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PRACTICE FISCAL ANALYSIS

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The Nexus Between Land Use and Fiscal Balance

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Land-use decisions directly influence the financial health of a community. Every development project, whether it be a single-family subdivision, a downtown storefront, or a corporate business park, contributes to local government tax revenues and service costs. In aggregate, these individual projects and land uses determine the tax base and the annual budget of a community. Therefore, evaluating the net fiscal impact—the difference between revenues and costs to serve a development by a governmental jurisdiction—is an important consideration in the development approval process to maintain financial sustainability. Fiscal zoning—explicitly considering fiscal health in zoning—has been debated by practitioners and implemented in various forms for decades. However, this often takes the form of overzoning for preferred fiscally positive uses or evaluating potential fiscal impacts only on a project-by-project basis. These approaches are insufficient over the long run and do not account for broader community priorities that may not generate positive fiscal impacts. A holistic, communitywide assessment weighing community growth and development goals, overall fiscal balance, and broader policy objectives is needed.

UNDERSTANDING MUNICIPAL BUDGETS
Municipalities rely on a variety of revenue streams to support municipal services. Nationally, a majority of municipal revenues are derived from local sources, including property taxes, sales taxes, income taxes, utility taxes, and charges for service. Many of these local sources are dependent on the particular land-use mix of the community. Property taxes generated per acre of land can vary dramatically depending on land use and density. Retail uses generate substantial municipal revenues in states that distribute sales taxes based on point of sale. To illustrate the effects of differing land-use and development patterns, the relative land-use mixes and sources of revenue for

three suburban Chicago municipalities are presented below.

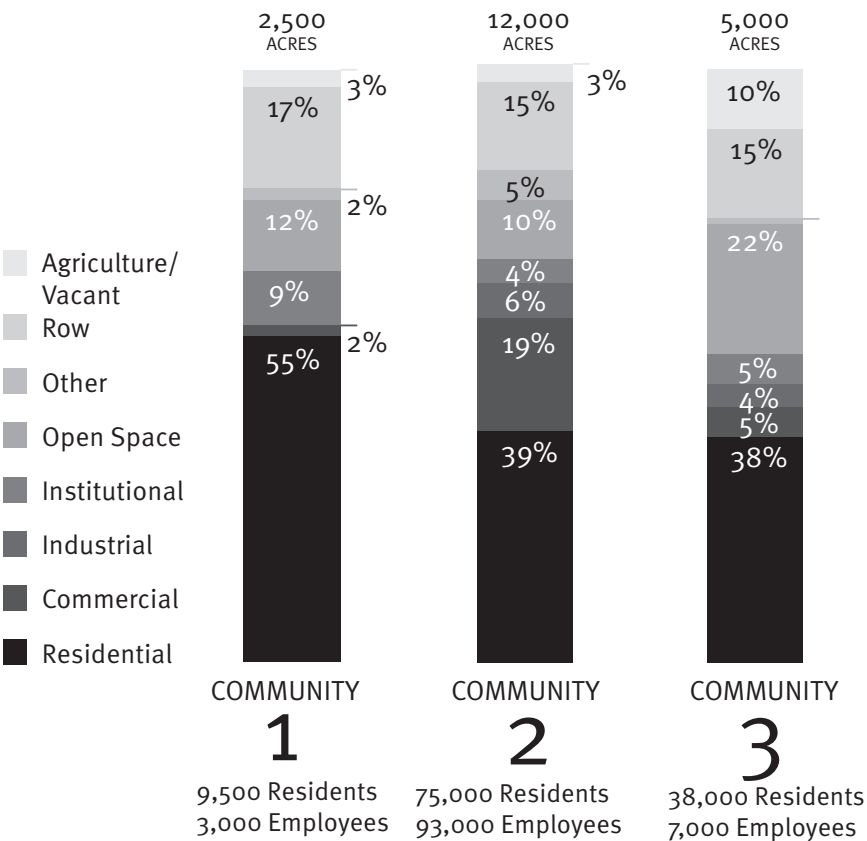
Community one is a small predominantly bedroom community with about 10,000 residents. The community is stable and largely built out, with little vacant or agricultural land that might develop over time. The opportunity for growth is primarily through infill redevelopment. Community one has limited sales-tax generating retail, indicating a need to rely on alternate revenue streams (primarily property taxes in this case). This is common for communities with limited retail or locations in states that do not distribute sales tax based on point of sale.

Community two is a large community with about 75,000 residents and is also home to a major regional mall and

substantial office development. New development in this community is also primarily through infill redevelopment. This municipality is heavily reliant on sales tax revenue.

Community three has about 38,000 residents and a mix of land uses. This is a rapidly changing community: It added more than 7,000 new residents between 2000 and 2010, growing by nearly 25 percent. Revenues are currently relatively evenly distributed between property taxes, sales taxes, and other sources. Community three has continued opportunities for future greenfield and infill growth, as well as municipal expansion.

Beyond driving local revenues, the land-use mix and development patterns also have a direct impact on municipal expenses,



including the provision of services, capital requirements, and ongoing public works maintenance. Public safety services (police, fire, and EMS) are often the largest line item in a municipal budget. The number of calls for service, and therefore municipal expenses, generated by development varies

by land use, location within a municipality, and building typology. Is new development located in a police beat with adequate capacity? Is there a fire station close enough to ensure the response times are acceptable, and does the fire department have the required equipment (e.g., ladder truck

with sufficient height) to serve the type of development contemplated? Rapidly growing communities that extend infrastructure may have increased public works spending. Again, the three prototypical communities illustrate these concepts:

Community one, the bedroom community, has primarily public safety expenses, with general government and public works relatively equal.

Community two, the large community with regional shopping and employment, has substantially higher general government costs, reflecting the tendency for larger municipalities to offer a higher level of service overall, as well as more services.

Community three, which has a relatively balanced land use, expanded rapidly in population and geographical area between 2000 and 2010. This community has relatively higher public works costs, reflecting installation and maintenance of additional roadways and water and sewer infrastructure.

HOW DO YOU ASSESS FISCAL IMPACT?

Assessing the potential fiscal impacts of proposed development requires careful estimation of municipal revenues and costs. Municipal comprehensive annual financial reports and budgets are a key source of data in understanding the particular revenue and expense structure of a community. In addition to a development program (indicating number and type of residential units and square footage by land use), an estimate of total population, schoolchildren, employees, number of publicly dedicated new lane miles, and other factors associated with the development are required as allocation factors to estimate new service needs and associated costs.

Revenues for a particular project are often estimated using outcomes from comparable local projects: estimating likely property value and applying the municipal property tax rate; estimating the number of residents and applying any per capita revenue rates for state sources of funds; and estimating sales tax for the particular type of retail proposed and applying the local sales tax rate, etc.

Certain municipal costs are generally fixed and do not increase with population or geographical growth, while others are variable, increasing in proportion to development (e.g., building department personnel). While there are many variations, two core approaches are generally used to estimate the annual service costs related to new development: average cost or marginal cost. These approaches are applied to both operational and capital costs.

The **average cost approach** typically involves estimating the taxing district

operating budget on a per capita (or other appropriate method) basis and allocating the cost to the development, based on the population generation of that development. While it is a straightforward methodology, the average cost approach attributes fixed and variable costs to new development, without accounting for departmental capacity or any unique needs or costs of the proposed development. Especially in the case of relatively mature communities with adequate service capacity, the average cost approach tends to overstate the service cost impacts of new development, resulting in a negative fiscal impact. Conversely, it may understate the costs of service in a rapidly expanding community where departments are already at capacity.

The **marginal cost approach** requires a more detailed review of taxing district costs based on interviews with directors or representatives of each department to understand the true incremental increase in costs of providing services for particular proposed project. This approach specifically accounts for the available capacity to deliver services by estimating how different municipal departments will be affected by a given development. In the marginal cost approach, fixed costs are not considered since they are covered by existing development and not impacted by new development. The cost estimating focuses on the variable portion of departmental expenses that changes with new development.

Any estimation of fiscal impacts must be undertaken carefully, with individual departmental budgets thoroughly reviewed and considered. As noted above, results can be skewed—either positively or negatively—unless the community condition and service capacity are assessed.

DEVELOPMENT AND THE FISCAL PERSPECTIVE

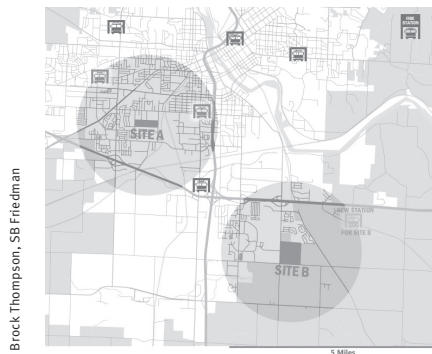
Several key factors drive fiscal impacts of development—whether infrastructure is in place or must be extended to serve the development, land-use mix, development density, and state tax policy, among others. These factors must be carefully considered to ensure the long-term financial sustainability of a community. However, fiscal impacts alone cannot drive community decisions on future development; fiscal health should account for other important community needs, such as placemaking, equitable development, and inclusive growth. Key takeaways on development from the fiscal perspective are described below.

Developments Requiring Major New Infrastructure Tend to Generate Fiscal Stress

New greenfield developments, particularly those on the urban-rural edge, typically require municipal extensions of infrastructure such as a sewer and water mains or arterial roads. Front-funding these infrastructure extensions speculatively to lay the groundwork for growth can lead to a fiscal burden for municipalities if future development does not occur or stalls as it did in

the Great Recession. Many municipalities therefore shift the initial capital cost of infrastructure extensions to developers.

However, even communities that have policies requiring developers to pay for upfront capital costs of transportation, sewer, and water infrastructure can experience fiscal stress from ongoing operating and future capital costs. Developer-funded infrastructure is typically publicly dedicated, with the long-term maintenance of the infrastructure a municipal responsibility and cost. This includes the public works department's snow removal and repairs to potholes and cracks on roads. Sewer and water maintenance costs are typically paid through user fees based on the volume of water usage;



➡ Greenfield development often requires extension of infrastructure and expansion of municipal service areas, triggering the need for new fire stations or other facilities. Communities do not always consider the fiscal stresses from associated long-term maintenance and capital costs.

if the fees are properly calibrated, they can offset the cost of providing sewer and water services. What is often not factored in a development decision are the future costs to resurface or reconstruct roads every 20 to 40 years.

Since motor fuel taxes (gasoline taxes) have remained flat for decades, municipalities will not be able to rely on their share of

these sources as a way to offset future reconstruction costs.

Similarly, developments that are located too far from existing fire stations or police patrol areas (beats) may be outside the municipality's standard emergency response times and trigger new costs. This could include personnel wages, vehicles and equipment, or capital cost increases related to new facilities, such as a fire station.

Communities need to be cautious and account for both the annual maintenance and future capital costs to ensure that developments are fiscally sustainable over the long term.

Focusing on Infill Areas With Infrastructure Capacity Is Fiscally Prudent

Municipalities already pay to maintain existing infrastructure within their jurisdiction; therefore, prioritizing new development in infill locations served by existing infrastructure with available capacity is fiscally prudent. New development in areas with existing roads adds little or no new operational or capital costs. Similarly, the cost impact of police, fire, and ambulance calls for service are typically minimized if new development is located within current police beats or fire station catchment areas. This allows existing infrastructure to be used as efficiently as possible and investments for further extensions of infrastructure can be prolonged until capacity constraints are being approached. Municipalities should proactively assess development pressures and infrastructure capacities within their jurisdiction and compare the financial cost-benefits of developing in different locations.

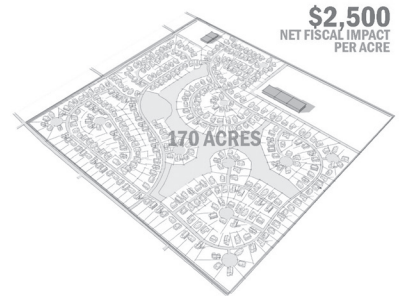
URBAN DENSITY

372
RESIDENTIAL
UNITS
70,000
RETAIL SF
0.2
MILES
ROAD MILES



SUBURBAN LOW DENSITY

377
RESIDENTIAL
UNITS
70,000
RETAIL SF
3.3
MILES
ROAD MILES



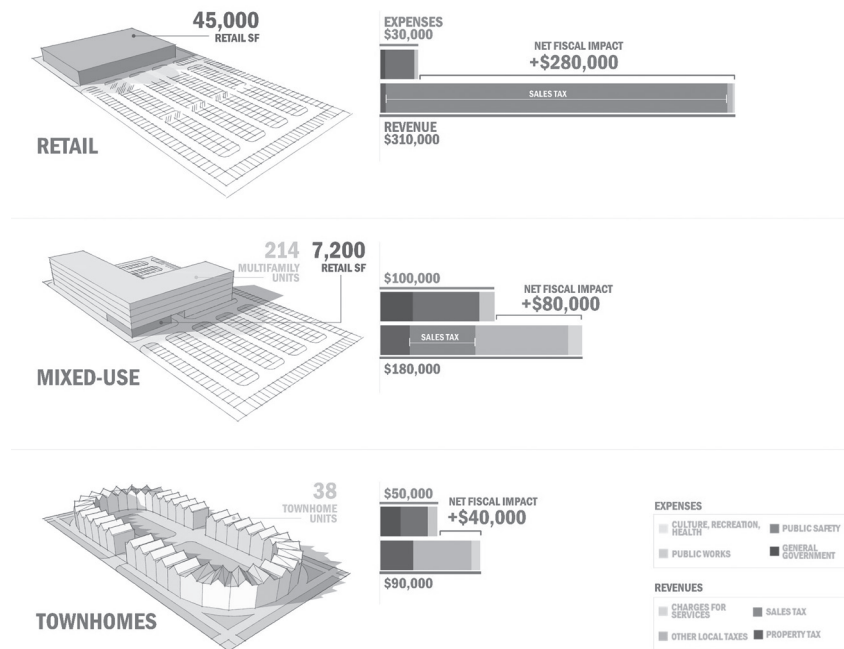
Elizabeth Ginsberg, SB Friedman

➡ Smart growth requires less new infrastructure for the same amount of development and reduces upfront capital and ongoing maintenance costs, compared to conventional suburban growth.

Municipal staff and officials can use this information to craft future land-use plans that simultaneously direct growth in fiscally efficient locations and outline strategies to finance infrastructure expansions to accommodate new growth.

Smart Growth Is Fiscally Smart

There is strong evidence that smart growth development patterns, characterized by compact, walkable places with a mix of uses, are fiscally more beneficial than conventional suburban developments that are spread out and auto-dependent. A 2013 study by Smart Growth America titled *Building Better Budgets: A National Examination of the Fiscal Benefits of Smart Growth Development* examined 17 nationwide case studies of these two development typologies and quantified the average municipal fiscal savings from smart growth development patterns. The study demonstrated the following:



- ➡ Varying the intensity and mix of land use on the same site generates substantially different fiscal impacts, with smart growth leading to higher revenues than conventional suburban development. Auto-oriented retail generates more revenue than any other land use in many states, leading to competition for retail development.

Smart growth development generally costs one-third less for upfront infrastructure. Because smart growth development is more compact, uses land more efficiently, and has a more diverse housing stock of varying densities, it can fit more development (in terms of units or square feet of building) in less land area than conventional suburban development that tends to have homogenous building types spread over a larger area. Because less land is used, smart growth tends to require fewer road miles for the same amount of development, resulting in lower total miles of road, sewer and water infrastructure. This directly translates to lower costs of upfront infrastructure for smart growth compared to conventional suburban growth.

Smart growth development saves an average of 10 percent in ongoing delivery of services such as police, ambulance, and fire service costs. The combination of relatively

lower road lengths and a more interconnected grid pattern typical of smart growth development reduces driving distance for service vehicles. This results in savings on fuel and personnel time, and in some cases leads to fewer personnel, equipment, and facility needs.

Smart growth development generates 10 times more tax revenue per acre than conventional suburban development. Smart growth development strives to create walkable environments with a sense of place. Evidence from multiple studies, including ones by Redfin and George Washington University, show that these environments are in higher demand; people and businesses are willing to pay a premium to live, work, or shop in them. These studies use Walk Score—a measure of walkability on a scale from zero to 100 based on walking routes to key destinations such as grocery stores, schools, parks, restaurants, and retail. The Redfin

study found that one Walk Score point can increase the price of a home by an average of \$3,250 or 0.9 percent. George Washington University's study, *Foot Traffic Ahead: Ranking Walkable Urbanism in America's Largest Metros 2016*, found that relative to drivable suburban areas, all 30 of the nation's largest metros exhibited positive average rent premiums ranging from four to 191 percent (and averaging 74 percent) for walkable urban real estate. This value premium translates to higher market value, which in turn results in more property tax revenues for a municipality. The value premium is significantly more pronounced on a per-acre basis since smart growth development is more compact and efficient than suburban development.

State Fiscal Structures Often Favor Big-Box Auto-Oriented Development in the Near Term

In general, following smart growth development strategies is likely to result in financially beneficial municipal outcomes. However, sales tax generating uses that might be highly auto-dependent can still generate significant financial benefits for municipalities in states with a local option sales tax.

There are 38 states in the nation that have a local option sales tax, which means that a specified percent (typically one to three percent) of the total sales from a retail establishment is distributed to the municipality where it is located. This fiscal structure favors high sales tax-generating uses such as regional malls, big-box retail stores, and auto dealerships, which tend to be auto-oriented and frequently located in conventional suburban development. The net fiscal benefits from these uses can surpass nearly all other land uses on a total-dollar basis or dollars-per-acre basis.

This fiscal reality creates an environment where municipalities are competing against each other to seek sales tax-generating uses over other uses with the goal of easing the fiscal burden on their residents. It is not uncommon for municipalities to offer incentives to developers or anchor retailers from their share of municipal sales tax to attract retail uses. While in the near term offering incentives to lure a sales tax

generating use is a rational approach for the municipality, it is not always beneficial for the larger region in the long term. When incentives are used purely as a way to attract a retailer from one neighboring jurisdiction to the other (rather than to cure a site development problem such as environmental remediation) there is no net benefit to the region.

Placemaking Will Endure

As long as state tax structures favor retail, municipalities will continue to compete for retail uses to strengthen their tax base. However, municipalities need to pay close attention to the rapid changes in retailing. E-commerce continues to be the fastest growing sector in retail, and it is dramatically disrupting brick-and-mortar retail. To be competitive, these retailers are focusing on creating a unique consumer experience that cannot be replicated online. The experiential component is not just internal to their physical stores but extends to the larger “place” where the stores are located. In response to these trends, retailers are increasingly preferring locations within activity hubs that include a mix of uses such as office, entertainment, education, and health care. To fit into these mixed use hubs, even retailers that have long favored auto-oriented, big-box formats with large surface parking lots are now adapting to create smaller format stores.

The continuously changing retail landscape also means that in the future, sales tax revenues from retail stores might be a less reliable source of revenue. Municipalities will need to diversify their tax base to build resilience toward such changes. By promoting mixed use activity hubs that have a strong sense of place, municipalities can simultaneously build a diversified tax base and attract retail formats of the future.

It Isn't All About the Fiscal Perspective

While municipalities have a core responsibility of fiscal stewardship, they also need to balance long-term financial sustainability with other important community needs, such as placemaking, social equity, and inclusive growth. Municipal planners have

a responsibility to strive to create neighborhoods that offer a high quality of life for a diversity of income, age, and household types. This requires planning for a diversity of land uses and real estate products—including affordable housing, workforce housing, and senior housing—that as individual projects may not have a positive net fiscal impact but serve other important social functions. Affordable and workforce housing, beyond ensuring residents from a range of backgrounds can live in a community, make businesses more competitive by allowing employers to recruit and retain employees close to their workplace. Senior housing allows community residents to age in place.

Therefore, a purely fiscal lens at the near-term, project-specific level is insufficient to ensure that a municipality is meeting long-term fiscal balance, community development, and policy goals.

THE CURRENT MUNICIPAL PRACTICE OF FISCAL IMPACT ANALYSIS

There is a constant tension between long-term goals and short-term priorities in municipal planning and financing considerations. The overarching planning and development frameworks are formulated for the long term: The comprehensive plan, zoning code, and economic development strategies set out an aspirational vision for what the community wants to be in the long term. In the near term, municipalities respond to and make decisions regarding individual development projects that may or may not meet long-term goals for a variety of reasons. These near-term decisions, even when made in ways that are consistent with the planning and regulatory framework, may have unanticipated consequences on municipal finances over the long term.

A Deal-By-Deal Approach to Fiscal Impact Provides a Limited, Short-Term Financial Snapshot

While critical long-term policies guiding growth and development are often the outcome of extensive planning processes and incorporate a wide range of considerations, all too often they do not carefully consider

municipal fiscal balance: Does the planned development ensure a balanced fiscal future for the municipality? Is it even achievable based on market conditions? Or is it setting up a situation where service capacity will be strained, substantial investments (such as a new fire station) are likely to be required, or long-term operating and maintenance costs cannot be supported by new revenues?

Many municipalities do consider fiscal impacts, as they are often inherently incorporated into comprehensive plans and zoning ordinances. It is common knowledge that retail uses tend to be fiscally positive, as they can generate substantial revenues with relatively low costs of service, and that large single-family home developments are likely to increase service costs. Communities therefore often over-plan or overzone for retail and commercial uses, reserving as much land as possible for a potentially positive use that may not be feasible based on the local real estate market. At the same time, entrenched ideas about the costs of service for certain uses may lead communities to limit certain types of development.

Near-term municipal fiscal considerations that impact planning and development decisions often receive more attention than long-term efforts and may have unintended or unexamined long-term impacts. Municipal administrators and finance directors must consider the costs of providing critical municipal services—fire and police protection, maintenance and replacement of infrastructure, etc., every year—ensuring that sufficient revenues are generated to cover costs. Inflationary pressures cause service costs to increase, even when the level of service remains constant. Revenue generation may be challenging, as state and federal resources have declined, population growth has shifted, and growth in tax revenues stagnated following the Great Recession. Municipalities may be unable or unwilling to increase tax rates, facing pressure from residents to limit new spending. It is therefore critical to control costs of municipal service by ensuring that development occurs in ways to either use existing capacity or consciously expand service areas to particular geographies.

Decisions made by municipal governing bodies, zoning boards, plan commissions, and staff on a deal-by-deal or site-by-site basis often reflect these tensions. Approval of a planned development, requested rezoning, conditional use, or annexation is made within the long-term framework (zoning code, comp plan), but is often driven by particular considerations specific to the time and place, including whether the project is likely to increase revenues or costs, and to what extent. In many municipalities, the anticipated fiscal impact of a project is one consideration when a zoning amendment or public financial assistance is required. Understanding the municipal revenues and costs associated with individual projects is an important first step in ensuring long-term fiscal balance, but it is insufficient on its own.

Evaluating Long-Term Fiscal Balance and Policy Trade-Offs Requires a Holistic Assessment

While individual decisions may appear fiscally smart on a case-by-case basis, in the aggregate, such decisions may have unanticipated consequences. A particular development project may have little or no impact on municipal costs of service, but several consecutive projects may tip the balance. All of a sudden, it seems, a new police beat is required or a new fire station must be constructed at considerable expense. Such service needs often build incrementally over time, depending on where development is going. On the other hand, municipalities may deny uses that appear fiscally negative on their own. Senior-oriented housing is often associated with a high volume of calls for service, resulting in higher annual municipal service costs than revenues. If a municipality considers only the fiscal benefits of development, senior housing would be undesirable, but there are important policy considerations that make providing senior-oriented housing desirable. The same goes for affordable and workforce housing—relatively lower values (due to intentionally restricted rents and sale prices) depress municipal revenues, but such housing

serves a critical municipal function. It is clear that considering fiscal impacts of individual projects in isolation is insufficient to ensure a community can achieve long-term fiscal balance while also meeting broader policy objectives. These goals are best addressed at a community level rather than project level, analyzed as part of holistic conversation centered around community goals and required trade-offs.

A PATHWAY TO FISCAL BALANCE

Municipalities have an opportunity to evaluate fiscal and policy trade-offs and make a reasoned decision to accommodate growth and maintain fiscal balance. Incorporating fiscal balance into the comprehensive plan and zoning code ensures that the long-term vision is fiscally sustainable and provides a framework for implementation. Fiscal impacts of future development should be considered in the aggregate, not just on a project level, considering the location, type, and character of anticipated development. This analysis should build on the market analysis conducted as part of the comprehensive plan, ensuring that the anticipated development is feasible; without market support, the comprehensive plan and zoning code represent a vision that cannot be achieved, likely leading to ad hoc zoning changes later when planned uses don't materialize.

Communitywide fiscal analysis provides critical information indicating whether the desired land-use mix and community character will result in long-term fiscal balance. Such information allows the municipality to direct growth to areas with existing infrastructure and service capacity and calibrate impact fees and fees for service to fully cover the costs of new infrastructure or service related to expansions.

Incorporating fiscal balance into the regulatory framework guiding planning and development presents a new paradigm for comprehensive planning and zoning. This deliberate consideration to balance community goals of financial sustainability with a mix of land uses can set municipalities up for success, guiding decisions on how to grow and where to grow.

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Creating Great Communities for All

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HOW DOES YOUR COMMUNITY USE ZONING TO PROTECT FISCAL HEALTH?

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