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**BRIEFLY**

**The Growth Management Act presents several challenges for the real estate development industry. The help of local governments in meeting these challenges is critical to the success of Smart Growth.**

# Growth Management Effects on Real Estate

As communities develop their visions for the future, they are deciding how much land is needed for their growing populations. Washington State, under the 1990 Growth Management Act, and dozens of cities and counties around the country, have drawn geographical boundaries designed to halt sprawl and concentrate development into urban growth areas (UGAs). By channeling growth into these urban areas, and assuring the appropriate infrastructure is available, government intends to encourage economic development even as it preserves environmental quality.

But early examples of how these policies actually play out in real life demonstrate that growth management can have serious, unintended consequences. It has contributed to increases in land prices and development costs. These, in turn, have driven up new housing prices and placed an upward pressure on prices for existing housing.

The following paragraphs discuss how growth management has affected the real estate market, including buildable lands within the UGAs. As well, because financing of real estate development projects is so critical to their success, this paper reviews the financial community's wariness of Smart Growth projects, and how local governments are responding.


## Urban growth boundaries restrict supply, contribute to increased real estate prices

The intention of urban growth boundaries is to promote "smart growth," rather than to stop growth. Communities that draw growth boundaries seek to balance several goals, including stimulating economic development while preserving resource lands and rural areas. However, without revising existing land use policies and regulations to accommodate them, such boundaries limit the supply of land for new housing, leading to higher prices both for vacant land and for existing housing within the boundaries.

Consider Portland's example. As part of Oregon's statewide growth management law, a growth boundary was drawn around the Portland area in 1979. It encompassed 24 cities and three counties. The regional government, Metro, sought to increase housing density and to redevelop urban areas. "Meanwhile," according to a 1999 study published by the Reason Public Policy Institute, "housing prices have increased dramatically. In less than a decade, Portland has transformed itself from one of the most affordable to one of the least affordable housing markets on the West Coast. While inflation as measured by the Consumer Price Index increased by 52.5 percent from 1990 to 1995, lot prices in Portland more than doubled," the study says.[1]

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Efforts to widen the Portland boundary have met resistance from environmental activists and zero-expansion advocates, according to the study. In a compromise between these interests and pro-development groups, Metro voted to expand the boundary in late 1998, but not by much. Since then, Metro has agreed to extend the boundary still farther, in a move to dampen the rapidly rising cost of housing.

What is happening in the Portland area is typical of conditions in many parts of the country, according to the National Association of Home Builders (NAHB). As a result, debate has sharpened "over urban growth that is restricting development patterns and inflating the value of land still available for residential use."[2]

The debate has also heated up in King County. In line with the state's Growth Management Act, King County established its urban growth boundary in 1994. Combined with soaring job and population growth in the mid to late 1990s, housing prices in the UGA skyrocketed.

The rising cost of housing in King County has been exacerbated by strict local zoning codes that often do not permit higher residential densities. The Seattle-King County Association of Realtors, in a 1997 study, concluded that the county's cities had failed to allow for enough housing and were behind schedule by about 12,600 units (over the six-year period from 1990-1996).[3] Indicating a generally positive market response, but still suggesting a problem of some magnitude, King County agreed that its cities were collectively behind schedule, estimating a shortfall of 1,450 housing units over the three-year period from 1995 to 1997. [4]

According to the Washington Center for Real Estate Research, which says that a "6-month supply describes a fairly balanced market," King County has "a scant 1.8-month supply of homes priced under $80,000." In a recent news release on housing supply, Center Director, Glenn Crellin said, "King consistently has the most limited supply, with only a total 3.6-month's inventory for all price ranges…indicative of continued price increases."

In an attempt to keep up with the market demand, Seattle has increased the number of permits it has issued. In a new report the city says that Seattle issued 6,685 housing permits in 2000, up 50 percent from the prior year. New condominium and apartment complexes of 100 units or more accounted for more than half of the housing growth — the fastest the city has ever seen, according to the report. About 2,500 of the units — 37 percent of the total — are scheduled for the greater downtown area.[5]

This record housing boom is probably still not enough to fill market demand. For example, for every five jobs created in Seattle during the past five years, only one housing unit has been built. Not surprisingly, the jobs-housing balance on a county-wide basis is not as severe (for more information on the jobs-housing balance question, see Washington Research Council, ePB 01-1, *Managing Growth is a Balancing Act*). Meanwhile, low vacancy rates have pushed rents up by an average of 25 percent in the past five years.[6]

An example of the difficult struggle to manage rapid sprawl in rural areas and direct development to urban areas is playing out currently in King County. The County Council adopted a controversial moratorium as part of the county's

updated Comprehensive Plan. Prohibiting large schools and churches outside urban growth areas, the moratorium will last nearly a year while a task force reviews the issue.

King County Executive Ron Sims requested the moratorium, which was then approved by a majority of the council. They expressed concern that such facilities produce traffic congestion on rural roads and require heavy infrastructure, such as sewer lines.

Moratorium supporters say churches are trying to develop inexpensive or donated property that will, in turn, spur more development. Meanwhile church officials are organizing their opposition.

## Concept or reality - developing inside Urban Growth Areas

From a bureaucratic standpoint, the definition of "buildable land" includes any area within the UGA that meets the Smart Growth criteria of more efficient land use and preservation of environmentally sensitive land.

From a developer's viewpoint this can be only achieved by increasing density and building more compactly. According to the National Association of Home Builders (NAHB), compact development helps reduce infrastructure and development costs, provides more opportunities for pedestrian access, promotes densities that can be served more efficiently by mass transit, and results in more affordable housing.[7]

Compact development could be clustered single-family homes in the suburbs, higher density housing around transit stops in the inner suburbs, or traditional neighborhoods with mixed uses. NAHB suggests several alternatives for compact development: Cluster Developments, otherwise known as Open Spaced Development or Conservation Development, Higher Density Development, Traditional Neighborhood Developments, Transit-Oriented Developments, Master Planned Communities/Planned Unit Developments, and Mixed-Use Developments.[8]

Every community has unique housing, economic and environmental goals. Smart Growth concepts have taken on many different and innovative forms to balance the interests of all involved parties. Consider just three examples:

In the city of Frederick, Maryland, a northwest suburb of Washington D.C., there is a large mixed-use development receiving national and international acclaim from designers, builders, and homeowners alike. Wormald's Mill seeks to mimic patterns and densities of development from years past. The 307-acre development has a mix of housing types, including condominiums, duplexes, quad units, and single-family homes with prices ranging widely from $105,000 to $350,000. In addition, more than 100 acres of the site are designated for natural parkland.[9]

In Portland, developers are using smart-growth strategies to accommodate the brisk demand for retail space. They are restoring older buildings within the Portland city limits and constructing mixed-used properties. Still, new supply continues to trail demand, keeping retail vacancy rates very low — hovering around three to four percent since 1994 — compared to the U.S. average of seven

to eight percent. Tight supply, in turn, has led to increasing lease rates and sales prices. On average, rents in Portland have climbed 25 percent since 1995, while sales prices have risen more than 20 percent over the same period.[10]

Closer to home, Redmond Ridge is a master-planned community near Redmond. Situated on 1,000 acres, the project will eventually hold 1,500 homes and condominiums ranging from $180,000 to $460,000, 272 apartments, 4,000 to 5,500 people, a 1.2 million square foot business park, 100,000 square feet of retail, and more than 600 acres dedicated to parks, trails, wetlands, and forests. The development plans include more than 14 parks, including soccer and baseball fields, a 4,000 square foot community center with tennis, volleyball, and basketball courts, playground equipment, meeting rooms, and a community YMCA, and 15 miles of hard and soft-surface trails. Six builders – Quadrant, Centex, Meadow Ridge Homes, Carino, CamWest, and Simpson Housing – are involved in the initial residential phases, with future development to include a retail center, fire station, new elementary school and a high tech business park.

Often, however, local zoning codes do not permit compact development. And even when land is zoned appropriately, citizen opposition can prolong the permit approval process (as it did at Redmond Ridge), run up development costs with expensive legal fees, and even defeat some projects in the end.[11, 12]

So, while development within the UGA is technically possible, maybe a demonstrable improvement over existing conditions, local regulations, property rights and values, political and citizen opposition often combine in a way that — at a minimum — drives up real estate prices. In the most severe instances these conditions can cause the developer to abandon the project all together.

## Support of the financial community is critical, banks say "show me"

All this has not been lost on the financial community, which has been slow to embrace Smart Growth. Banks are rationally reluctant to finance projects that require variances in local zoning code or that may meet with organized citizen resistance. Yet, Smart Growth's ability to move forward and demonstrate success depends greatly upon the financial community's willingness to invest.

There are several obstacles that are causing most of the problem.

1. Difficulty identifying suitable comparables during the appraisal process;
2. Lack of good market research to show the financial feasibility of higher-density smart growth projects; and
3. No clear presentation of project objectives, risks, and mitigation alternatives.

Projects that entail heavy upfront costs, including potential legal expenses of defending against community opposition, greater expense of environmentally sound infrastructure, and the possibility of being politically derailed have a greater challenge in obtaining financing.[13]

These problems have led to finger-pointing as to who bears responsibility for Smart Growth's success.

During an Urban Land Institute (ULI) Smart Growth forum held in April of

2000, some participants argued that the banking community should look beyond the bottom line, partner with each other to achieve better yields and reduce risks, increase their awareness of community visioning, and adopt incentives such as smart growth credits, in order to accommodate more and better Smart Growth projects.

Others say it is government that is promoting this kind of development, so it should underwrite and thereby reduce the financial risks for the private investment community. Senior Urban Land Institute executive Ron Terwilliger from Trammell Crow stated, "There are developments that are not economically feasible unless the government contributes either through tax-increment financing or direct construction of some of the infrastructure."[14]

Not surprisingly, these views have their detractors. Over time, however, these problems will be addressed and eventually disappear as more Smart Growth developments are built and demonstrate a track record of community acceptance and financial success.

In the meantime, developers look to alternative sources of financing such as real estate investment trusts (REITs), pension funds, and insurance companies and they are using nationally successful developments as surrogates for local comparables in order to bolster their financing applications.[15]

## Local governments respond

The ultimate goal of land use planning models like Smart Growth is to create more livable communities and improve land use efficiency. Their objective is to increase urban densities and preserve open space. However, the transition from more traditional planning policies to these new views on development policy is resulting in adverse impacts on local housing markets, as witnessed by recent examples in Portland, Oregon and King County, Washington.

In addition to widening the boundaries and allowing more area to be designated "urban," local governments have identified other steps to achieve Smart Growth goals. These include:[16]

- Streamlining and expediting permitting processes for developers;
- Encouraging a wider variety of housing options;
- Allowing smaller residential lots and expanding the range of allowable lot sizes;
- Permitting manufactured housing on individual lots;
- Providing density or height bonuses for including affordable housing in a project;
- Encouraging infill development where infrastructure already exists;
- Establishing minimum densities in residential zoning. (For example, requiring that houses be sited to allow future development at densities similar to older towns and small cities;
- Rehabilitating older buildings;

- Reintroducing the mixed-use concept into permitted development (Mixed-use includes apartments or condominiums built above retail and commercial development);
- Preserving or improving existing housing stock;
- Allowing accessory dwelling units or "granny flats" in single –family residential areas;
- Approving market-rate housing developments that include some low-income housing units;
- Providing tax incentives for multifamily housing in urban centers;
- Encouraging using old-style homes, with front porches and alleys in the back, to foster livable walkable neighborhoods;
- Allowing townhomes and zero-lot line homes; and
- Incorporating the regional "fair-share" affordable housing concept into policies and plans to more equally contribute towards housing needs with a region.

In order to achieve a reasonable balance between quality of life, affordable housing, and economic growth, communities will need to find solutions appropriate to their specific circumstances. But, the bottom line message seems clear. As Snoqualmie Mayor R. Fletcher was quoted recently, "We are going to have growth…There's no way around it."[17] Now, we need to anticipate and accommodate it as best we can.

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## ENDNOTES

[1] A Line in the Land: Urban-growth Boundaries, Smart Growth, and Housing Affordability, Reason Public Policy Institute, by Samuel Staley, Jefferson Edgens and Gerard Mildner, November, 1999.

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[5] "Record Number of Housing Units Approved in 2000", City of Seattle News Advisory, Department of Design, Construction, and Land Use, January 1, 2001.

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