

Capitalizing On the U.G.B.

by Richard Forester



Throughout the country and around the world, Portland has won great acclaim for its efforts to manage the rapid population growth we have long known would be inevitable. Here in Oregon, however, such efforts have been much more controversial. One of the most controversial tools the Portland metropolitan area has used to manage growth is the Urban Growth Boundary (UGB), a "line in the sand" that separates urban Portland from its surrounding rural areas. Inside the boundary, land can be developed to urban densities. Outside the boundary, land cannot be developed at all unless its owner already had government approval to do so prior to 1978.

The heated debate over the UGB has pitted developers against urban planners. The most strident opponents of the UGB denounce it as an exercise in elitist command and control. "It will double densities in your neighborhood and lead to multi-story garden apartments on every block!" they bemoan. UGB supporters counter with dire predictions that "including one more acre in the UGB will destroy the livability of the region!" To some the UGB has come to represent salvation, to others, damnation. But the UGB is neither a road to a green socialist utopia nor a totalitarian nightmare. It is merely a tool that can help Portland grow into the kind of city we want—or not—depending on how we wield it.

Hitherto, debate between developers and growth managers has focused on where the UGB should be drawn. Unfortunately, that debate obscures the even more fundamental issues of how growth within the boundary should be planned and how the construction of the infrastructure upon which growth depends should be financed. Failure to adequately address these issues could end up costing the taxpayers upwards

of one billion dollars and promoting precisely the kind of inefficient and haphazard development the UGB was meant to avoid. To make the UGB a tool that works for all of metro Portland's residents, we must see that those who reap the inevitable increase also pay the costs of growth.

If Portland's managed growth is the envy of urban planners across the country and the subject of laudatory coverage in media as diverse as the *New York Times* and *USA Today*, what makes it the cursed bane of the development community? Answering this question reveals the secret of the economic impetus behind sprawling development and the power of a properly implemented UGB to control it.

With or without growth boundaries, all rapidly developing urban areas have one thing in common—rapidly increasing real estate prices. Developers garner the

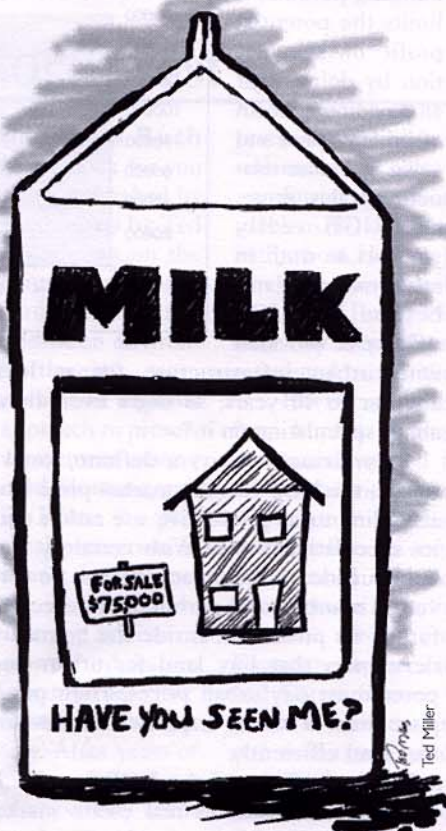
greatest profits when they are able to buy land for low prices while it is still rural, and sell it for much higher prices as it becomes more urban. Without a UGB and other growth management tools, opportunities to reap tremendous profits increase.

Failure could cost one billion dollars and promote inefficient and haphazard development.

Under normal conditions, urban land is much more valuable than rural land because its residential and commercial uses produce much more income per acre than rural land uses such as farming. Economic productivity is said to reflect the land's "value". Productive value closely matches market price unless other factors distort the relationship. In Oregon, raw land commands well over \$100,000 per acre in the city and well under \$10,000 per acre in the country.

Where urban centers are expanding into rural areas, however, speculation can contribute to wide discrepancies between land's current productive value and its price. Speculators, hoping rural values will eventually increase when the land is put to urban uses, often buy rural land for more than its current productive value. When one piece of property sells at an inflated price, it drives up the market price for all surrounding property. As a result, land whose current rural productive value may be only \$1,200 per acre may sell for as much as \$20,000 per acre to speculators or developers who expect the growing city to expand in their direction.

This pattern is exacerbated in areas where there are few charges for holding land like property taxes or development dues. Without the overhead that taxes, user fees, or dues impose, speculators can afford to buy land and hold on to it for long periods of time without putting it to its optimal economic use. When land seldom changes hands, market forces are not there to ensure



that productive value will match market price. This is more true the more rural a piece of land is. In places where owners pay higher land taxes (or fees or dues), investors can not afford to speculate and must sell out to others who intend to put the land to its highest and best current use, thus keeping value and price in close relationship.

Those who reap the increase would also pay the costs.

Because most cities in the United States have neither growth boundaries nor high site taxes (or land dues or user fees), their land markets are inefficient; their prices do not reflect the current productive value or optimal use of the land. Speculators buy farm land, take it out of production and wait for the city to grow or develop it themselves. Land markets driven by speculation rather than productive use give rise to "leapfrogging" as land developers move ever further away to avoid high land prices. Where they land, "leapfroggers" drive land prices even higher. Urban land prices come to resemble a gigantic circus tent with its highest peak in the center, but with other peaks scattered throughout and elevated land prices extending 50 miles or more into the countryside.

To make matters worse, much of the cost of this sprawling development pattern is paid by the government agencies that build the infrastructure it requires. Tax dollars raised by state, county, and city governments, from citizens who already have residences and businesses, pay for the roads, sewers, schools, fire departments, police stations, etc. that have to be built to serve the expanding metropolitan region.

Public investment in infrastructure pumps up profits from development.

The new infrastructure tends to be especially expensive, and often inadequate, because it must serve the sprawling tracts that developers prefer to build in order to reap the greater profits from converting cheap rural land to profitable urban uses. If developers had to pay the costs of building the infrastructure themselves instead of taxpayers, such development would

usually be too inefficient and costly to turn a profit. Thus inefficient and haphazard growth—urban sprawl—is subsidized by a twisted form of "developer welfare."

The real reason developers oppose the UGB is that once one is properly imposed, subsidized land speculation and sprawling development become far less rewarding.

Obscured by the current focus of the UGB debate on the intricacies of the data on growth and the regulatory nuances that govern it is the fact that the UGB is fundamentally a financial planning tool. The UGB clearly delineates where on the map federal, state, and local governments are going to spend their precious urban infrastructure tax dollars. If no government agencies build the water systems, sewers, parks, schools, freeways, and arterials that connect a new development to the urban center, giving developers a permit to build hardly matters.

Thus the UGB not only limits sprawl by restricting building permits, it limits the potential profit of speculation by doing what all economists dream of: bringing price and value into close relation. In this sense, the UGB really amounts to truth in advertising: "land beyond our UGB will not be provided with urban infrastructure for at least another 40 years; so don't even think about speculating on it."

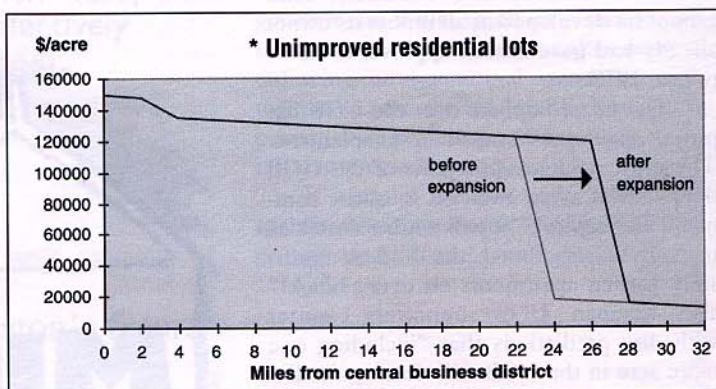
By giving property a definite, known future, the UGB lets the market price land according to its productive use rather than its speculative value. With certainty that land outside the boundary will not be converted to urban uses within the foreseeable future, its price falls. Inside the boundary, developers that buy land for urban purposes must pay urban prices. High prices give them a strong incentive to develop that land efficiently.

These effects of the UGB are clearly reflected in Portland's real estate market (see the accompanying graph). Starting at

about the Central Business District, land for single family residential purposes is valued at about \$150,000 per acre. This amount falls slowly so that by the time we get to the edge of the present UGB, about 23 to 24 miles out, land values per acre are \$120,000. Once we cross the UGB land prices fall precipitously to about \$18,000 per acre reflecting its rural residential use and a bit of speculation. Clearly, the market takes the UGB seriously and pays close attention to it.

Why should the economist's dream of matching price and value be the developer's nightmare? Because with the UGB, the investment community has a smaller speculative bubble to blow up and trade away. Curbing sprawl makes it harder to siphon off the value of future public investments in transportation, water, sewers, and related public facilities years before they are actually constructed. If you were used to windfall profits from speculation and public investment, you would hate it too. Stuck with a UGB, it is not surprising that developers would like to have it expanded as much as possible. Pushing the UGB out

Land* Price Jumps As UGB Expands



two more miles results in the price of the newly included areas rising from \$18,000 per acre to about \$120,000. Even land being considered for inclusion in the UGB has jumped from under \$20,000 to over \$60,000 per acre in less than six months. No wonder speculative developers want to push out the UGB.

The crucial question that is not often addressed in debates about how much new land should be included within the UGB is who should reap the profits from the newly included land's increase in value. When prices go up 600 percent to 1000 percent, where does the money go? According to our current social contract, it goes to whomever happens to own the land at the time the

area gets included in the UGB. Sometimes that may be a family that has owned and farmed the land for generations; sometimes it may be a developer who wants to build homes and businesses on it as soon as possible; sometimes it may be a land development company exclusively interested in its present selling price. Whoever now catches this windfall did little or nothing to create it. They just happened to own the right land at the right time.

To convert a rural area into a vital urban community takes new neighborhood goods. Who is going to pay the \$20,000 to \$30,000 per dwelling unit it costs? As things stand now, taxpayers already housed and businesses already in operation foot

What would happen if an assessment for community facilities and planning were imposed on the land as a condition of development? The community's infrastructure development costs would be paid out of the developers profits at the time of land sale or development. Knowing this, buyers would pay that much less for the land. This is what happens today in East Multnomah County where properties have a sanitary sewer assessment due when they change hands. Buyers pay a sales price equal to the open market, yet the sewer assessment is paid from the proceeds, reducing the seller's profit. A UGB land conversion assessment, collected by Metro, could work in exactly the same way.

From our example above, sellers would no longer pocket over \$120,000 per acre. They would net something in the order of \$100,000 per acre after the dues were paid. Yet, although developers would be sharing the

increase in value generated by the conversion of their land to urban uses with the taxpayers who pay for the new infrastructure, rather than capturing it all for themselves, they too would be better off.

Making development pay its own way would ensure that full urban services sufficient for development to urban densities would be provided in a timely fashion. Presently, without this mechanism inside the UGB, government is not recouping the value it creates. Hence, development is slow, uncertain, incomplete, and often at densities below an economic optimum.

Public investment in infrastructure pumps up profits from development. With speculative profits so high, one can expect some resistance to reform. Yet the sooner reformers act, the easier it will be for government—i.e. the taxpayer—to share the wealth that UGB expansion creates. Assessing the costs of providing public services to newly developed land allows for efficient and timely provision of those services. Real estate prices might remain the same, but by reforming the current "developer welfare" system, those who reap the benefits of Portland's growth would also pay their fair share of the costs.

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Graph source: Metro Housing Needs Analysis, Technical Appendix 1 (p. 24, 1996)

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Whoever now catches this windfall did little or nothing to create it.

the bill. Because no mechanism currently exists to share the profits created by converting land from rural to urban uses, those who own the land reap all the benefits and pay none of the costs.

Founders of a New Northwest

by David Roth

If you're interested in this Forum, there's a new book for you to read. It's *Founders of a New Northwest* (\$10), just published by Sustainable Northwest, a non-profit foundation established by Ted Hallock after his stint as one of Oregon's representatives on the Northwest Power Planning Council. The book contains profiles of several dozen people and organizations whose work exemplifies the foundation's mission: to resolve the conflict between environmental preservation and prosperity here in the Northwest.

The Northwest Power Planning Council was the first regional effort in the Northwest to develop an ecological approach to preservation and development. It was established by agreement among the four NW states, Oregon, Washington, Idaho and Montana, and funded by the Bonneville Power Administration. It was the precursor of the watershed approach to environmental protection of endangered species which was established more than a decade later by the Clinton administration.

The Council's purpose was to manage the energy system of the Northwest to sustain reasonable economic growth and restore the Columbia River salmon runs to something of their former vigor. Put more simply, its job was to prevent the extinction of the last Columbia salmon runs without removing the dams. After years of research, experiment, and debate by the Council, its efforts have recently been buried under a flood of contempt caused by scandalous reports that the salmon runs continue to decline despite

massive expenditures (mainly in the form of foregone electrical revenues).

Sustainable Northwest takes a grassroots approach to the same problem. It is led by some of the same environmental pragmatists with whom Hallock has worked for a long time. The best known are two governors—Neal Goldschmidt, who originally appointed Hallock to the NW Power Planning Council, and Cecil Andrus, of Idaho, the other NW Republican Governor who gave President Nixon an environmental pain in the neck.

Having seen the bitterness of the environmental conflict spread from lumber to ranching and farming, the leaders of Sustainable Northwest wanted to publicize and sponsor projects designed to escape the vicious circle of attack and counterattack. They believe that environmentalists and the people who depend on the land for their livelihoods actually share an interest in preservation, and that they should work together to find ways to preserve both natural habitat and the traditional ways of life. Hence this book.

The stories are drawn from all over the Northwest. The Founders include ranchers, Native Americans, lawyers, politicians, and Forest Service personnel. Their stories fall into such categories as business and marketing, collaborative land management and restoration, and forest and timber management. If you're looking for ideas or contacts, start here. Copies may be ordered from Sustainable Northwest, 1020 SW Taylor Suite 200, Portland, OR 97205; (503)221-6911; e-mail: sustnw@teleport.com.

Book Review