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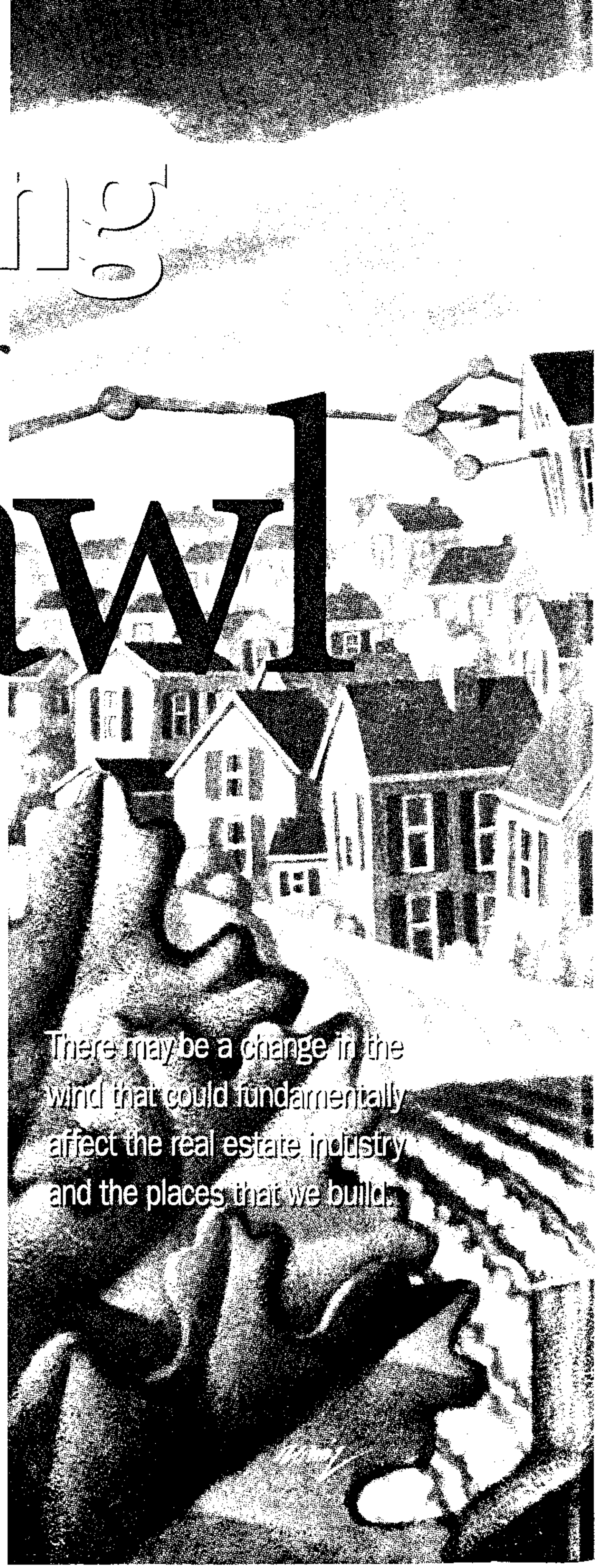
The Beginning of the End of Sprawl



There may be a change in the wind that could fundamentally affect the real estate industry and the places that we build.

CHRISTOPHER B. LEINBERGER

Two factors—evident in virtually every metropolitan area—have defined how real estate developers and municipal agencies build commercial and residential developments and infrastructure improvements. The first is the concentration of executive housing—which tends to be located in one general area, although a few of the largest metropolitan areas claim two or three such concentrations. The second factor is the concentration of lower-income housing, which generally is located 90 to 180 degrees away from the concentration of executive housing. Since the bosses usually select a company's employment location, job concentrations tend to be driven by their proximity to executive housing, as well as their access to the regional freeway system.

These two factors have led to the emergence of the "favored quarter," where nearly all new and relocating jobs cluster and where 70 to 80 percent of infrastructure dollars are spent. This trend has pushed the fringe of the region farther and farther out, suburbanizing the rural countryside at an ever-increasing pace in the favored quarter. Edge cities of one decade become inner suburbs of the next decade as new edge cities are built farther out. The last 50 years have witnessed a geometric expansion in the physical space occupied by metropolitan areas. Specifically, the land claimed by the nation's metropolises has expanded at least seven times as fast as their metropolitan population.

During the early to mid-1990s, the physical growth rate of metropolitan areas accelerated even faster than the rapid rates of the previous decades. Fringe commercial developments sprang up in the hinterlands of metropolitan areas, such as the Alliance Airport area of Dallas/Fort Worth, the north Scottsdale area near Phoenix, and Cherokee and Gwinnett counties in Georgia, 40 miles north of downtown Atlanta. As sprawl has accelerated, it has emerged as a political issue that has moved from the local level—where it had simmered for years and at times boiled—to the state level and most recently to the national level.

Over the past few years, with the country's economic recovery continuing to set records and the expectation of further sprawl fueling community and political opposition, something entirely unexpected may be occurring—the beginning of the end of sprawl. The fringe of metropolitan areas will continue their outward push, suburban subdivisions will continue to be developed on former farmland, and huge build-to-suit offices and plants still will be sited on greenfield sites located 40 to 60 miles from downtown. However, there appears to be a small, but significant, shift in where selected new development is heading—to more infill and downtown locations. Some signs even portend a structural shift in how metropolitan areas are built and how Americans want to live. While a change in public policy—which subsidized suburban sprawl over the past 50 years—to a more balanced policy could accelerate the end of sprawl, what is really at work is a market shift that no amount of government intervention can stop.

In his book, *Metropolitics*, Myron Orfield, a member of the Minnesota House of Representatives and the advisory board of the Brookings Institution's Center on Urban and Metropolitan Policy, reports the results of recent studies he conducted that show that infrastructure improvements have been disproportionately concentrated in favored areas even though funding for the improvements comes from throughout the surrounding metropolitan area. In Chicago, for example, the tolls paid by predominantly working- and middle-class workers driving the fully paid-for Illinois Turnpike on the south side have subsidized roads built primarily in the favored quarter to the northwest and north of downtown. Given the correlation between location of employment and home values, southside commuters pay tolls to drive longer distances to work, while the value of their homes continues to decline.

However, sprawl has become a formula-driven business—reinforced by the financial markets' desire for predictability—that has led to characterless suburbs that could be located anywhere. As author Tom Wolfe wrote in his latest book, *A Man in Full* (see review in April 1999 *Urban Land*), "The only way you could tell you were leaving one community and entering another was when the fran-

Denver, Colorado.

chises started repeating." In the search for answers to why children too often turn to violence, numerous writers have editorialized about the placelessness of suburbs such as Littleton, Colorado. While it is impossible to say whether characterless sprawl can play a role in the violent, antisocial behavior of youth, there is agreement that many suburbs can be described only as ugly, inhuman, and soulless.

But, anecdotal evidence suggests that lower-density, sprawling development may be changing. The first and most obvious piece of evidence is the surprising comeback of many of America's downtowns. Nearly half have rebounded or are in the process of reemerging as vibrant centers of urban life: office rents are at or above replacement levels, housing is seeing a resale market, and retail uses are reaching critical mass, putting people on the streets. Twenty years ago, only midtown Manhattan, San Francisco, Boston, and Chicago could boast viable downtowns; anyone who wanted an urban lifestyle migrated to these four cities. Today, the number of resurgent downtowns includes San Diego, Denver, Seattle, Portland, and Baltimore, among others. Even more impressive is the list of downtowns that are in the middle of the comeback process: San Jose, Phoenix, Dallas, Houston, Austin, San Antonio, Boise, Minneapolis, Memphis, Chattanooga, Nashville, Charlotte, Atlanta, Providence, Cleveland, Columbus, and Cincinnati, among others. It is not unreasonable to say that most, if not all, American downtowns will either be, or are on their way, to becoming viable real estate markets ten years from now.

The emergence of healthy urban real estate markets is not confined to downtowns. Many "third-generation" metropolitan cores—edge cities that emerged in the 1970s but today are miles from the edge due to continued sprawl—have begun to urbanize, including West Los Angeles, Century City, Bellevue (Seattle), Buckhead (Atlanta), and the profusion of urbanizing cores (primarily due to the success of the Metro transit system) around suburban Washington, D.C., namely, Bethesda and Chevy Chase in nearby Maryland and the Ballston and Court House areas in nearby Virginia.

A recent research study conducted in Atlanta, Chattanooga, and Albuquerque by Robert Charles Lesser & Co., an independent real estate advisory firm based in Los Angeles, asked consumers a series of tradeoff questions regarding lifestyle preferences in one of three housing categories: semi-rural, suburban, or urban. Despite the prospect of smaller dwelling units with little or no yard area, over 30 percent of respondents expressed a preference for urban housing and the opportunity to walk to restaurants, shops, and work. Interestingly, not one of the three cities in the research study can point to a recent trend in urban housing. Perhaps, then, as more urban neighborhoods evolve, the percentage of consumers favoring urban housing will increase.

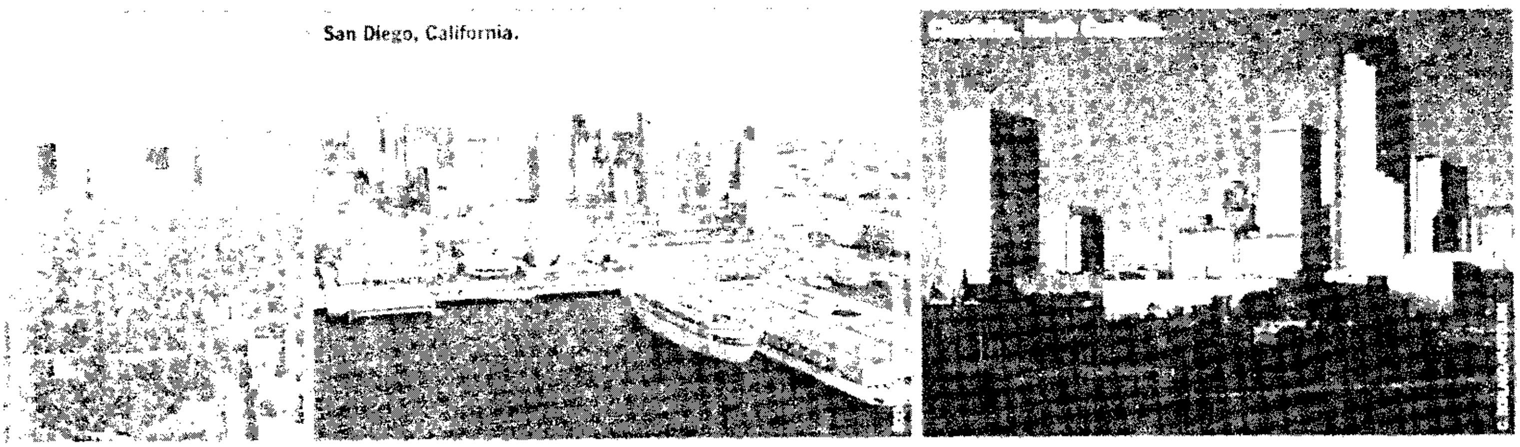
The underlying reason for the consumer shift is probably the aging of the baby boom generation. As baby boomers move into their 50s and many enter the empty-nest stage, some have started to question the wisdom of remaining in suburban isolation. They seem to be reevaluating how they want to live the next phase of their lives, and many report that they intend to be far more active and involved than were previous generations. An urban lifestyle may offer just the alternative they are seeking.

Apparently, many Generation Xers also prefer urban settings. The most popular Gen-X television shows—*Friends, Seinfeld, Dharma & Greg*, and *Two Guys and a Girl*—are all based in cities. The most popular shows of previous generations—*Leave It to Beaver, The Dick Van Dyke Show*, and *The Brady Bunch*—all were set in the suburbs.

A significant trend throughout the country in the past few years has been the relative price appreciation of the favored-quarter inner suburbs. Since the mid-1990s, housing prices in favored quarter inner suburbs, such as Bethesda, Buckhead, Bellevue, Palo Alto, and the Park Cities in Dallas, have increased between 10 and 20 percent per year. In contrast, the price appreciation of new housing built on the fringe of the favored quarter has barely kept pace with inflation. To avoid traffic congestion, people are willing to pay more to live in closer-in neighborhoods with history and character—neighborhoods that offer easy access to public transportation.

With bosses beginning to move back downtown and the favored-quarter inner suburbs enjoying a renaissance, it could be only be a matter of time before jobs begin to return to these areas as well. In Seattle, many Gen-X software developers live downtown and have even moved their places of business downtown. Households willing to pay $200 per square foot for a downtown loft in Denver's LoDo have generated a demand for office space that now fetches rents of over $30 per square foot. In addition, as bosses residing in traditional suburban executive housing concentrations have come

San Diego, California.



to realize that reverse commuting is an illusion, the downtown and infill business locations hold new appeal.

Other forces at work that may, on the surface, slow sprawl appear unrelated. The first is the environmental movement, which has named sprawl "public enemy number one." Nearly all environmental organizations, from the Conservation Fund to the Sierra Club, have endorsed major initiatives to help combat sprawl. A case in point is the open-space initiatives that appeared on ballots in 1998 and 1999 across the country asking voters to approve the use of tax dollars to buy land to protect it from development. A New Jersey ballot measure has committed the state to buy half of the Garden State's remaining undeveloped land over the next decade or so. In addition, the land trust movement has grown exponentially, using federal and state tax breaks to ensure that land remains as open space forever. The result is de facto growth boundaries around many metropolitan areas such as Miami, San Francisco, and Chicago, not to mention the growth boundaries expressly imposed by a few metropolitan areas themselves, such as Portland and Seattle.

Another force that may slow the spread of sprawl is the recognition of sprawl's cost. Recent local government fiscal impact studies demonstrate that sprawl-oriented development costs significantly more than compact development. For local governments, the difference in cost over the next 20 years between sprawl-oriented development and compact development in mid-sized metropolitan areas is measured in billions of dollars. In a special election, the citizens of Albuquerque recently passed a measure to raise taxes to pay for road improvements—but only for existing roads. Now that it is becoming known that sprawl is subsidized, imagine the effect on the sale of single-family housing located on the fringe if impact fees of $20,000 to $80,000 per dwelling unit were levied, as the fiscal impact studies conclude they should be.

Even utility deregulation may have an impact on sprawl. Before deregulation, a state utility commission would simply add up, mark up, and approve a private utility's proposed charges for a new development—without regard for unit cost by location for the delivery of electricity or natural gas. Now increasingly deregulated utilities have every incentive to join the rest of American business in basing the price of their goods on actual costs. One preliminary utility study in Chicago indicated that the delivery of electricity to fringe developments may cost two to three times as much as to in-town locations.

In most metropolitan areas, the local news media have focused on sprawl, generally painting it as a great social and environmental evil. In its weekly Horizon section, *The Atlanta Constitution* has been highly critical of sprawl. In fact, Atlanta has been considered the capital of sprawl since the early 1990s. Even major charitable foundations are now interested in combating sprawl. This past January, most of the country's largest foundations, including Packard, Hewlett, and MacArthur, among others, came together to discuss how they could use their formidable resources to fight sprawl.

Given the strength of the national economy and the booming real estate market, the issue of growth management has gone beyond the local level to state and even national levels. As Tony Downs, an analyst at the Washington, D.C.–based Brookings Institution, notes in his recent book *Metropolitan Visions*, most observers of metropolitan growth areas now recognize that state governments need to be involved in solutions to sprawl. Over 20 state legislatures apparently agree, as evidenced by the passage of statewide growth management legislation over the past decade. The most unexpected and potentially sweeping measure in recent years has been legislation passed in early 1999 to create the Georgia Regional Transportation Authority. It is almost unthinkable that such a conservative state took the unprecedented action of directing the governor to appoint a land use and transportation regulatory body over the Atlanta metropolitan area. Historically, however, the Atlanta real estate community has been known for its progressive, forward-looking view of development trends. Accordingly, the real estate industry's reaction to the new law has been favorable.

Even more surprising has been the emergence of the sprawl issue on the national political agenda. Brought to the fore by Vice President Al Gore, sprawl has taken on the mantle of a secondary presidential issue in the 2000 election campaign. Nearly every major news weekly and opinion magazine has or will soon run a major story about sprawl.

Perhaps the hidden force influencing the sprawl debate will be Wall Street. After the 1980s real estate debacle, investment bankers became the governors of the real estate industry not only through their function as financial intermediaries for real estate investment

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trusts (REITs) and the secondary mortgage market but also through continuing analysis of the nation's real estate industry. The market condition that most concerns Wall Street is overbuilding, and credit markets have been proficient in restricting the flow of new money to markets and product types that show signs of overbuilding. In fact, some of the most highly regarded REITs have strategically positioned themselves to focus on "high barrier to entry" markets, building only in urban locations. Suburban development, on the other hand, is more prone to overbuilding because of an almost always ample supply of well-located land. In contrast, urban locations in metropolitan areas are few in number and pedestrian focused, imposing a natural limit on how far potential consumers will walk.

The combination of environmental, public policy, financial, and, most important, market forces will eventually put such extreme pressure on those who induce sprawl that a new approach to development will emerge. The question is how the real estate industry can adapt to it and make a profit in the process.

The most significant effect of a new approach to development will be the shift from producing a simple, formula-driven suburban product to a more complex, mixed-use urban product. This shift will require a retooling of corporate strategies, financing, tactics, and skills. With great urban places created over time, the industry will require even more patient equity than in the 1990s. Land assembly and acquisition skills will take on great importance since infill development requires developers to deal with many more landowners than development at the fringe. And teaming up with environmental groups to fight NIMBYism may be required to achieve zoning and neighborhood support. It will be much more time-consuming to get a project through the development pipeline, but the project should perform better amid less-formidable competition. Finally, given that urban land values are among the highest in the country, the chance of a major financial upside is better than in the suburbs, where real estate is becoming a mass-produced commodity.

Where will buyers and tenants get the money to pay for a more costly urban product? The answer is from the automobile industry. After taxes, the average car costs $7,000 per year to own, maintain, and operate. By locating in a pedestrian-transit-oriented community, consumers can own fewer cars. The savings realized from giving up one car frees up over $120,000 in a mortgage loan for a house ($7,000 after taxes equals $10,700 before taxes—with 35 percent in state and federal taxes. At 8 percent interest over 30 years, this amount equals a mortgage of $121,200.)

If such trends portend the beginning of the end of sprawl, it will not be an easy transition for many in the real estate industry. But if the late 1990s turn out to be the high-water mark for sprawl, it would be wise to understand the implications sooner—rather than later. ■

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