

Understanding the tax base consequences of local economic development programs

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It is generally accepted by economic development professionals and municipal officials that new real estate development will not only enhance the economic base of the community, but that it will also expand the tax base. The purpose of this article is to show that this is not always the case, and that new developments, if not properly planned, can in aggregate have a negative impact on the tax base. A recent case study prepared for Concord, New Hampshire, is used to illustrate some of the main points discussed herein.

Economic development traditionally focuses on such things as job generation, the provision of affordable housing, and the creation of retail centers. Tax base expansion focuses primarily on maintaining and enhancing real estate values within the municipality. In the author's professional experience, based upon working with cities and towns throughout the United States, municipalities tend to pursue economic development with almost a religious fervor, and often do not think strategically about the overall real estate impacts of their economic development initiatives. Yet, the existing tax base in almost every municipality throughout the United States is an important source of revenue for funding municipal and school expenditures.

For public sector officials it is important to recognize the potential for a conflict between these two distinct, yet overlapping areas of public policy, and to establish procedures to achieve the proper balance in this regard. For real estate investors it is important to recognize when public policy is not fully cognizant of the impact of its actions on the real estate market, because of the potential negative impact on property values. This article concludes with a series of recommendations for municipal officials to help them ensure that economic development projects in their community truly do enhance the local tax base.

THE CONFLICT: HOW DOES IT OCCUR?

The conflict between economic development and tax base expansion can occur in one or more of the following ways:

New Development Detracts From an Existing Component of the Tax Base

Many forms of new development can detract from the existing tax base. Some examples include a new shopping center which has a negative impact on business and vacancy rates downtown; a new prison which creates a negative impact on an adjacent residential neighborhood; and a large subsidized housing project which adversely impacts market rate rental housing values. Naturally, not all new development within a community will have a negative impact, but these are three examples of the types of projects which can. Municipal officials need to be cognizant of the potential for negative impacts, and if they still decide to proceed with the development, to establish procedures for mitigating these impacts.

Zoning Does Not Properly Protect Existing Values

Zoning is the tool by which most municipalities establish and maintain certain land uses. Generally, zoning is relatively restrictive, except in certain cases where problems can occur.

The two most frequent problems the author has encountered are in the typical office/industrial zone and at the edge of two incompatible zones. Within an office/industrial zone, property values can vary substantially. Suburban office buildings typically cost \$90 to \$110 per square foot, while light industrial and warehouse buildings cost around \$30 per square foot. Also, parking, lighting, and landscaping requirements vary substantially. Why communities mix these uses in the same zone is not clear, but it is akin to allowing a mobile home park in the middle of an exclusive single-family residential community. The addition of an industrial building into an area of established office buildings will have a negative impact on the value of the office buildings.

The second type of conflict can occur when an industrial park is developed adjacent to a residential neighborhood without an adequate buffer, or a shopping center generates increased traffic through an existing residential or commercial area.

An Inordinate Emphasis is Placed on New Development

Many municipalities seem to forget about their existing tax base and infrastructure. Older neighborhoods, shopping centers, and industrial areas are allowed to "exist," but public policy and funding is directed to new development or possibly downtown revitalization. Yet even if these new developments are extremely successful, they seldom contribute more than one or two percent to the tax base. Meanwhile, the existing tax base in the rest of the municipality declines.

The purpose of these three examples is to illustrate some ways in which a municipality can pursue new development at one location and inadvertently cause property values to decline at another location. The following case study for Concord, New Hampshire, which was prepared by the author, illustrates these points more fully.

CASE STUDY: CONCORD, NH

Concord, the capital city of New Hampshire, has an estimated population of 39,000. The city is located in the central part of the state and has excellent regional highway access. The Merrimack River runs through Concord, but because of highway locations, the city is largely cut off from access to the river. Although total land area in Concord exceeds 41,000 acres, only a small portion of it is developed.

Concord is in the enviable position of having added over 2.8 million square feet of new commercial and industrial development in the last 12 years. The total assessment in the city, however, declined from \$1.9 to \$1.5 billion, or 19 percent, since 1990 (Figure 1). Part of this decline is attributable to the recession at the beginning of the decade. Although real estate markets have recovered throughout much of New Hampshire since 1990, Concord's real estate values have languished. Today Concord has one of the highest tax rates in the state.

To help address the question of why, the city was divided into 10 sub-districts which were then evaluated for performance trends using the tax assessors data base (which fortunately was fully automated). Residential, retail, industrial, and office property trends, along with zoning and existing land uses, were then compared within each sub-district. The findings from this analysis were as follows:

New Retail Development Had Been a Mixed Blessing: Retail values were relatively high in the major development corridors, but the assessment data indicates that older retail areas, in and around the downtown, were losing value as a result of additional competition. Alternate uses have not been found for these declining areas.

Commercial Encroachment Into Residential Neighborhoods Had Created Use and Value Conflicts: Commercial and industrial encroachment into residential neighborhoods was having a negative impact on residential property values. Since residential property represented 57 percent of the municipal tax base, the overall impact on assessed values was sizeable.

Office Development Was Not Properly Segregated From Light Industrial/Warehouse Uses: Current zoning allowed office and industrial property to be mixed in the same zones. The result was that developers were building lowend office space because of uncertainty over long-term values, so the city was not realizing the full value potential from office development within the community.

Office Development Was Not a High Priority Despite Its Tax Base Benefit: Concord, being the state capital and having an excellent regional location, has strong office market potential. However the city had not developed a first class office park, despite the fact that in percentage terms office development utilized a relatively small land area which creates the highest tax base yield (Figure 2).

Residential Development Was Not Balanced: Residential development over the years was not balanced between affordable, middle income and upper-end housing. For example, recent attempts to build an upper-end, empty nester golf course community were thwarted by environmentalists, while affordable rental housing projects proliferate and have adversely impacted the value of market rate rentals as well as for-sale properties.

No Adaptive Reuse Strategy Existed: The city placed an excessive emphasis on preserving and reusing older buildings. The city had over one million square feet of vacancy in older buildings which are physically, functionally, and economically obsolete, and which in many cases occupied prime real estate. These vacant buildings had a negative affect on adjacent properties, yet the city had no real plan to work with developers to recycle or demolish these properties. Also, since these properties were zoned for office usage, and were empty, the city incorrectly assumed no office market existed.

The net result of this analysis showed that while substantial new growth had occurred in Concord, it had often been to the detriment of existing property values. The city also lacked a long-term strategic focus for managing its tax base and did not fully understand the linkage between tax base management and economic development.

RECOMMENDATIONS FOR BALANCING ECONOMIC DEVELOPMENT AND TAX BASE EXPANSION

The experience of Concord, New Hampshire, is typical of other municipalities across the United States. Well-intentioned efforts to bolster local economies often have unintended negative consequences on some portion of the tax base. Also, state and federal policies and actions, such as the location of a new highway, can have both positive and negative impacts on local real estate markets. Within this context, as well as local politics, the economic development professional must function.

The following recommendations are offered to municipalities seeking to not only pursue economic development but also to maximize the tax base benefit from these initiatives.

Monitor Land Uses and Tax Base Contributions - From a strategic perspective it is important to understand not only how land is being utilized within a community, but also the respective contribution of different types of land uses to the tax base. For example, in Concord residential properties represented 57 percent of the assessment in the city, and residential values were declining faster than the city could add new commercial and industrial tax base. It

became readily apparent that a neighborhood revitalization strategy was almost more important than building another industrial park.

Evaluate Impacts of New Projects - Politicians and economic development professionals often assume that a new project, such as a shopping center, is good for the community at large as well as the tax base. While this may be true, it may also be true that the market cannot support a new center without having an adverse impact on either the downtown or existing older centers. As a result the community may gain tax base in one location, only to see values decline in another.

Monitor Real Estate Markets - It is important for economic development professionals to monitor all real estate markets in their community, and to initiate actions to maintain the viability of these markets.

Do Not Compete With the Private Sector - Many municipalities develop industrial parks and sell the land at or below cost to attract new employment. This concept often makes sense in areas of dire economic need, but does not make sense in a healthy economy and vibrant real estate market. In the case of Concord, NH, the public sector was marketing office/industrial land for around \$25,000 per acre when the private sector was trying to sell similar land at up to \$50,000 per acre. Yes, the lower priced land helped attract some tenants, but it also reduced the real estate value of the private sector's property.

Separate Office and Industrial Uses Where Possible - Office and light industrial uses are typically included in the same zone in most municipalities, however office buildings often cost three times more than industrial buildings to build. This type of value disparity among uses does not benefit the tax base anymore than mixing subsidized housing and single-family homes in the same neighborhood. Also office parks require a more comprehensive set of design standards and guidelines to remain viable, similar to an upscale residential community.

Utilize Incentives - Traditionally municipalities utilize incentives to attract businesses to create jobs, and it works. Why not use incentives to enhance the real estate asset, such as a zoning density bonus for good design? Commercial and industrial tax abatements are not recommended because they can mushroom out of control, and ultimately can place too much of a burden on residential property.

Include the Tax Assessor in the Economic Development Process - In most municipalities, the economic development function is managed by an economic development department (or authority) and there is usually a strong working relationship with the Department of Public Works. The tax assessor is seldom consulted, but in the author's opinion, should be an integral part of the team.

Establish Design Standards - Design standards can help a community derive the maximum tax base benefit from a project. Little things, like a brick facade on an industrial building, rather than cinder block or corrugated steel, can make an important difference in the value of the building and in the overall image this project represents to the entire community.

Buffer Potentially Incompatible Uses - Many communities experience conflicts between industrial and residential zones or commercial and residential areas. These conflicts may arise from traffic, noise, or simply a gradual encroachment as properties are converted (via a variance) from one use to the other. For example, in Concord single-family residential properties adjacent to the downtown have been converting to multi-family or office usage. The land use and parking requirements of these various uses are different, which can cause conflicts and an ultimate loss in property values. Where possible clear buffers and boundaries should be established.

In summary, the concept of tax base management is really one of asset management and is particularly important in states where municipalities derive much of their revenue from their real estate assessments. To underscore this point, it was demonstrated to city officials in Concord that a five percent overall increase in the assessed value of existing property would have the same impact on the tax rate as the addition of two million square feet of new industrial property or one million square feet of new office/R&D development, both of which are likely to take 15 or more years to realize.

In addition to being responsible for managing the tax base, a community should also be responsible for helping to ensure economic prosperity for its citizens. These two goals can be in conflict unless a long-term view is taken regarding public policy actions, and if the impacts of alternate development actions and programs and priorities are not carefully evaluated. In the author's experience, good tax base management will lead to even better economic development because investors and businesses will want to be in your community. Instead of offering incentives to attract business, they will be willing to pay to come to your community because it is a good place to live, work, shop, and play.

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