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The Potential for Value Capture as a Revenue Raising Tool in the United States

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Defining “Value Capture”

- Working definition: assessing and collecting (at least some of the) cost of public/governmental improvement from those private properties directly benefited (in terms of increased market value) by the public investment
- Amount can vary, depending on proximity to improvement, importance of improvement, etc. to a particular lot

George W. McCarthy, President, Lincoln Institute of Land Policy; *Land Lines* April 2017:

“Land value capture is based on the notion that the public is entitled all, or a portion of, land value increases that result from public investment in land improvements or public actions that increase land value. If a municipality pays for roads, sewers, or public transportation that increase the value of proximate land, the municipality is entitled to recoup some, or all, of this increased value from landowners or developers. Similarly, if a city rezones a neighborhood to permit more dense development, the city is entitled to a share of the resulting land value increase. This recompense is predicated on a basic principle: those responsible for creating value should reap some, if not all, of the benefits.”

Value Capture Devices for Revenue

- Consensual—voluntary agreement between owner and government
 - PPPs—Public Private Partnerships
 - Community Benefits Agreements
 - Develop Agreements (general)
- Mandatory—government unilaterally extracts value from owner
 - Special assessments, general or via districts
 - Low FARs, owner “buys up”; ~incentive zoning
 - Impact fees
- Focus today: Non-consensual approaches

Legal Rules of the Game

- Focus on YOUR state law
 - Authority under the state constitution
 - Adequate local laws implementing programs
 - Prior legislation or judicial rulings authorizing/limiting tools?
 - Careful about assuming uniformity: “laboratory of Federalism”
- Federal law
 - Fifth Amendment, U.S. Constitution—the law of Takings

Fifth Amendment--Takings

- Text: “nor shall private property be taken for public use, without just compensation”
- Types of takings:
 - Eminent domain—intentional, taking physical control of land by government for public use, e.g., a public highway
 - “Regulatory taking”—where *effect* of governmental land use regulation (e.g., zoning) is to deprive the owner of so much use of property that government must pay owner compensation

Test for Regulatory Taking?

- Justice Holmes, *Penn. Coal Co. v. Mahon* (U.S. Sup. Ct. 1922):
“While property may be regulated to a certain extent, if regulation **goes too far** it will be recognized as a taking....We are in danger of forgetting that a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change....[T]his is a question of degree—and therefore cannot be disposed of by general propositions.”
- ~ 100 years, owners, legislators, officials, courts, etc. have struggled to determine when regulation “goes too far” requiring compensation
- Flexibility exists, property rights not absolute, e.g., *Penn. Central*

Koontz v. St. Johns River Water Management Dist. (U.S. Sup. Ct. 2013)

- In *Nollan, Dolan* Supreme Court had held in building permit cases: land exactions from owners by govt. must bear “nexus” and “rough proportionality” between the property govt. demanded and the social cost of the proposed development
- *Koontz*: instead of land exaction, govt. required money exaction for a permit—to be spent on property owned by govt. elsewhere to mitigate the effects of the development: monetary impact fee
- *Koontz* broke new ground: holding that monetary fees, not just land exactions, are subject to takings scrutiny; must meet nexus and rough proportionality test; impact fees no longer immune under Fifth Amendment

Koontz v. St. Johns River Water Management Dist. (U.S. Sup. Ct. 2013)

- Major takeaway: collecting money for impact of development, or attempt to collect money under value capture principles—now likely subject to Takings analysis under the Fifth Amendment
- Complication: “nexus” and “rough proportionality” requirements assume that payments are allowed **ONLY** for reducing harm of development (must be related to offsetting the “social cost” of the development); not conceptualized as capturing society’s contribution to the value enhancement of the property
- Task going forward—to increase judicial understanding of LVC
- Query: composition of US Sup. Ct.?

Topic I: Special Assessments—In General

- Imposed by local govts on property in limited geographical area to pay for special or local improvements
- Not a tax: not a general tax placed on all citizens or properties to pay for general costs of govt
- Classic examples of special assessments: sewer and water lines, road improvements, street lighting
- Can be done by general legislation or via establishment of special assessment district

Special Assessments—Not a Tax

- Special assessment is a “permanent public improvement (such as a local park or landscaped median islands on a local road) which inures to the benefit of that discrete group. The public as a whole may be incidentally benefitted, but the discrete group is specifically benefitted....The public should not be required to finance an expenditure through taxation which benefits only a small segment of the population.” *Evans v. City of San Jose*, 3 Cal.App.4th 728 (1992)
- A general tax is “enacted without reference to peculiar benefits to particular individuals or property. [Taxes often are imposed] on individuals who enjoy no direct benefit from its expenditure.” *Knox v. City of Oakland*, 4 Cal.4th 132 (1992)
- Key: must find “special benefit” to properties for special assessment

Special Assessments--Requirements

1. Special or local benefit, not general benefit
 - Street lights or sewer line on particular street: easier cases
 - Parks, parking lots and structures: courts still find dominant local benefit, though public at large has some benefit
2. Amount of assessment cannot exceed benefit to the particular property
3. Assessment must be proportional
 - Must be a rational method for apportioning costs among parcels

Special Assessments—Takings or Constitutional?

- Will *St. Johns v. Koontz* get takings scrutiny and present problems for special assessments?
 - Money payment to govt (and not tax which is free from scrutiny), so seemingly subject to scrutiny now
 - BUT, seems court may not find a taking actually occurred: law requires direct benefit to the parcel, assessment not exceeding benefit, and benefits proportional among the various lots; thus a “quid pro quo” in essence, between owner and govt, built in compensation
 - Similar to *Penn Central* case where Sup. Ct. held that landmarking was not taking because, among other factors, owners had ability to transfer development rights elsewhere and had benefit of other properties being landmarked

Special Assessment Districts

- State enabling acts may permit local govts to establish districts to construct improvements and to impose special assessments on benefitted properties—e.g., highways, business improvement, transit
- Advantage of district approach: frees local legislature from complicated improvement and assessment decisions, delegating to district which develops expertise
- State statute may require a percentage of affected property owners to consent to establishment of district and the assessment amount (not required when legislature directly imposes without using district)
- Districts for mass transit; but same legal restraints (i.e., local benefit)

Special Assessment District Case Study-- Seattle South Lake Union Streetcar



Seattle South Lake Union Street Car— Special Assessment Story

- Previously abandoned 1.3 mile streetcar line from downtown
- Paul Allen (formerly Microsoft, then Vulcan) took leadership—new line would serve his new company’s offices
- Businesses lobbied for streetcar, council approved concept in 2005
- “Local Improvement Tax District” created; state law required vote by owners in district; only 12/750 owners objected
- Total cost line, cars = \$53 mil.; special assessments = \$25 mil. (47% of cost); line opened 2007
- 2016 annual ridership = 518,000

Special Assessment Districts—Lessons Learned

- Explore special assessments as viable LVC tool: post-*St. Johns v. Koontz* seem defensible under Constitutional scrutiny
- State enabling acts:
 - Must permit use of special assessments for major infrastructure, not limited to street lighting and paving for example (e.g., Wash. State)
 - Perhaps act could allow particular infrastructure districts (e.g., Cal. statute has rail transit station special district legislation)
 - Act should permit funds to be used for maintenance and operations, not only construction
 - Avoid limiting to certain geographical areas of state
- Comply with legal rules in making assessments

Topic II: Low FARs, Owner “Buys Up;” Incentive Zoning

- Martim Smolka of Lincoln Institute has done leading edge work on comparative approaches
 - France: since 1976 sets basic FAR at 1.0, with Paris at 1.5
 - Brazil: since 2001 allows municipalities to lower FAR to perhaps 1.0, with owners to increase based on cash payments to govt or providing in-kind community benefits (e.g., affordable housing)
- “[T]he additional square footage of the building constitutes public patrimony, and is not to be given away to favor one citizen above another.” Smolka, *Implementing Value Capture in Latin America*, p. 35 (2013)

Can This Work in the U.S.?

- Yes! It has already, known as “incentive zoning”
 - The key: the **baseline** FAR assigned to the property
 - The issue: if baseline is too low, the courts will likely view this as taking for which compensation must be paid
 - GK: I think 1.0 won’t work, but other numbers can/do (e.g., NYC max FAR for residential building in residential district = 10)
 - Constitutional (and philosophical) limits in U.S.:
- “While property may be regulated to a certain extent, if regulation **goes too far** it will be recognized as a taking....” Justice Holmes, redux

Incentive Zoning—In General

- Incentive zoning concept: zoning ordinance sets standard FARs but specifically provides for FAR bonuses to structure if owner/developer provides publicly desired infrastructure or benefits (origin: 1961 NYC zoning law)
- LVC theory: Owner “entitled” to build to certain point under U.S. law and property theory, but thereafter the public should share the benefits of the additional construction (owner gets more floors, public gets an enhancement)
- “Incentive zoning is based on the premise that certain uneconomic uses and amenities will not be provided by private development without economic incentive....The bonus awarded for each amenity must be carefully structured, however, to make the cost-benefit equation favorable enough to induce the developer to provide the desired uneconomic benefit to the city but sufficiently limited to avoid a windfall to it.” *Asian Americans for Equality v. Koch*, 72 N.Y.2d 121 (1988)

Incentive Zoning—Legal Requirements

- State enabling act must permit: e.g., NY Gen. City Law 81-d “open space, housing for persons of low or moderate income, parks, elder care, day care, or other specific physical, social, or cultural amenities, or cash in lieu thereof”
- Local zoning law must have provision
- Constitutional issues
 - Original FAR number must not create “taking”
 - Valid as a free exchange between owner and government

Incentive Zoning—Current Examples

- Public spaces, plazas, POPS (Privately Owned Public Spaces)

Issues:

- Keeping a record of such places—Jerold Kayden (2000)
- Monitoring for violations of public access
- Rules for use: hours, “behavior,” accessibility, private vs. govt
- Subway station renovation, improvements (NYC Zoning Law 74-634)
- Affordable housing
 - Seattle: awarded \$32 mil., for 610 units in Dec. 2016
 - Ann Arbor, MI: density increase in Planned Unit Development for 10%-15% affordable units
 - Middlesex County, VA: incentives for retirement housing

One Liberty Plaza (public plaza)—across from WTC, approved in 38 NY2d 144 (1975)



“The public space in Trump Tower in Manhattan. An audit found that the building violated the terms of a decades-old agreement regarding tables in the lobby.” NY Times, 4/20/17, p. A19



Incentive Zoning—Lessons Learned

- Viable LVC tool—useful to acquire infrastructure improvements, desired social programs (affordable housing), and perhaps cash
- Can be structured to survive Constitutional challenges if baseline FAR is sufficient to overcome Takings claim
- Has been successful in numerous cities across U.S.

Topic III: Impact Fees/Exactions—In General

- Municipalities may require exactions of land from developers in return for zoning/building approvals
- Theory: force developer to internalize costs of development and not spread them to rest of town
- LVC perspective: developer should not be able to “free ride” on public infrastructure that makes the property more valuable
- Exaction may be in form of land (e.g., strip to build a new street lane) or impact fee to pay for needed capital facility caused by subdivision, to offset negative externality (e.g., contribution to sewage treatment facility fund; see NH stat 674:21)

Exactions/Impact Fees--Issues

- Constitutional: *Koontz* was a building permit but likely would be applied here; money not just land; must be “nexus” and “rough proportionality” between the development’s harm and the action required
- Viability of Exactions/Impact fees post-*Koontz*?
 - “Even though the *Koontz* Court reassured state and local governments that the case ‘does not affect the ability of governments to impose property taxes, user fees, and similar laws and regulations that may impose financial burdens on property owners,’ it would appear that impact fees and other bargained-for concessions are at risk.” Mandelker & Wolf, *Land Use Law* § 9.16 (2016)
 - Possible owner claim: no exaction/impact fee for improvement previously given to other owners that had been financed from general rev

Exactions/Impact Fees—Lessons Learned

- Despite doomsday forecasts, no post-*Koontz* cases casting doubt on principle of exactions and impact fees
- My view: exactions/impact fees remain viable LVC tool for municipalities
- Must focus on meeting *Koontz* requirements (nexus, rough proportionality), but doable
- Remain important tool to re-capture past community investment in infrastructure and to prevent new free-riding by development

Thank you!

Questions...



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