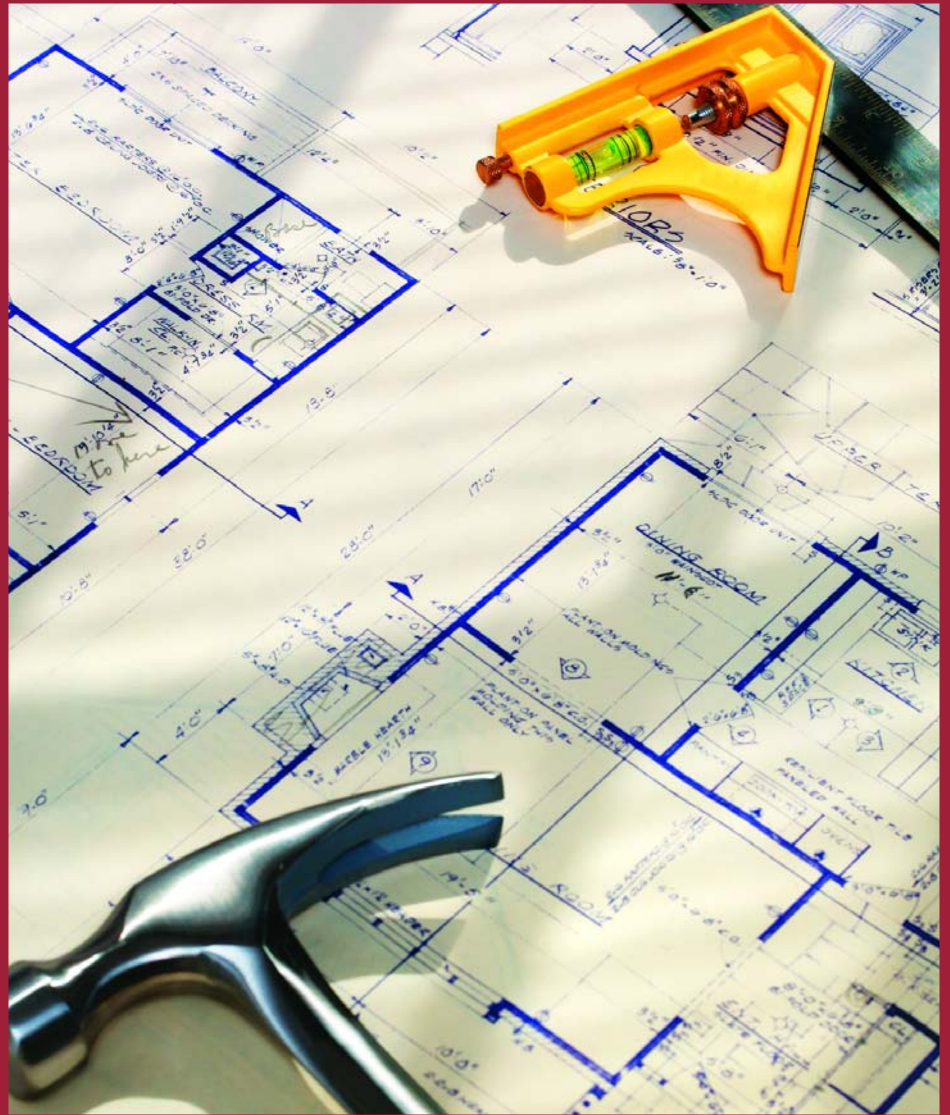

are new housing and commercial developments subsidized?

Are New Housing And Commercial Developments Subsidized In Hampton Roads?

To grow faster than one is able to manage is flirting with disaster.

—An Wang, founder of Wang Laboratories

Most people believe economic growth is good because it produces jobs, tax revenues to support public services, increased amenities and, if Pearl Buck was correct, because it contains a mysterious "germ of happiness." Population growth is both a cause and a consequence of economic growth. People follow jobs and, to some extent, jobs follow people. Most often, people follow jobs and that is why the population of Hampton Roads did not grow as rapidly as that of the Commonwealth of Virginia during most of the 1990s.

Between 1991 and 2002, the population of Hampton Roads grew by 139,792, or 9.78 percent. As Table 1 illustrates, among the region's larger cities, only Chesapeake, whose population increased 34.96 percent, and Suffolk, whose population increased 32.72 percent, grew more rapidly than the state average of 14.4 percent. The fastest-growing areas in our region were (in descending order) James City County/Williamsburg, Chesapeake, Suffolk and York County/Poquoson. In these areas, the population grew at least 31 percent between 1991 and 2002. During the first part of this period (1991-96), Chesapeake and York County/Poquoson grew dramatically by 21 percent and 23 percent, respectively. By contrast, growth in Suffolk and James City County/Williamsburg has been a more recent phenomenon, with their populations increasing by 25 percent and 22 percent, respectively, between 1996 and 2002.

The question we address in this chapter is, on the face of it, a simple one. When communities grow and new subdivisions are constructed, do cities and counties subsidize these developments with tax revenues derived from other segments of the community? Or, alternatively, does economic growth pay for itself by generating tax revenues at least equal to the tax revenues expended to support the development? Roads must be constructed, schools built, public safety provided, parklands and recreation facilities created, and a variety of utility, health and sanitation services provided. Do developers and new residents pay their own way? Or, do others subsidize them? That is our focus in this chapter.

TABLE 1
CHANGES IN POPULATION IN HAMPTON ROADS, BY CITY AND COUNTY, 1991-2002

Area	1991	2002	Percent Change
Chesapeake	151,976	205,100	34.96%
Hampton	133,793	145,200	8.53%
Newport News	170,045	179,300	5.44%
Norfolk	261,229	234,100	-10.39%
York/Poquoson	53,427	70,400	31.77%
Portsmouth	103,907	98,400	-5.30%
Suffolk	52,141	69,200	32.72%
Virginia Beach	393,069	428,400	8.99%
James City/Williamsburg	46,389	64,400	38.83%
Gloucester	30,131	35,000	16.16%
Isle of Wight	25,053	30,500	21.74%
Mathews	8,348	9,300	11.40%
Hampton Roads	**1,429,508**	**1,569,300**	**9.78%**
Virginia	**6,189,197**	**7,078,515**	**14.4%**

A considerable literature exists in urban planning that uses value-laden terms such as "urban sprawl" and "smart growth." Because to some extent growth is inevitable, the manner in which such growth is accommodated becomes very crucial. Will growth result in urban sprawl (characterized as "bad"), or will it be smart growth (synonymous with "good")? Of course, what to one person is obnoxious, uncontrolled sprawl may to another person be smart, efficient growth. In this chapter, we will concentrate upon the tax revenue and expenditure implications of growth, although we recognize growth generates other effects as well.

In a keynote speech at Brookings Symposium on the "Relationship Between Affordable Housing and Growth Management" (May 29, 2003), real estate authority Anthony Downs stated, "Growth management means specific regulatory policies aimed at influencing how growth occurs, mainly within a locality. These affect density, availability of land, mixtures of uses and timing of development. Growth management seeks to accommodate growth rationally, not to prevent or limit it. That is growth control." He continued, "Smart growth refers to an overall set of broad goals designed to counteract sprawl. These usually include (1) limiting outward expansion; (2) encouraging higher-density development; (3) encouraging mixed-use zoning; (4) reducing travel by private vehicles; (5) revitalizing older areas; and (6) preserving open space. Promoting more affordable housing can be a goal, but usually is not."

According to Jan Brueckner (International Regional Science Review, 2000), urban sprawl, as opposed to smart growth, is the result of three market failures. The first is a failure to take into account the social values of open space when land is converted to urban use. The second is a failure on the part of individual commuters to recognize the social cost of congestion created by their use of road networks. The third is a failure on the part of developers to take into account public infrastructure needs (roads, schools, etc.) and similar costs generated by their projects. To remedy these market failures, Brueckner proposed: (1) a development tax on each acre of land converted from an agricultural to an urban use; (2) congestion tolls on automobiles; and (3) a system of impact fees to cover infrastructure costs. Brueckner noted that growth inevitably generates costs, which are not necessarily reflected in housing prices and tax rates. In other words, some costs of this growth are passed on to others. For the most part, this occurs because builders and local authorities fail to take into account the governmental operating infrastructure and public service costs generated by new residential developments, but also because developments also may impose other kinds of costs on citizens, for example, traffic congestion and crime.

Increasing awareness of the costs of sprawl has triggered an intense debate about growth around the country. Legislatures in several states have begun to take initiatives to create what they believe to be smart-growth frameworks. Bruce Katz, in an analysis done for the London School of Economics in 2002, points out that these initiatives generally appear in five distinct and yet complementary forms. Some jurisdictions have:

- Created new forms of metropolitan governance to handle transportation, environment, waste management, cultural amenities and economic development. [Here in Hampton Roads, we have the Hampton Roads Sanitation District and Hampton Roads Transit.]
- Instituted land-use reforms to manage growth at the metropolitan fringe. [The "Green Line" and the "Transition Area" in Virginia Beach are examples.]
- Used their resources to preserve tracts of land threatened by sprawl. [Additional parks in cities and counties throughout the region provide illustrations, though they have not always been connected to developments.]
- Directed infrastructure investments toward specific areas. [Provision of land for the Virginia Beach Higher Education Center is an example.]
- Considered tax reforms to reduce fiscal disparities between jurisdictions. [By and large, this has not occurred within the region, though some action has been taken at the state level. Once again, however, that action has not necessarily been connected to new developments.]

Many high-growth states have established impact fees charging developers for the cost of infrastructure associated with new developments. These fees are applied regardless of whether the property owner has the necessary zoning in place to develop the property. The Code of Virginia prohibits the use of impact fees in the Commonwealth. As we shall see, this is a legal prohibition that has generated significant problems.

However, the Commonwealth does permit localities an opportunity to establish a conditional zoning ordinance. Such an ordinance allows localities to obtain a voluntary proffer (cash or in-kind contributions that can be applied to offset the cost of infrastructure) from developers seeking to upgrade zoning of land. A typical example involves a developer seeking to rezone agricultural land, which has a low impact on city services, to residential land, which will have a much higher impact on services. Note that if the developer owns land that already has appropriate zoning, then no proffer can be required and there is little a Virginia city or county can do to prevent that developer from developing that land and thereby imposing costs on other individuals. **The key in Virginia, then, is zoning decisions. This is where the rubber meets the road insofar as development costs are concerned.**

Many studies of the fiscal impact of development (revenues vs. expenditures) suggest that residential growth has a negative fiscal impact on a locality. Single-family homes generate the largest deficit, primarily due to the cost of educating the children who inhabit these homes. Apartments and townhouses, on the other hand, often are fiscally neutral or even slightly positive. Most nonresidential uses (businesses) usually generate more tax revenues than they require. Yet, as we will see, much depends upon individual circumstances.

If a community can demonstrate a sufficient backlog of infrastructure needs and documents its difficulty in providing the anticipated services needed for a development, then it can deny a rezoning request. Because this is often the case in some communities, developers often will include a proffer in their request for a rezoning. However, experience suggests city and county authorities often exhibit a tendency to approve rezoning requests without examining the precise fiscal consequences of the growth the rezoning will produce.

Some Clarifying Examples

The fundamental question remains: Are communities in Hampton Roads subsidizing residential and commercial development, or do those developments represent cash cows for the cities and counties? In order to clarify the circumstances, we will present contrasting examples involving Chesapeake, James City County and Virginia Beach.

CHESAPEAKE

In February 1994, the Chesapeake City Council adopted policies pertaining to acceptable level of service (LOS) standards that focused on three critical growth infrastructure areas: education, road capacity and sewer capacity. If a developer applied for rezoning, perhaps to change a parcel of land from agricultural to residential use, and the city's analysis determined that the public infrastructure was insufficient to meet the needs generated by the proposed development, then the policy suggests the rezoning application should be denied. Of course, an alternative in such a case is for the developer to make a proffer (cash or in-kind contributions to offset infrastructure costs) along with his or her request for a rezoning. Indeed, in the minds of many, stimulating proffers was the express purpose of the policy.

A proposed rezoning triggers the *education* version of the LOS standards if the schools that will service the proposed development are already operating at 120 percent or more of their rated capacity. The standards relating to roads require that the traffic on the nearest major roads and/or existing signalized intersections that will carry the majority of traffic generated by the proposed development receive a grade of "D" or better, as determined by the Department of Public Works. The sewer standard is simple – all the property proposed for rezoning must be located wholly within the current boundaries of the Hampton Roads Sanitation District service area.

In making projections about education, traffic and sewer requirements, Chesapeake's city planners are required to take into account only the proposed project, existing homes and other projects where the city has received final construction plans for approval. Planners are not permitted to take into account any approved developments for which final construction plans have not yet been submitted to the city. The apparent rationale for this provision is that it avoids a situation where one developer could be held hostage by another, slow-moving developer whose project had been approved and has appropriate zoning, but has not been initiated. On the other hand, this rule has the effect of putting analytical blinders on Chesapeake's city planners, who often are quite confident other developments are on the near-term horizon, but nonetheless cannot take them into consideration.

Consider a recent example. In June 2002, the Chesapeake City Council approved rezoning of a 105-acre parcel for the construction of 180 single-family homes along Mount Pleasant Road. The land within this project, usually referred to as the Miller Property, received the lowest passing grade, "D," on one intersection, and grades of "C" on two others. The developer also proffered to dedicate one-half of a 120-foot road right-of-way along Mount Pleasant Road.

According to the report on the effect of the project on education, the schools serving the proposed development were expected to be operating at less than 120 percent of their rated capacity. However, the report pointed out that consideration should be given to property already zoned for residential development for which construction plans had not yet been submitted. Further, the report estimated that the development of this project would entail approximately $1.8 million in initial capital costs and $300,000 yearly in continuing operational costs. However, since the developer did not make any proffers to offset the capital costs, these will have to be funded (subsidized) from other tax revenues.

The Chesapeake Planning Commission eventually recommended approval of the Miller Property development after the developer made two proffers. The developer agreed to limit the number of homes to 180 and to phase the development such that, at any time, the number of active building permits would be 75 or fewer. Meanwhile, other development projects, such as the 258-home Edinburgh project, previously approved in October 2001, were not counted in making projections and meeting LOS standards. The rationale was that since actual building plans had not been submitted for these developments, according to the established rules they were irrelevant to this request.

Current enrollment at four of the six high schools in Chesapeake exceeds the standard of 120 percent of rated capacity. This excess demand is being met by means of a large number of portable classrooms. Five of the six high schools have a total of 95 portable classrooms; another 50 will be needed at these schools by 2007 if current projections hold. In 2002-03, high schools in the city had 1,456 students in excess of rated capacity; this number is expected to rise to 2,144 for 2003-04. The number of students in Chesapeake's high schools is expected to increase by another 2,000 over the next five years. The Chesapeake School Board has estimated that the school system will require another $162 million during this period to meet projected increases in enrollment.

It is clear that Chesapeake has been struggling to meet its educational needs. Between 1991 and 2002, Chesapeake's "real" (inflation-adjusted) per capita expenditures on education increased from $1,031 to $1,152, or 11.8 percent. Even that increase, however, was not sufficient to take care of the city's K-12 enrollment bulge, and Chesapeake's rate of increase was substantially lower than those of Hampton, Newport News and Virginia Beach. A major culprit here has been the inability (or the reluctance) of the city to impose the true total costs of development and expansion upon those who develop and occupy these new projects, most of which require additional operational and infrastructure expenditures.

The city's school-crowding problems and the consequent impact on the LOS already have had a significant effect on the rezoning application approval process. On Nov. 26, 2002, Robert McCabe of The Virginian-Pilot reported that three zoning applications were withdrawn, three were denied in October, and another denied in November.

Recognizing the mismatch in residential developments and the infrastructure needed to support this growth, the City of Chesapeake has for several years sought "slow growth" legislation from the Virginia General Assembly. One proposal is labeled an Adequate Public Facility (APF) ordinance. With an APF, fast-growing communities would be in a better position to control residential growth and ensure the availability of public infrastructure, even if the land is already zoned residential. As it happens, Chesapeake already has approximately 4,000 acres that were rezoned for residential use in the 1960s; however, it cannot currently take such approvals into account. Thus, APF provisions could allow a better management of growth. An alternative form of the legislation would permit the cities to charge impact fees (Robert McCabe, Virginian-Pilot, Feb. 28, 2003). This would ensure that the developers pay the costs of public infrastructure needed. However, impact fees are not legal in the Commonwealth. In any case, neither the APF nor the impact-fee proposals appears to have sufficient legislative support to become law, and the (in)famous Dillon Rule prevents cities from acting on their own in these areas.

JAMES CITY COUNTY

Two major developments have been approved in James City County since 2000. These are the Colonial Heritage Williamsburg Planned Active Adult Community approved in 2000 and the New Town Development approved in 2001. Both projects are currently being developed.

The Colonial Heritage development is a 740-acre, age-restricted community (at least one member of every household must be 55 or older). Two thousand housing units, a golf course and a clubhouse for residents are part of the plan. The proposed residential mix is 1,200 single-family detached homes valued at about $300,000 each, 600 single-family attached homes valued at $220,000 each and 200 multifamily units valued at $175,000 each. The developers also proposed 350,000 square feet of commercial space consisting of retail and office space and assisted-living facilities. This project is to be developed over a period of 20 years, with total construction investment estimated at $607 million.

The fiscal impact study for this development concluded that the project would have a substantial positive fiscal impact on James City County. During the construction phase, the project would provide the county with about $117 million in additional net revenues. Further, the development would provide the county with an estimated $13 million in additional revenues per year after the project is completed. Because it is an adult community, the educational costs associated with it are minimal. At the same time, the residents of such developments tend to have higher than average incomes and often spend more on goods and services in the community. These actions generate more tax revenue for James City County; per capita, inflation-adjusted local government revenue in the county increased by 20.2 percent between 1991 and 2002. This is a community that has had considerable additional "real," inflation-adjusted local government revenue to spend over the past decade because of the nature of its residential and commercial developments.

The New Town Development entails construction of 263 multifamily apartments, 262 multifamily condominium units, 602,500 square feet of commercial space and 122,500 square feet of Class A office space on approximately 79 acres. The development will be completed over the next six years. The developer agreed to a proffer of $750 per dwelling unit to help offset the cost of new schools in the county. The project will yield positive cash flow to James City County during the construction phase, but the county will realize a net loss per year after the project is completed. However, the net value of the cash flow for the first 20 years is estimated to be $2.3 million. That is, the county estimates that the initial positive cash flow will outweigh the subsequent losses associated with the project.

VIRGINIA BEACH

The "Transition Area" of Virginia Beach represents a 9,600-acre buffer between the city's densely populated north and its more rural south. This area lies below the "Green Line," a boundary city leaders drew in 1979 to slow or stop the southward growth of the city. In 1997, when the city revised its comprehensive plan, it called for the Transition Area "to be seen as an open space and recreation mecca with residential development present only to the extent it would support the primary purpose of advancing open space and recreational uses." Further, the plan called for development to take place only if it is at least fiscally neutral.

The Transition Area Technical Advisory Committee (TATAC) was formed by City Council in August 2002. One of the responsibilities of the committee was to suggest a plan for developing an overall funding scenario for future development in the area. On Feb. 25, 2003, the council adopted the committee's recommendations and currently uses them as interim guidelines. The committee's recommendation on infrastructure and funding is:

> "The staff should develop a multi-year infrastructure improvement plan, emphasizing those elements highlighted by the committee, including funding for their construction and ongoing maintenance. The funding should not place tax burdens on taxpayers outside the Transition Area for improvements whose benefit is unique to the Transition Area. Instead, it should derive its funding primarily from the substantial differential between the cost of new houses constructed in this area and the average cost of a new home built in the community. [It should] Earmark an appropriate amount of the increased revenue for construction and maintenance of public facilities in the Transition Area. Should individual developments not generate sufficient funds to cover their impact on the Transition Area infrastructure, other strategies such as proffers may be employed to make up the difference."

A detailed fiscal analysis conducted by the city revealed that single-family homes valued at approximately $203,000 currently provide a fiscal break-even point for governmental operating costs, meaning that the revenues from this home ownership would cover operating (not infrastructure) costs of city services. During 2002, the average value of a new single-family home in Virginia Beach was about $230,000, an amount that exceeds the operating break-even value. Therefore, at least in 2002, the typical new home in Virginia Beach was generating more in taxes than the operating costs of the city services the residents of the home were receiving. Of course, infrastructure costs (schools, roads, sewers, etc.) are not included here, nor are non-governmental costs associated with congestion, etc.

Interestingly, the average value of new single-family homes constructed in the Transition Area has been approximately $400,000. Thus, these homes generate tax revenues in excess of anticipated operating costs. The relevant question is this: Will this $170,000 increment in housing values be sufficient to fund the necessary infrastructure? On the basis of Virginia Beach's current real estate tax rate, each home in the Transition Area would bring in about $2,000 more per year in real estate taxes than the typical home in the city. The city suggests that approximately 53 percent of this amount should be used to provide funds to the school system and the remaining 47 percent should be used to address the infrastructure costs. The

fiscal analysis conducted by Virginia Beach concludes that if the average value of a home in the Transition Area were to equal or exceed $381,750, the Transition Area would pay for both operating and infrastructure costs, even given any pessimistic assumptions about the future.

Current plans forecast the development of 3,000 new homes in the Transition Area over the next 20 years. The City Council, within a month of approving the interim guidelines, voted to rezone two agricultural parcels to residential use. These two developments call for building 129 homes. The homes are expected to pay sufficient taxes to cover all associated costs of services and some or all of the infrastructure costs.

According to a Virginian-Pilot editorial dated Feb. 24, 2003, Virginia Beach recorded nearly $500 million of development in 2002. Most of this development occurred in areas where services such as schools, roads, fire protection and city water were already in place. Hence, infrastructure costs were not large. Virginia Beach's city manager, James Spore, stated, "We had in-fill growth, a lot of remodeling, a lot of additions, a lot of tear-downs and replacements. All of those kind of things, from a municipal standpoint, are the good kinds of growth."

This kind of growth is the result of a policy turnaround that occurred in the 1990s. Prior to that time, the Virginia Beach city councils had approved many housing subdivisions without taking into account additional infrastructure needs. "If it meant growth, they approved it, sometimes almost without considering the costs," commented a veteran, and somewhat cynical, observer. Succeeding councils have been much more careful and adopted the Green Line to slow, or even block, development to the south. This has caused a slowing of population growth in Virginia Beach, but has averted many (but not all) of the infrastructure challenges that have afflicted neighboring Chesapeake. One evidence of this is the 22.9 percent real, inflation-adjusted increase in the Beach's per capita expenditures on K-12 education between 1991 and 2002, almost twice the comparable increase of Chesapeake.

Subsidized Or Not?

What answer can we now provide to our basic question: Are new residential and commercial developments in Hampton Roads subsidized by people not involved in their construction and who do not live and work in those developments? Our answer is, "It depends." Some cities (for example, Virginia Beach) have become much more vigilant in computing the governmental operating and infrastructure costs associated with new residential and commercial developments. Virginia Beach deserves a metaphorical gold star for becoming much more rational about its expansion. This approach has reduced the city's rate of population growth (the Beach grew less than the Virginia average between 1991 and 2002), and has avoided school crowding and road problems of the magnitude that have afflicted some other cities.

Other cities (such as Chesapeake) have not moved in this direction as vigorously and find themselves in the position of approving developments that exacerbate already severe infrastructure problems. It appears that older, more established residents and businesses in Chesapeake are subsidizing newer residents and businesses in that city.

In still other cities, the character of new developments has tended to reduce infrastructure costs and avoid subsidization. James City County is a case in point. Both James City County and the City of Williamsburg have positioned themselves to become quite attractive as living sites for mature adults and retirees. Such individuals usually do not bring many schoolchildren with them and hence educational infrastructure costs are minimized. Further, these individuals often have above-average incomes and hence are able to construct upscale homes and condominiums that generate considerable streams of income and taxes.

The verdict is still out with respect to rapidly growing areas such as Suffolk and York County/Poquoson. It is not yet clear the extent to which they intend to attempt to control or shape growth and development.

Meanwhile, older cities such as Hampton, Newport News, Norfolk and Portsmouth, for the most part, find themselves in very different situations. Their basic infrastructure is largely in place, though perhaps in need of maintenance. For these cities, their focus often is on renewing and rehabilitating housing, or on projects that once were labeled "urban renewal." The financial mathematics of such developments is different, as is true of large-scale commercial developments such as MacArthur Center in Norfolk.

This brings us to the subject of "affordable housing," which is an oft-stated goal of many people. Though citizens and elected officials often talk of the need for affordable housing, the truth is the development of affordable housing often is subsidized by the taxes of others in the community. A rough rule of thumb is that any development is subsidized if it consists of homes with average values of $200,000 or less. Usually, it is the remaining citizens and businesses of that city that subsidize such developments by means of their taxes. However, it is possible that the citizens of other cities also may subsidize such developments if they incur costs associated with traffic jams, crime and the like.

Thus, on the face of it, most affordable housing developments do not pay their own way in terms of governmental operating and infrastructure costs. Of course, some argue that newly constructed affordable housing nonetheless may be a good idea because it may replace dilapidated housing complexes that required even larger operating and infrastructure subsidies from other taxpayers. Thus, an elected official who was motivated only by economic considerations might vote for an affordable housing development that must be subsidized because it will reduce the amount of an ongoing subsidy to citizens who already live in that city. The same argument, however, cannot be made for new developments that attract new residents from other cities or even other states.

Thus, some subsidized residential and commercial developments may make economic, political and social sense, especially if one takes a longer-term point of view. Subsidies may reflect our societal concern for each other, a desire to help others who are less fortunate and a desire to improve the perceived quality of life. Yet, it is not clear how a subsidized, new residential development in what once was a suburban field meets those standards. What is clear is that many such developments require people utterly unassociated with these projects to pay for them. Additionally, to quote a disappointed elected official, there is a certain "sneaky" character connected to such situations because most people in the community don't understand what has occurred until it is too late.

How can this situation be improved? First, changes in legislation at the state level are needed. If the Dillon Rule cannot be modified, then the General Assembly must make it possible for cities and counties to assess impact fees and, as they choose, to take into account the entire development picture of a city in a dynamic sense – not just the development in question and not just at this precise moment. Second, even if better legislation is not forthcoming, cities and counties must do a much better job evaluating the true costs associated with residential and commercial developments. Too many city and county bodies vote on proposed developments in ignorance of their actual costs and benefits. Third, while the current proffer system is a second-best approach to these concerns, it should be used more extensively, and elected officials should not shrink from requiring generous proffers that take into account the actual costs of developments.