

From Sprawlilles to Sustainable Suburbs: Ideas to Attract Private-Sector Investment in Suburban Improvement Projects in an Era of Reduced Public Support

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Fifty-one percent of Americans in metropolitan regions live in sprawling, unsustainable suburbs. In low-density suburban communities, homes, shopping, and work places are spread out. These communities often lack public transit, making it difficult for people living there to reach their destinations without a car. Many first- and second-ring suburban communities and their retail centers are over 50 years old and physically, economically, environmentally, and cosmetically deteriorating. Between 1990 and 2000, 26 percent of U.S. suburbs studied declined in population.¹

These conditions have not escaped the attention of a growing number of urban designers, local governments, and the U.S. Environmental Protection Agency, which have offered an impressive body of solutions to suburban issues, including sprawl repair,² suburban retrofit, and smart growth. However, these solutions often have not been applied in the field for lack of adequate funding and tools that were previously provided by the public sector.

Before 2005, federal, state, and local governments rebuilt existing communities using federal block grants, state tax revenues, and local bonding of future tax revenue, together with the power of eminent domain. Due to political resistance to taxation and tax-based solutions, federal and local governments are in a budgetary crisis that severely constrains funding of redevelopment projects. Since 2005, the use of eminent domain in redevelopment has been limited by statute in 38 states. In 2012, California became the extreme example of this trend when it limited the use of public-sector funding for redevelopment by completely eliminating redevelopment agencies and forcing the sale of already acquired properties. The role of public-sector redevelopment has eroded, which magnifies the challenge of rebuilding and reformulating ailing and unsustainable suburbs. Realistically, the private sector must assume some of the roles traditionally played by the public sector to reverse suburban sprawl. This is a tall order.

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¹ Lucy, William H. and David Phillips. *Tomorrow's Cities, Tomorrow's Suburbs*. Planners Press, 2006.

² Sprawl repair, suburban retrofits, and smart growth all involve finding ways to redevelop sprawling suburbs to create more compact, walkable communities with mixed uses and a variety of transportation options.

Previous examples of sprawl repair and retrofit projects were built at a time when redevelopment agency funding was robust and the politics, economics, market demand, public role playing, and funding were somewhat favorable. There are contemporary examples of redesigned and densified, pedestrian-friendly, mixed-use suburban projects built using private funding, such as Annapolis Town Center in Parole, Maryland. However, this does not mean that the methods used to fund and market such projects can be translated to suburbs in decline. Projects that have been built and are feasible without public subsidies and eminent domain are possible only in higher income areas, and replacing traditional redevelopment financing, management, eminent domain, and subsidies is a formidable task.

The Challenge of Change Without Traditional Redevelopment Support

Lack of funding (or in the case of California, lack of local development agencies) presents numerous issues when one designs projects for sustainable change. The following list identifies six of these issues:

- 1. Obstacles to parcel assemblage and addressing adverse title conditions.** Consolidating multiple parcels of land or buildings to create a single larger lot (parcel assembly) can create significant new possibilities for cities to reuse land. Small parcels of land may be of unusable size or shape; have leases that remain in effect; or have title covenants, conditions, and restrictions that are obstacles to effective sprawl repair. However, the threat of capital gains taxation on a sale or lack of a suitable tax-deferred exchange property may dampen owner interest in selling all or parts of necessary parcels. Courts may not sanction the application of eminent domain in many such situations. Existing parcel reconfiguration may also present refinancing issues.
- 2. Obstacles to refinancing.** Most existing improved property is subject to a mortgage. Replacement financing adequate to fund construction and take-out financing for additional improvements (with or without parcel acquisition costs) may be difficult to achieve in the present lending climate. Sources that compensate for diminished federal and state redevelopment funding for such operations are very limited.
- 3. Lack of mortgage financing for mixed-use projects.** Many suburban overhaul plans include plans to develop mixed-use communities. However, many mortgage lenders are averse to financing mixed-use projects as a result of unfavorable default and foreclosure experiences on mixed-use projects during the recession.
- 4. Lags in build-out time.** Visionary retrofits or sprawl repair designs and codes may require development windows of 7 to 20 years or longer for full development and market absorption. This is a mismatch with American investment practice, in which investments typically turn over in 3 to 5 years.
- 5. Entitlement expiration dates vs. project phasing and investment requirements.** Considerable lag time in market response can occur when design planning catalyzes land use and increases in density, but build-out and sell-off may take several years. Such dynamics require long-term project phasing. Most jurisdictions grant permits and

entitlements for only 18 to 24 months. When this mismatch occurs, investors and lenders become wary of funding long-term project build-outs because of the possibility of changes in applicable discretionary entitlements, land use ordinances, building codes, environmental impact obstacles, and court injunctions.

- 6. Front-end loading of costs for acquisition, infrastructure, and demolition.** Since the recession, start-up costs must be borne by developers who now operate with construction loans with terms of 2 to 5 years. Front-end loading of these costs may not be recoverable soon enough to provide viable financial break-even points for developers.

Transforming Sprawlville into Sustainable Suburbs Without Traditional Redevelopment

Sustainable suburban redevelopment designs alone will not motivate the private sector to invest. Designers and planners rely on developers to build the projects they design; in turn, developers rely on investors and lenders to build projects. Typically, none of these players have the tools or the desire to build innovative projects. Investors and lenders rely on due diligence³ based on documented successful market precedents to make decisions. Precedents are, by definition, lacking for innovative projects such as suburban redesign and reconstruction.

In the current real estate and political environment, transforming suburbia into sustainable communities will require new tools and new ways of using existing tools to attract private-sector involvement in suburban reconstruction. Some suggestions are offered below to stimulate a discussion about how to support reconstruction in areas without the benefit of a high-income population or adequate public redevelopment resources.

- 1. Integrate design with market and financial planning.** Many community improvement plans are based on the ideal, leaving developers to make the ideal feasible. But innovative projects make lenders and investors nervous because they have not been tried before and therefore lack a proven financial track record. In the absence of traditional redevelopment support from government, retrofitting sustainability with mixed-use density in existing American suburbs requires strategic planning and a continuous feedback loop between project design characteristics and financial marketing requirements. Where possible, innovative designs might be tweaked or reformatted to appear less risky to financial players. This would require designers and marketers, lenders, and investors to remain in constant communication from project inception to project launch.
- 2. Extend project phasing.** The idea of extending project phasing beyond 3 or 5 years is known as planned densification or incremental development. This idea is promising because it addresses a mismatch in market dynamics. Market prospects can improve once redevelopment efforts have had time to prove user demand and create a new image for a community formerly in decline. Without substantial public subsidies for site pricing, infrastructure, and land banking, redevelopment planning often spans many years

³ Due diligence refers to inspecting and investigating property, identifying sources of capital and determining the likelihood of gaining needed entitlements before making a decision to proceed with a merger, acquisition, or loan transaction.

because leases must expire; buildings must reach functional obsolescence; and potential buyer, renter, and investor capacity and willingness to engage must evolve. However, the typical period of American investment, development loans, and ownership is only 3 to 5 years. Designers and planners need more time for market forces to mature to overcome resistance from investors and lenders. Extended project phasing will be helpful in addressing the absence of a land banking function formerly filled by local redevelopment agencies.

- 3. Create durable, transferable, uniform, long-term density and development entitlements.** As discussed above, there can be a considerable lag time in market response when project designs are innovative and lead to changes in local population density. Project build-out and sales may take decades. This circumstance requires long-term project phasing and unprecedented long-term construction and take-out loan commitments. This entails protracted phasing beyond the time expiration periods of most local entitlements.

Another issue during this attenuated period is that some developers, investors, lenders, and neighbors will likely turn over, as will local politics and the composition and orientation of planning commissions and city councils. Long-term entitlements or development contracts between local governments and developers could encourage private investment and developer participation. Entitlements immune to change mitigate developer and investor risk levels by resolving the mismatch between the time required for project build-out and permits that typically expire in 18 to 36 months.

Some states, such as Arizona, California, Colorado, Florida, Hawaii, Maryland, Minnesota, and Nevada, permit the issuance of development agreements, commonly referred to as vested rights, between developers and local governments. Most other states would likely require enabling legislation to allow local governments to issue vested rights. Vested rights should not expire prematurely but should remain in force for the projected life of an incremental suburban redevelopment project. After issuance, they should not be subject to discretionary cancellation or modifications by regulators.

Subdivisions that are entitled but not built until future years (“paper subdivisions”) can conceivably serve the same purposes assigned to vested rights or durable entitlements if they are not saddled with provisions that require physical development within short time frames that do not match build-out forecasts for incremental development projects.

- 4. Develop insurance for vested rights.** Creating a new category of insurance against loss of entitlements by governmental or legal medication or confiscation could attract investment by limiting some of the risk of investing in development entitlement futures. This could be a new line of business for title insurance companies.
- 5. Create financial equity shares in vested future redevelopment rights and a marketplace for their purchase and sale.** The transfer of irrevocable entitled rights to build at any time several years in the future would follow the precedent of the sale of

transferable development rights.⁴ The right to harvest future profits from entitlements could be invested in, valued, traded, leveraged, and financed in such a marketplace. Durability of entitlements and transferability could mitigate and distribute some of the risk for market players. Initial offerings of development futures in the marketplace could be bid upon. The discounted present value of harvesting future benefits would yield relatively low prices but could represent an important source of funding for the initial phases of construction. Future development shares in any phase of a project might be traded for options to purchase the parcels. The combination of land leasing and distribution of future shares could motivate potential property owners to participate in redevelopment projects affecting their holdings.

- 6. Distribute redevelopment and density benefits to multiple stakeholders.** Property owners and sellers, municipalities, transit and utility districts, property user associations, and advocates for environmental and affordable housing are a few of the stakeholders that could receive marketable development share futures to advance their causes or help mitigate their issues. It could also take the place of power of eminent domain.
- 7. Standardize redevelopment products and make mortgage industry changes.** Lienberger prescribed that most redevelopment projects result in a standardized (similar) physical model recognizable by lenders and investors and that lenders develop a mortgage product tailored to the standardized projects. The redevelopment and mortgage industry could change to facilitate suburban redevelopment.⁵ Such an evolution would likely be the result of pioneering efforts to rebuild suburbia. This remedy would be an outgrowth of suburban repair projects that are proven to be financially successful and can serve as models, but standardization and lender acceptance are not likely to occur spontaneously. Until we have such models of suburban overhaul, it will be necessary to use existing tools and develop new ones, such as those suggested in this paper. If nonprofits and government agencies assist in creating models, standardization and institutional acceptance is more likely.
- 8. Use the Federal Community Reinvestment Act (12 U.S.C. 2901).** This act, as amended, requires banks to reinvest a portion of their funds in the communities where branches are located. While there are many aspects as to how this requirement must be discharged, one historical use of funds was to assist distressed communities in recovery with an emphasis on job creation. Redevelopment that promotes mixed land uses, including commercial or industrial uses that can be characterized to provide new employment, satisfies some Community Reinvestment Act banking requirements.

⁴ Transferable development rights (TDRs) are granted by some local governments that allow land owners to apply densities allowable on one property to be transferred to another parcel. These rights to intensify use on the receiving parcel can be bought and sold. The future development rights referred to here do not allow for transfer of intensive use between parcels but do allow the rights to be transferred as a whole or in portions between parties.

⁵ Lienberger, Christopher. The Need for Alternatives to the Nineteen Standard Real Estate

⁵ Lienberger, Christopher. The Need for Alternatives to the Nineteen Standard Real Estate Product Types. *Places* 17:2. March 2008. <http://escholarship.org/uc/item/00f0r5kn>.

9. **Use rent guarantees or sandwich leases.** Public sponsors of a suburban repair project can opt to reduce investment or mortgage risk associated with an unproven type of project by committing to lease properties to be developed with the ability to sublease to the ultimate tenant. The arrangement does create a contingent liability to a government but it can give certainty of rental income to a proposed project. This vehicle has the upside of allowing the holder of the sandwich lease to be able to create a revenue margin or profit between the underlying rent to the property owner/investor if rents increase over time.
10. **Use public subsidies and non-profit funding to support model projects.** Model projects of any size can do much to encourage private funding of future projects if they are successful. Although robust traditional redevelopment funding and support appears to be a political impossibility, the limited funds that are available should be used to present models and data that will help developers and their backers raise capital to finance subsequent projects.
11. **Create infrastructure trusts.**⁶ This financial vehicle was recently enacted in Chicago. It presents a model of how to involve private funding in reworking infrastructure for suburban redevelopment projects. The financial model of tailoring advantaged financing, which enables each project to customize a financing structure using taxable or tax-exempt debt, equity investments, and other forms of private and institutional support, might also be adapted to parcel acquisitions and building improvements in suburban redevelopment projects. Indeed, this model could be one driver of the other innovations discussed above.

Conclusion

Americans need sustainable regions. This is not possible until we tackle unsustainable suburban sprawl. Although there is an emerging movement to address suburban sprawl, the output is largely limited to case studies and designs. Missing are the robust financial support, public subsidies, and eminent domain that were once available from redevelopment agencies.

In the current political climate, it is unlikely that public funding for suburban retrofits will return to previous levels anytime soon. Meanwhile, the private sector cannot provide subsidies or fill the role of master developer that redevelopment agencies once played. In the absence of substantial public investment, much work needs to be done to attract private investment and mortgage capital to overhaul our ailing suburbs. Adaptation and innovation will be necessary to involve lenders and investors in this effort. This paper does not proffer the ultimate solutions, but

⁶ The Chicago Infrastructure Trust (CIT) is a quasi-governmental entity designed to leverage private investment from a consortium of banks to allow Chicago to undertake up to \$7 billion in infrastructure projects. Projects already slated for CIT funding include \$200 million in energy-efficient projects at city facilities. By using CIT to finance projects with defined revenue streams—without relying on federal and state grants and tax-exempt bonds—the city will conserve its strained revenue-backed bonding capacity for additional projects. To learn more about the Chicago Trust, read “Chicago Infrastructure Trust a Model as More Mega-Projects Turn to Private Investors” *Huffington Post*, November 17, 2012, http://www.huffingtonpost.com/2012/07/08/chicago-infrastructure-tr_0_n_1657348.html.

the approaches suggested herein are intended to stimulate dialogue about how to attract private-sector investment and redirect public investment to regenerate our declining suburbs.

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