city in a give-and-take process referred to as a "peer review." The process ends when both consultants agree on the soundness of the analyses.

LUCE established a tiered community benefits structure for projects requesting an increase in the base height of 32 feet. There are three tiers.

Tier 1 establishes the base height and FAR. No community benefits in addition to the existing ones are required, and the approval process is ministerial. Three to seven extra feet are allowed if affordable housing is provided on-site or close to transit corridors.

TABLE 1. FEE SCHEDULE FOR *EASTERN NEIGHBORHOODS PLAN* AREAS

Tier	Description	Residential	Commercial
1	Projects that remain at current height. Projects under increased housing requirements, affordable housing, or other "protected" development types.	$8/GSF	$16/GSF
2	Projects rezoned with minimal (1–2 story) increase in height.	$12/GSF	$20/GSF
3	Projects rezoned with significant (3 or more story) increase in height; other designated districts.	$16/GSF	$24/GSF

Tier 2 allows additional height and FAR through a ministerial approval process when community benefits are provided.

With Tier 3 even more height and FAR are allowed in exchange for higher levels of community benefits. It is when developers seek Tier 3 density increases that development agreements are required. This process requires additional public review and flexibility and encourages high-quality projects. Tier 3 projects are larger in scale, and development agreements provide developers with a greater degree of entitlement certainty.

However, given the high costs of development agreements, the city is now pursuing a ministerial approach with fixed fee schedules as part of its zoning code update. When a developer chooses to exceed densities from Tier 1 up to Tier 2, he will be required to provide additional community benefits. The quantity (additional fees or affordable housing units) of these community benefits will be defined in 2015 as part of the city's zoning update. At the time this article was written (April 2015), the proposed benefits are:

Given the high costs of development agreements, Santa Monica is now pursuing a ministerial approach with fixed fee schedules as part of its zoning code update.

- *Affordable Housing*: At least 50 percent more than what is required under Tier 1. For nonresidential projects the housing mitigation fee is increased by 14 percent above the base fee as required under the affordable housing fee for commercial development.
- *Transportation Impact Fee, Open Space Fee, and Child Care Facilities*: 14 percent above base fee. An alternative for open space is the provision of accessible open space that complies with specific requirements.

These increases were based on financial analyses of development prototypes that found that the proposed increases could be absorbed by developers of projects like the ones analyzed, and could result in financially feasible projects.

CONCLUSIONS

Value capture can generate benefits for both the public and the developer, provided that decisions about incentives and amenities are based on economic analysis, transparency, accountability, and intensive public participation. The value captured is a portion of the *increase* in land values that result from public action. This increase is referred to in other English-speaking countries as "planning gain." The San Diego and San Francisco case studies show examples of value capture based on plans. In Santa Monica the overall program is also based on a plan, the *LUCE*, that provides a framework for its "negotiation-based" implementation, based on development agreements. In the making is an alternative approach for smaller projects based on fixed fees.

At a time when planners advocate for compact development that is likely to sharply increase land values, and as public resources continue to decline, planners in areas with growth potential should capture a portion of that increase to ensure funding for the public city.

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