USING PUBLIC CAPITAL EXPENDITURES

TO STIMULATE REINVESTMENT

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About the Author:

Lawrence B. Rosser has served as Executive Director of the Woodstock Institute since its founding in 1973. The Woodstock Institute is a non-profit organization which conducts research, training and education for the public, private and voluntary sectors about ways to ameliorate disparities in the availability of capital and credit.

Dr. Rosser served as a faculty member of the Sociology Department of the Central YMCA Community College, and has lectured on urban affairs at the University of Chicago, Lewis University, and the Northwestern University Graduate School of Management. He is currently an Adjunct Lecturer in Urban Affairs at the University of Illinois School of Public Health.

An honorary board member of the Chicago Suburban Chapter of the Southern Christian Leadership Conference, and a co-founder and former convenor of the Chicago Regional Housing Study and Action Group, Dr. Rosser also serves as a public interest member of the Illinois Savings and Loan Board.

His professional memberships include the American Society of Planning Officials and the National Association of Housing and Redevelopment Officials. His recent publications are as follows: Maintaining Viable Communities: The Investment-Disinvestment Process and Some Strategies for Housing Maintenance and Rehabilitation in the Pilsen Community of Chicago (with Calvin Bradford); "Aurora, Illinois: A Case Study of a Low- and Moderate-Income Housing Set-Aside Ordinance;" "Using State Regulatory Authority to Stimulate Prudent Lending in a Changing Environment" (with Calvin Bradford and Stanley Hallett); Demand, Supply and Marketing of Single-Family Mortgage Credit (with Calvin Bradford and Dennis Marino); "Tying Bank Privileges to Performance."

In 1976, Dr. Rosser served as staff director for the first national conference on ways that states could use capital improvements to leverage private capital and credit. The conference was sponsored by Governor Daniel Walker of Illinois, and was entitled, "From Redlining to Reinvestment: Using State Regulatory Authority and Capital Expenditures to Leverage Private Capital and Credit."

He completed his undergraduate studies at the College of William and Mary, Williamsburg, Virginia, and received his M.Th. and D.Mn. degrees at the University of Chicago Divinity School.

Dr. Rosser resides in Hyde Park on Chicago's South Side where he serves on the board of the local community organization.

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Summary

This is another of a series of papers analyzing public sector initiatives to induce reinvestment. The paper notes that public capital expenditures for infrastructure (water, sewers, roads, public facilities and open space) have played a key role in creating new communities, and that new communities have disadvantaged older areas in the competition for private capital and credit. The author describes how the State of Massachusetts has taken the lead in developing a system at the cabinet officer level to review capital expenditures to determine their unintended negative consequences for that state's disinvestment problem, and he proposes in the conclusion that Missouri consider adopting a similar system of review to be used in conjunction with certain other value capture strategies.

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Introduction

In September, 1976, former Illinois Governor Daniel Walker delivered the keynote address at a conference entitled "From Redlining to Reinvestment: Using State Regulatory Authority and Capital Expenditures to Leverage Private Capital and Credit." In that address, Walker made the following observations:

> We have been paying the high price of creating new communities out of cornfields. We have been contributing to the conditions which allowed private investment to abandon older neighborhoods in favor of newer ones opened by our capital investments.[1]

Walker's comments provide a focus for the consideration of how states can reverse the current trend of exurban investment/urban disinvestment by targeting public capital expenditures to areas that need redevelopment. Before moving to a discussion of how such targeting is being accomplished in one Northeastern state, it is worth examining <u>how</u> public capital expenditures attract private investment.

In 1976, the Illinois Department of Transportation (IDOT) was asked by the Governor's office to develop an after-study of the impacts of highway construction on new suburban development. Using a series of techniques, including before and after aerial photography, IDOT's staff gave the following summary report of their findings:

> A 13.5 mile freeway link opened to traffic in 1974 cost the state and local governments \$8.5 million (\$85 million, total cost).

> Two years later, commercial and industrial development that had occurred since the highway construction began was measured at just three of the seven interchanges along the route. That development is valued at $195 million, making a ratio of state and local investment to private investment 1:23.
>
> Constructed predominately through farmland on the suburban fringe, the facility involved virtually no dislocation of existing development. Further, IDOT staff believe that of the total development, at least $90 million in industrial development can be traced to plants that have moved out from the central city [of Chicago].[2]

Obviously, not all public capital improvements have the same leveraging effect of the one described above. It is clear, however, that investors and developers cannot proceed without certain public improvements being committed or in-place, and it is also demonstrable that a conscious state policy of limiting the use of such improvements to areas where the state wishes to see redevelopment take place can foster shifts in the private allocation of capital and credit.

The Massachusetts Approach

Referred to by one of its officials as a state that is redlined, Massachusetts like other older industrial states in the Northeast has been trying to come to grips with its decreasing jobs and income base, and its increasing expenditures for transfer payments (welfare, unemployment and medical assistance). In 1975, when Michael Dukakis became governor, he vowed to turn "all of the state's existing regulatory powers and public investment programs, in a single-minded fashion, to one goal: reinforcement of existing city and town centers."[3]

In addition to encouraging Carol Greenwalt, Commissioner of Banks, to develop an aggressive regulatory posture which provides financial institutions with incentives for reinvestment, and disincentives for disinvestment, Dukakis initiated a cabinet level state-wide planning process to determine what were the redevelopment needs and opportunities in the state's urban areas. To insure that there would be sufficient coordination among state departments, the governor appointed the director of state planning as chairman of a seven member economic development council composed of department heads and the lieutenant governor.

The development cabinet efforts resulted in the publication of a document entitled "Towards a Growth Policy for Massachusetts." As reported in a speech by the planning department's deputy director, David Carter, this plan contained the following analysis:

> The dispersal of growth we have witnessed over the last half-century is in large part an expression of, and in some ways a cause of, prosperity and mobility in American society. But in Massachusetts, as well as in many other states, this pattern of growth and development also created problems. Chief among them are the following:
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> ---The inefficient use of land and unnecessary public and private costs from the inefficiency;
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> ---The deterioration of older centers, in each case the focus of substantial prior social and fiscal investment, and with that deterioration an increase in associated costs, burdens and inequities;
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> ---The inequities among households and communities resulting from unequal access to jobs, housing, open space, and quality municipal services; and

---The inadequate level of economic growth and residential investment.[4]

Based on this analysis of the problem, and the inescapable conclusion that the state would have to play a major role in limiting future growth to already developed core areas, the development cabinet produced the following priority elements of a growth policy for the commonwealth:

1. Stabilize the physical condition of existing residential neighborhoods.

2. Promote wider choice among residential environments for persons who traditionally have been denied such choice.

3. Promote the rehabilitation and adaptive reuse of existing residential, commercial and industrial buildings wherever possible.

4. Promote the location of new commerce and industry as close as possible to existing core areas with the infrastructure necessary to support them, and in densities sufficient to make efficient use of that infrastructure and of available land resources.

5. Make Massachusetts' levels of unemployment and income comparable with those of other industrial states by promoting the retention and growth of well-paying jobs and upgrading existing employment opportunities.[5]

An example illustrates how Massachusetts joins its commitment to limit growth with attempts to use state public capital expenditures to leverage private capital into already developed core areas. A dispute arose over the siting of a proposed shopping center in the Western part of the state. One site was downtown Pittsfield, a community that had expressed an interest in becoming the commercial center for that part of the state. The developer had proposed putting the facility on the periphery of a small community called Lenox where it could have caused serious deterioration of that community's shopping strip. As the National Journal reported, the state's message to the developer was clear: If you proceed with the Lenox site, "There will be no access to the state highway. Forget about your development. We just won't permit it."[6]

In addition to stopping and redirecting development pressures, the development cabinet has been successful in leveraging private capital and credit into priority areas. Perhaps the major example of this is the success of the state in getting private developers to use the site of the old Charlestown Navy Yard for a mixed-use project. Through the development cabinet, the developers were provided with "one-stop shopping" for the clearances necessary to proceed with this $100 million development.[7]

Conclusions and Possibilities

Two conclusions emerge from an examination of the Massachusetts efforts to redirect capital improvement expenditures. The first is that policymakers and elected officials in states willing to emulate Massachusetts have some difficult political decisions to make. Construction and real estate interests are not likely to greet this initiative with much enthusiasm. While their pecuniary interests presumably could be enhanced as much by developing in core areas as by opening new frontiers, their perceptions about the problems of inner-city development may make them fiercely resist growth planning.

In new suburban areas, for example, a developer can obtain control of an entire parcel, and thereby plan and pace his development activity according to a schedule that suits his resources. In core areas, large parcels are more likely to be democratically controlled by several owners, thereby making negotiations and packaging more difficult, time consuming and expensive. Elected officials can soften developer opposition to a certain extent by providing the kind of high-level, central coordination that Massachusetts has through its development cabinet. Nevertheless, since the development cabinet concept, like any governmental program, takes time to put in place and to begin functioning, the political vulnerability of elected officials may be high for a substantial period of time after the strategy is initiated.

The second conclusion is that a strategy to develop a state growth plan and to implement it through public capital expenditures is only the beginning of a comprehensive state strategy. To provide meaningful incentives--as opposed to creating disincentives by refusing funding for public improvements--requires that additional initiatives be developed. One set of strategies that could be used are those which capture the excess value created by public improvements in order to use them as inducements for development.

One of the most common forms of value capture is supplemental condemnation. This involves the governmental agency sponsoring a public improvement project in using its authority to condemn more land than it actually will need for the project. Once the project has been completed--and, presumably, additional value created for surrounding land--these "remnant" parcels can be sold to private interests for development. While courts have tended to frown upon some forms of "advance condemnation," especially those that are done expressly to guarantee the financial success of a public improvement project, there is in the opinion of some legal observers an increasing tendency to accept such practices as necessary.

Used in tandem with efforts to direct capital expenditures to core areas, supplemental condemnation might enable a public body to capture land adjacent to the proposed improvement at depressed prices, and then make it available to developers at low cost even though the value had increased substantially. In effect, therefore, developers would be getting a subsidy from the state which would not cost taxpayers any money. Such a "subsidy" might defray some of the additional costs that developers perceive as coincident to core development.

Whatever form the initiative takes, the use of capital expenditures by states to leverage private capital and credit into core areas appears to be promising. Or, to put it a different way, the <u>failure</u> of states to take account of the impacts of capital expenditures can frustrate other reinvestment strategies. As David Carter observed more than a year ago:

> Major state investment programs--sewer, water, roadway, rapid transit, school building, industrial bonding, parks and open space funding--are not locked into impossible formulas that cause them to move on inexorably, despite the need for new priorities and different sorts of spending patterns.
>
> These programs can be changed. Every one of them is subject to a comprehensive set of policies and priorities often required from the states on an annual basis. Every one of them is subject to reinterpretation through regulations.

States and people in neighborhoods should not be put off by old-line bureaucrats who insist on the rigidities of funding and the fact that there is only one way to run a program, the way they have been running it for the past twenty-five years. It is not true. Unless those major state investment programs are turned around, your efforts to rebuild neighborhoods will be constantly undercut by the destructive side of development patterns over the last twenty years.[9]

Footnotes

1. Governor Daniel Walker of Illinois, in remarks before a conference held in Chicago, Illinois, entitled, "From Redlining to Reinvestment: Using State Regulatory Authority and Capital Expenditures to Leverage Private Capital and Credit," September 1, 1976, p.3.

2. Bob Adams, Public Involvement Specialist, IDOT, in Memorandum to John Leek, Bureau of Planning, IDOT, Re: "Article on Reinvestment Conference for Planning Newsletter," September 22, 1976, p.2.

3. "Some States Are Putting Their Urban Strategies to Work," National Journal, October 15, 1977, p.1605.

4. David Carter, Office of State Planning, Commonwealth of Massachusetts, in remarks before a conference in Chicago, Illinois, entitled, "From Redlining to Reinvestment: Using State Regulatory Authority and Capital Expenditures to Leverage Private Capital and Credit," September 1, 1977, pp.36-37.

5. Ibid, p.37.

6. "Some States Are Putting Their Urban Strategies to Work," p.1606.

7. Carter, p.38.

8. For a discussion of value capture strategies, see David L. Callies, Carl P. Sharpe, and Donald L. Williams, "Value Capture Policy Gives the Public An Added Payoff," Planning, Vol. 42, No. 9, October, 1976, pp.22-23.

9. Carter, pp.39-40.