



**MAKING SMART GROWTH SUSTAINABLE:**  
**REAL WORLD FINANCIAL IMPEDIMENTS**

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**Makeover Montgomery II**

Breakout Session 2: Track C

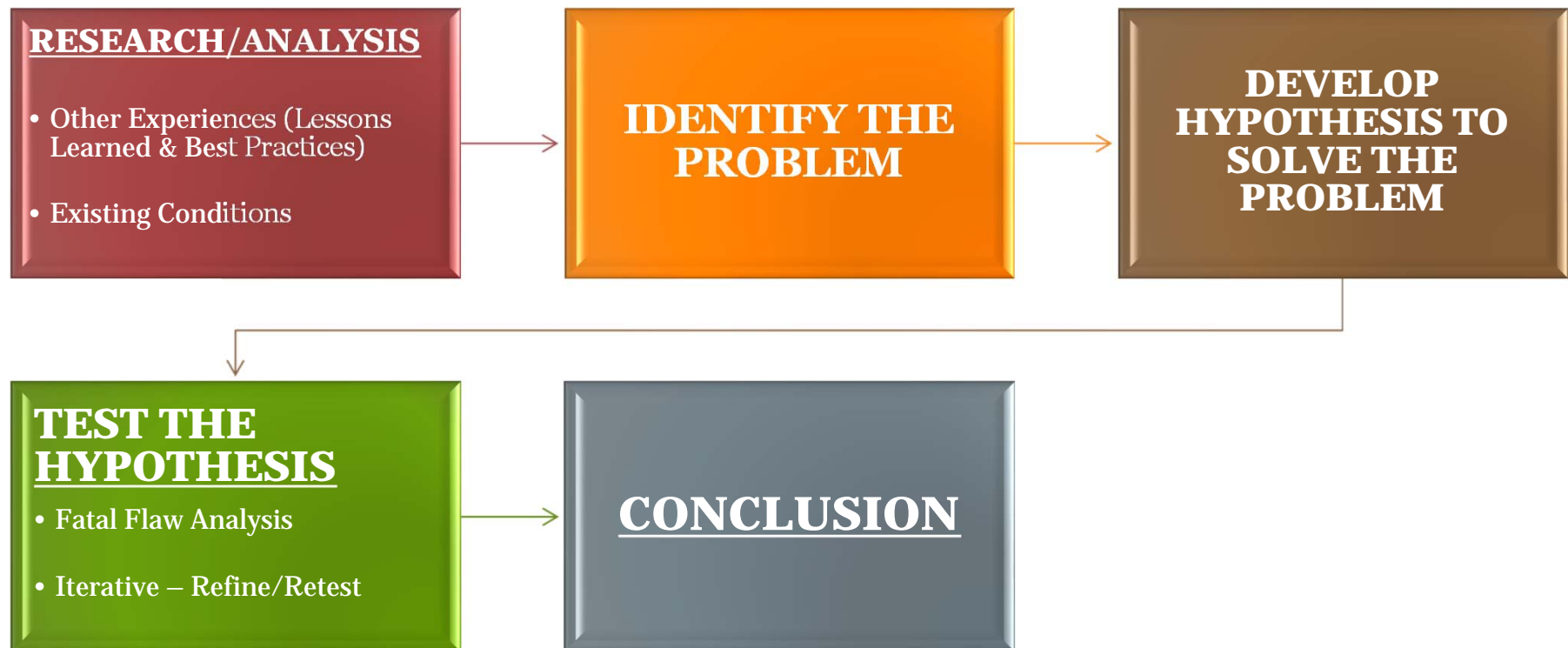
May 9, 2014

**Jonathan M. Genn**

Percontee, Inc.

# Silicon Valley's 5 Steps to Innovation

*[The "Scientific Method" of Discovery]*



# **Preliminary Disclaimers & Disclosures/Confessions**

1. **Politically Agnostic:** (ala Simpson/Bowles Deficit Reduction Commission)
2. **Only One Person's Perspective:** From experience in dealing with equity capital and debt financing, as well as tax-exempt bond financing of large-scale mixed-use community developments around the Country.
3. **Have a current financial interest:** In a proposed mixed-use community development presently before the County Council (White Oak, MD)
4. **Very Preliminary:** Not vetted with all stakeholders (e.g., capital markets, institutional lenders, bond underwriters, and others)

# **IDENTIFY THE PROBLEM**

## **(A Three-Part Analysis)**

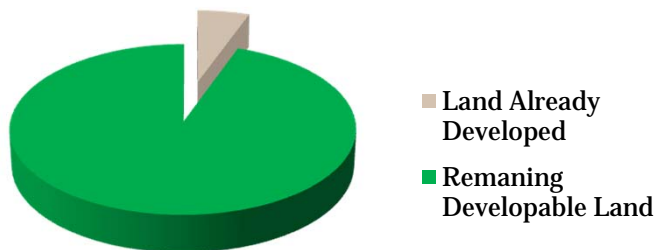
1. **Macro/Mega-Trend Challenges:** We have little to no influence or control (short-term or long-term)
2. **Naturally Occurring Financial Impediments:** We have little to no influence or control in short-term (but perhaps in long-term)
3. **Policy-Created Financial Impediments,** over which we have the most control both short-term and long-term (e.g., Ellen Harpel's strategies and eliminating policies that "shoot ourselves in the foot.")

# IDENTIFY THE PROBLEM

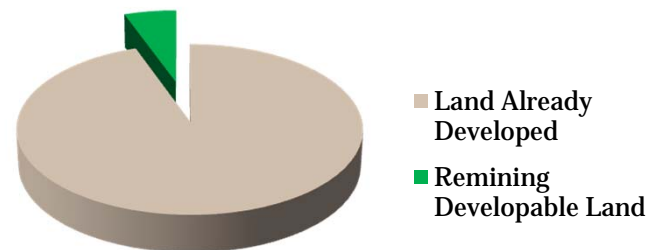
## Three Macro/Mega-Trend Challenges

1. >95% of County's developable land has already been developed; thus, most growth will be infill development.

**Mont Co Land - circa  
1950's**



**Mont Co Land - circa  
2010's**



# **IDENTIFY THE PROBLEM**

## **Three Macro/Mega-Trend Challenges**

2. [Dr. Steve Fuller/CRA] Percentage of moderate and lower income population will likely continue to grow; thus, Mont Co risks facing the challenges of a vanishing middle class.

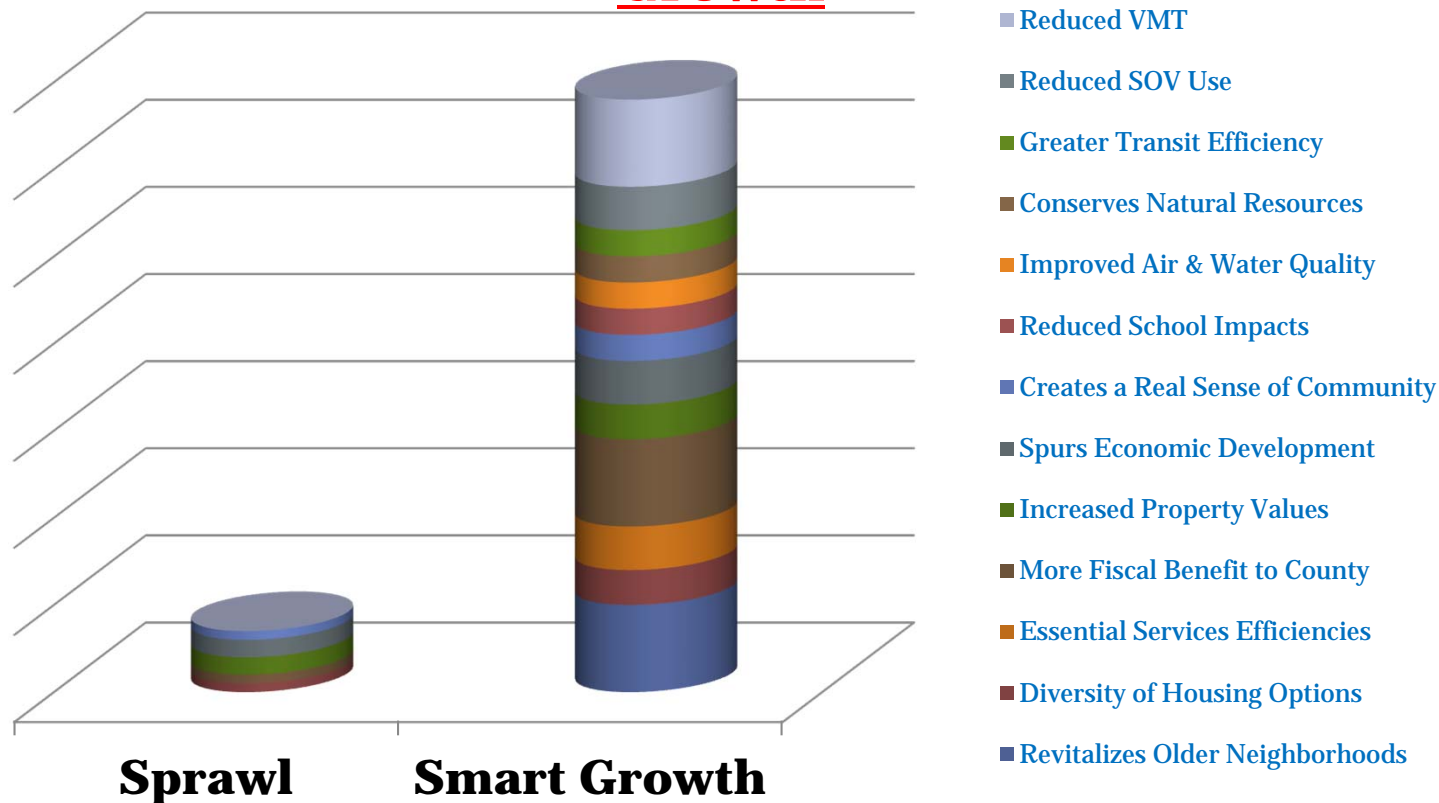
3. Consequence: Much of Mont Co's future sustainable communities will need to be financially viable for infill redevelopment of older, more moderate income neighborhoods.

# IDENTIFY THE PROBLEM

## Naturally Occurring Financial Impediments

### The Financial Cost-Benefit Disconnect

#### Social & Economic Benefits of Smart Growth

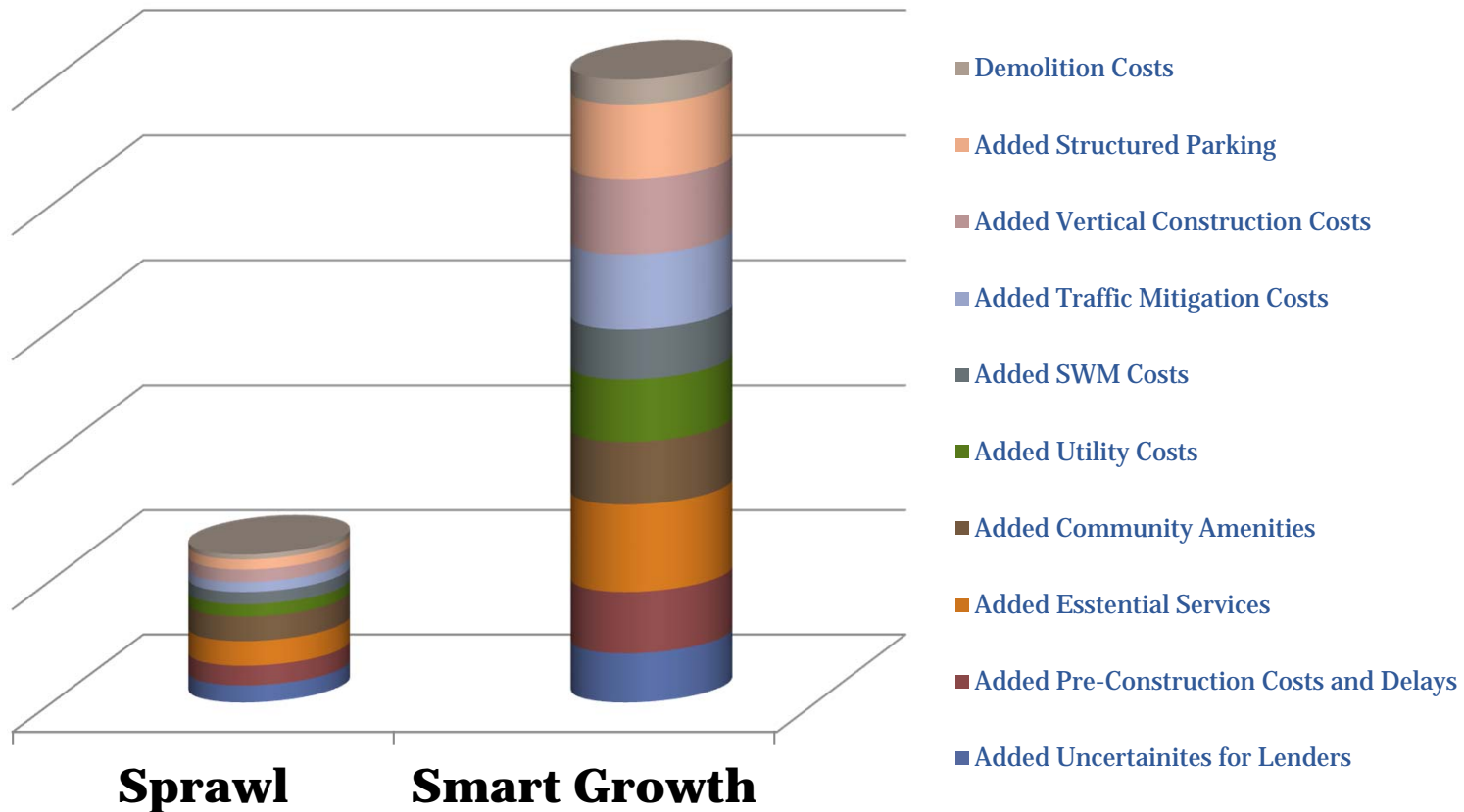


# IDENTIFY THE PROBLEM

## Naturally Occurring Financial Impediments

### The Financial Cost-Benefit Disconnect

#### Added Financial Burden Placed on Developers of Smart Growth Communities





# **IDENTIFY THE PROBLEM**

## **Naturally Occurring Financial Impediments**

### **HOW MUCH, IN REAL TERMS, IS THAT DISCONNECT?**

Example: Mixed-Use Community in Hyattsville, MD (within 1/3 mile of Prince Georges Plaza Metro Station)

Program:

~2,900 residences; ~225,000 sf office; ~60,000 sf retail; ~40,000 sf other

ADDED cost over suburban sprawl model for same program:

**Over \$121,000,000.00**

“Sprawl” IRR (Est.): **9.7%** (lower risks/faster absorption/more certainty)

“Smart Growth” IRR (Est.): **6.1%** (higher risks/slower absorption/less certainty)

# **IDENTIFY THE PROBLEM**

## **Naturally Occurring Financial Impediments**

**Cautionary note for next visual:**

***(Quote from H.L. Menken)***

**For every complex problem, there is a solution that is simple, neat, ...**

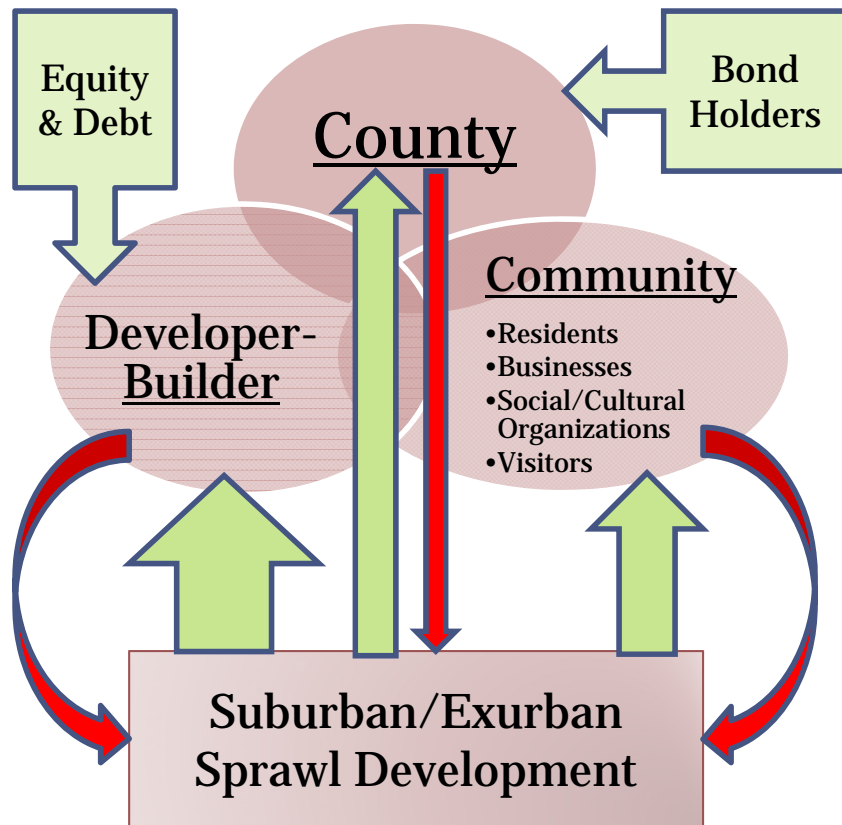
**...and wrong!**

# IDENTIFY THE PROBLEM

## Naturally Occurring Financial Impediments

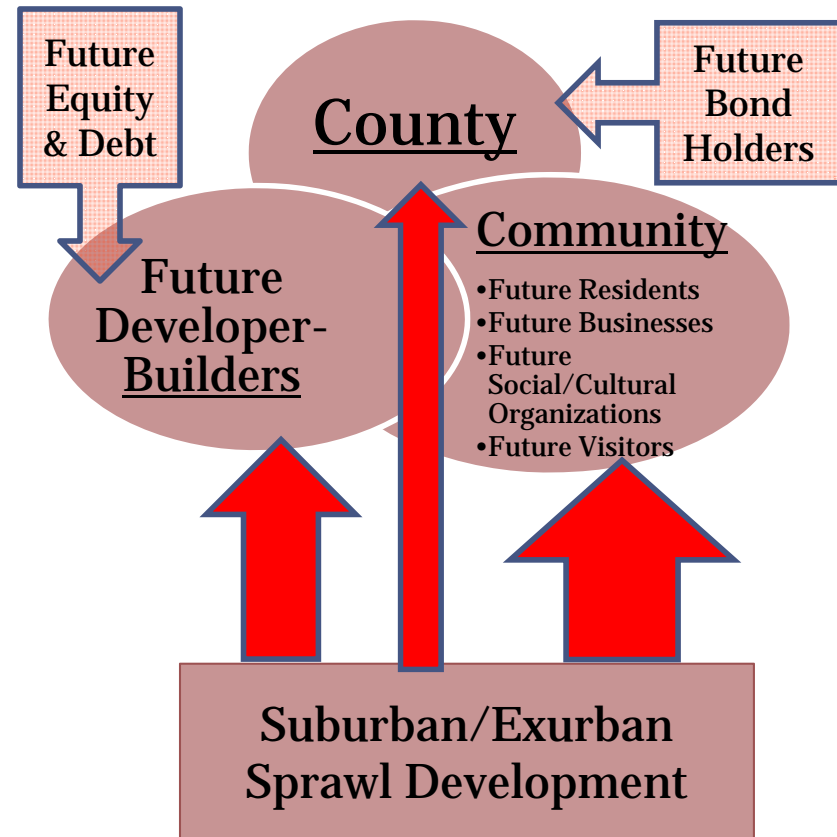
### SPRAWL ECOSYSTEM

#### Short-Term



### SPRAWL ECOSYSTEM

#### Long-Term

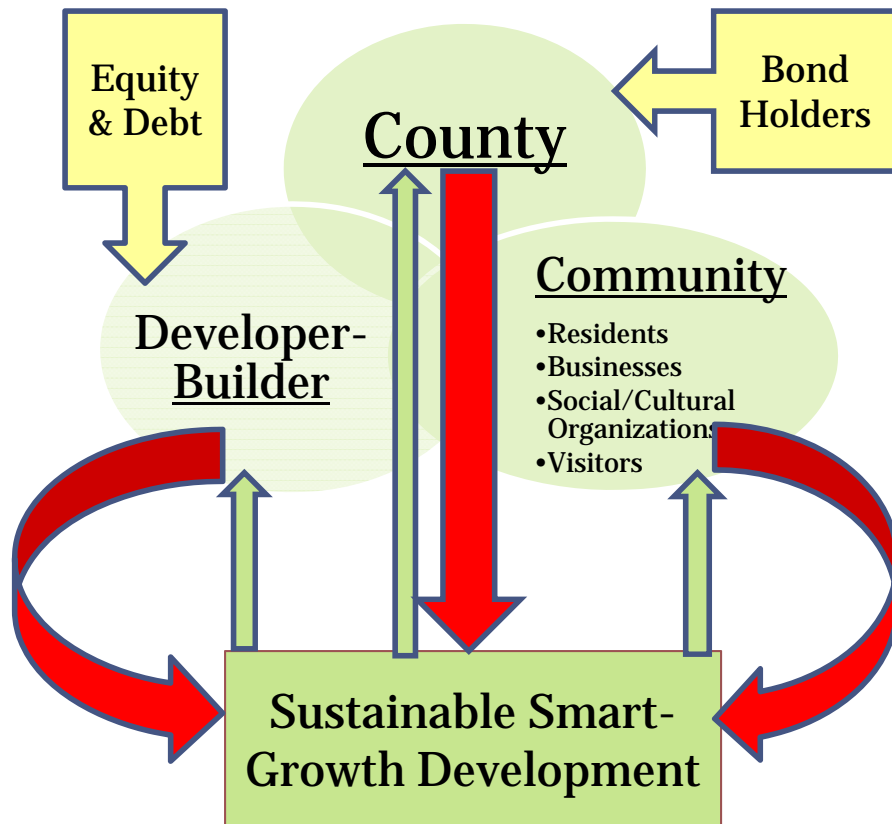


# IDENTIFY THE PROBLEM

## Naturally Occurring Financial Impediments

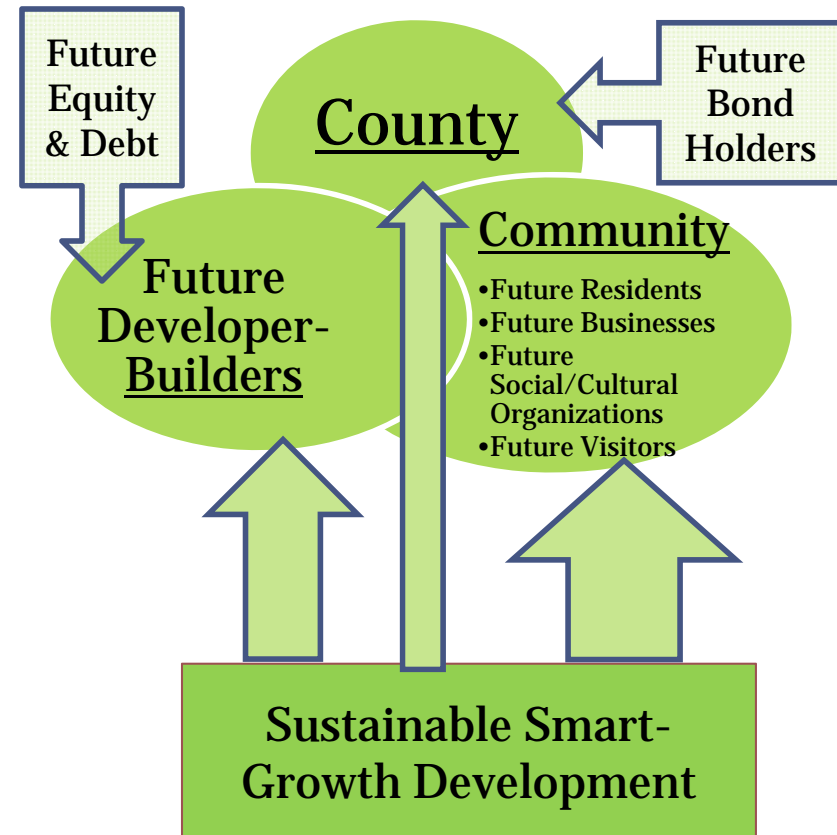
### SMART-GROWTH ECOSYSTEM

*Short-Term*



### SMART-GROWTH ECOSYSTEM

*Long-Term*

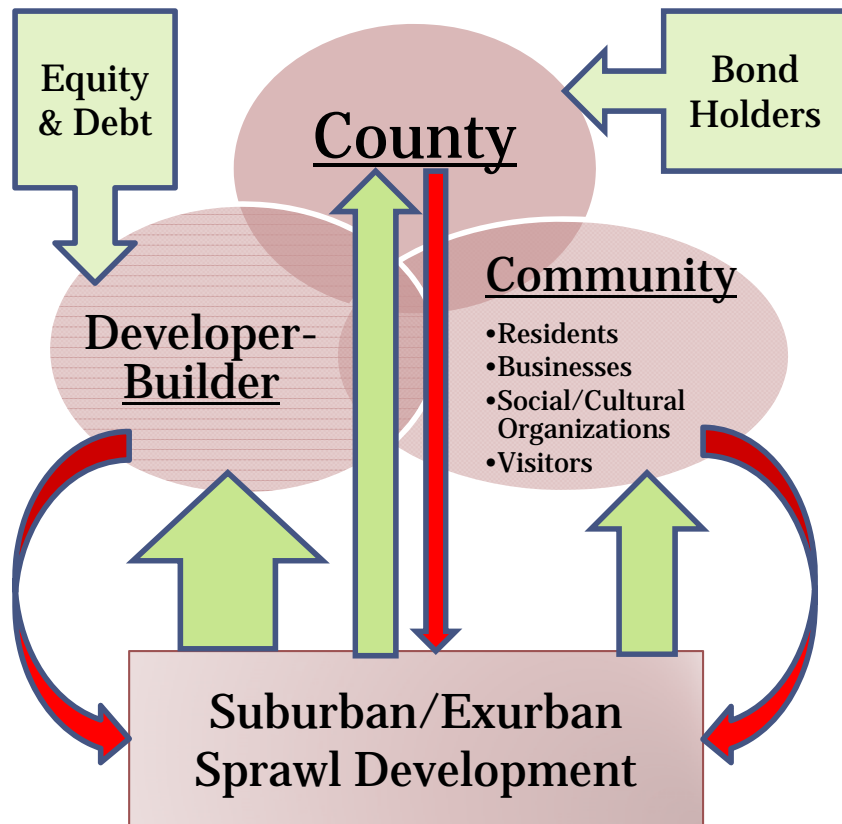


# IDENTIFY THE PROBLEM

## Naturally Occurring Financial Impediments

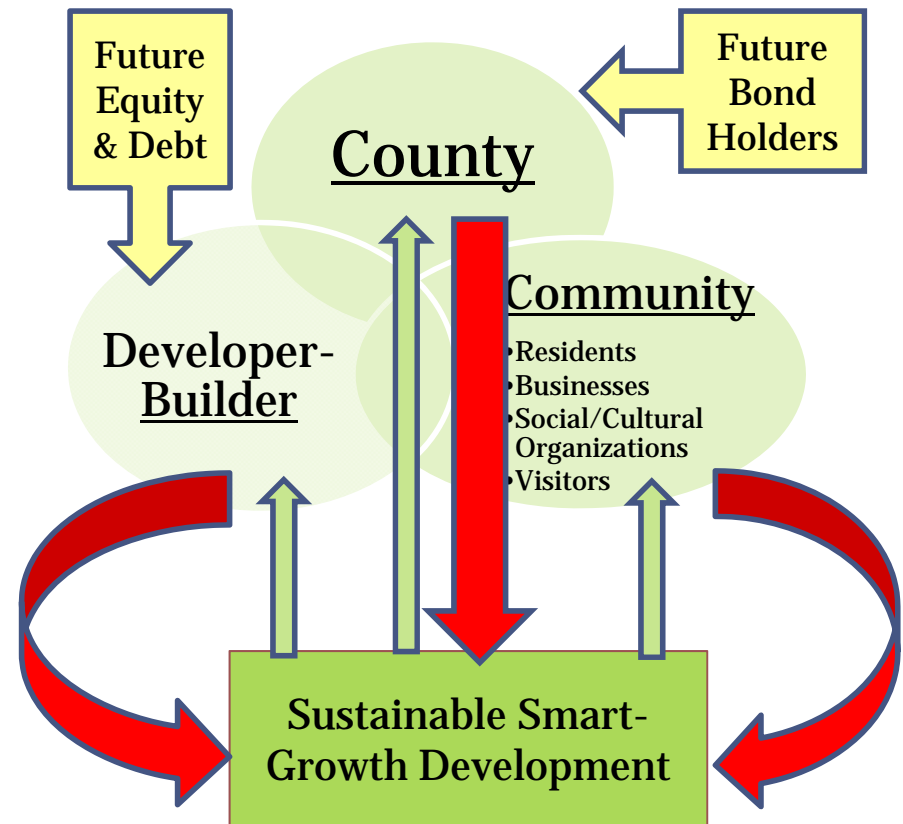
### SPRAWL ECOSYSTEM

Short-Term



### SMART-GROWTH ECOSYSTEM

Short-Term



# **HYPOTHESIS FOR SOLVING NATURALLY OCCURRING FINANCIAL IMPEDIMENTS**

## **SO HOW CAN WE SOFTEN THE NATURALLY OCCURRING FINANCIAL IMPEDIMENTS?**

- Hire Ellen Harpel  
([eharpel@businessdevelopmentadvisors.com](mailto:eharpel@businessdevelopmentadvisors.com))  
(1-571-212-3397)
- Have Ellen advise on how to custom-tailor the state-of-the-art best practices to most strategically, effectively, efficiently, and sustainably incentivize smart growth principles

# **IDENTIFY THE PROBLEM**

## **Policy-Created Financial Impediments**

### **TOP THREE PROBLEMS**

1. Subdivision Staging Policy: School & Transportation Tests/Taxes
2. Failing to get those who really profit from development to contribute fairly to the infrastructure that helps create sustainable, quality communities (and add value for everyone's benefit).
3. SSP and Permitting "advance payments" based on 100% inaccurate predictions of future, rather than payment "in arrears" based on 100% accurate statistics of actual past events.

# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

Problem #1 w/SSP: WORST FORM OF REGRESSIVE TAX

### Three Types of Regressive Tax

(1) A Flat PERCENTAGE (e.g., 1% transfer tax on raw land)

*Not really regressive (actually proportionate); but politically popular to criticize as regressive (although it does have regressive effects on disposable income above minimum living wage)*

Land Value: **\$400,000**

Flat % Tax: 1%

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Transfer Tax: **\$4,000**

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But as a % of discretionary income over living wage  
(e.g., \$20K/yr over living wage): **20%**

Land Value: **\$1,600,000**

Flat % Tax: 1%

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Transfer Tax: **\$16,000**

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But as a % of discretionary income over living wage  
(e.g., \$200K/yr over living wage): **8%**



# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

### Second Type of Regressive Tax

#### (2) A Flat DOLLAR AMOUNT:

(e.g., School Impact & Transportation Impact for SF Detached)

*Truly is regressive, further exacerbates the income gap and achievement gap, and renders sustainable community development cost-prohibitive for moderate and lower income residents (Avg Mont Co home = \$400,000 home and requires ~\$100K/yr household income)*

#### **Wheaton or Sil Spr SF Detached**

SF/Det Value:	<b>\$400,000</b>
Flat School Imp:	\$25,944
Flat Trans Imp:	\$6,754
Percent of Value:	<b><u>8.17%</u></b>

#### **Bethesda SF Detached**

SF/Det Value:	<b>\$1,600,000</b>
Flat School Imp:	\$25,944
Flat Trans Imp:	\$6,754
Percent of Value:	<b><u>2.04%</u></b>

**Wheaton & Silver Spring pay 4 times the relative amount**

# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

### Most Toxic Form of Regressive Tax

#### (3) Low Value Pays MUCH MORE Than High Value!

(e.g., School Facilities Payment disparity, often due to past, historic inequities in past infrastructure investment)

##### White Oak Townhome/Blake Cluster

Townhome Value:	<b>\$400,000</b>
\$\$ Impact Tax:	\$19,533
<u>\$\$ Facilities:</u>	<u><b>\$6,710</b></u>
% of Profit Margin:	<u><b>22.38%</b></u>

##### Park Potomac Townhome/R Mont Cluster

Townhome Value:	<b>\$1,600,000</b>
\$\$ Impact Tax:	\$19,533
<u>\$\$ Facilities:</u>	<u><b>\$0</b></u>
% of Profit Margin:	<u><b>3.5%</b></u>

*White Oak pays almost 7 times the relative amount of Potomac*

# **IDENTIFY THE PROBLEM**

## **Policy-Created Financial Impediments**

### **Most Toxic Form of Regressive Tax**

**Compounded Even More with Transportation Impact Taxes,  
LATR & TPAR**

#### **White Oak Townhome/Blake Cluster**

Townhome Value: \$400,000  
**% of Profit Margin that goes to**  
**SSP payment:**        **46.1%**  
IRR: **7.51%** (4.69% w/1.5 yr delay)

(50% more than Boyds & nearly 7 times that of Potomac)

#### **Boyds Townhome/Northwest Cluster**

Townhome Value: \$400,000  
**% of Profit Margin that goes to**  
**SSP Payment:**        **29.75%**  
IRR: **10.74%** (6.71% w/1.5 yr delay)

#### **Park Potomac Townhome/R Mont Cluster**

Townhome Value: \$1,600,000  
**% of Profit Margin that goes to SSP**  
**Payment:**                **6.84%**  
IRR: **19.18%** (11.99% w/1.5 yr delay)

# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

**Problem #2 w/SSP: Based on flawed foundation that only new development creates added student population; and thus, should pay capital costs of school facilities**

### 250 NEW condos

(mid-rise w/structured parking)

#### STUDENT GENERATION RATE

Elem (250 x .042) = 11

Middle (250 x .039) = 10

High (250 x .033) = 9

NEW STUDENTS = 30

**SSP PMT: \$612,500**

### 250 existing SF detached

(Of surrounding 1,000 homes, 25% with seniors/empty-nesters who sell to families)

#### STUDENT GENERATION RATE

Elem (250 x ..32) = 80

Middle (250 x ..144) = 36

High (250 x .131) = 33

NEW STUDENTS = 149

**SSP PMT: \$0**

# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

**Problem #3 w/SSP: Based on flawed foundation that only new development creates the new automobile trip generation**

### 250 NEW condos

(mid-rise w/structured parking)

#### TRIP GENERATION RATE

Trip Generation (250 x 1.1) = 275

NEW TRIPS = 275

SSP PMT: \$5,034,500

### 250 existing SF detached

(Of surrounding 1,000 homes, 25% with seniors/empty-nesters who sell to families)

#### TRIP GENERATION RATE

Existing seniors (250 x .25) = 63

Sell to family of 4 w/school age kids:

Resulting trips (1.75 x 250) = 438

NEW TRIPS = 375

SSP PMT: \$0

# **IDENTIFY THE PROBLEM**

## **Policy-Created Financial Impediments**

What do these analyses tell us about the SSP?

**They amount to a discriminatory surtax that does not bear a rational relationship to their purported purposes.**

*[A classic definition of taxes that are of dubious constitutionality.]*

# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

**Problem #4 w/SSP: Based on flawed foundation that builder/developer profits are best source for taxing/revenues for infrastructure**

### WHO REALLY PROFITS FROM NEW DEVELOPMENT?

[Who actually makes the money to be taxed for infrastructure?]

	White Oak Townhome	
	Per Home	100 Residence Development
Example of Builder/Developer \$\$:	100 townhomes (3 Bd, 2.5 bath) avg sq ft:	1,500
<b>Sales Price</b>	<b>\$400,000</b>	<b>\$40,000,000</b>
Costs B/4 "Smart Growth" & SSP	\$252,000	\$25,200,000
GROSS PROFIT B/4 "Smart Growth" & SSP	\$148,000	\$14,800,000
<i>Note: Builder Costs Invested in Quality/sq ft</i>	<i>\$110</i>	<i>\$130</i>
Smart Growth Additional Expenses	\$30,750	\$3,075,000
PROFIT (REPAY LENDERS) AFTER "Sm Gr" & B/4 SSP	\$117,250	\$11,725,000
<i>Add'l Sm Gr Costs as % of Profit B/4 Sm Gr &amp; SSP</i>	<i>20.78%</i>	<i>20.78%</i>
EXISTING SSP School & Transportation Taxes		
TOTAL SSP SCHOOL TAXES	\$26,243	\$2,624,300
TOTAL SSP TRANSPORTATION TAXES	\$27,813	\$2,781,250
TOTAL SSP SCHOOL AND TRANSPORTATION TAXES	\$54,056	\$5,405,550
<b>PROFIT (TO REPAY LENDERS) AFTER "SG" &amp; SSP</b>	<b>\$63,195</b>	<b>\$6,319,450</b>
<i>SSP Taxes as a % of Profit After "Sm Gr" and SSP</i>	<i>46.10%</i>	<i>46.10%</i>
<i>Combined Smart Growth &amp; SSP as % of Profit</i>	<i>57.30%</i>	<i>57.30%</i>
Estimated Internal Rate of Return (i.e., Underwriting Risk)	7.51%	7.51%
IRR w/ 1.5 year delay	4.69%	4.69%

So it appears Builder/Developer has profit to tap into for public infrastructure of:

**\$6,319,450**

# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

### WHO REALLY PROFITS FROM NEW DEVELOPMENT?

[Who actually makes the money to be taxed for infrastructure?]

BUT, where is the money really made on these homes (over 20 year bonding period)?

Presume Average Annual Home Value Growth Rate:

**3.75%**

	Value of Home	Annual Gain	Cumulative Gain
Beginning Value of Home:	\$400,000		
Year 1	\$415,000	\$15,000	\$15,000
Year 2	\$430,563	\$15,563	\$30,563
Year 3	\$446,709	\$16,146	\$46,709
Year 4	\$463,460	\$16,752	\$63,460
Year 5	\$480,840	\$17,380	\$80,840
Year 6	\$498,871	\$18,031	\$98,871
Year 7	\$517,579	\$18,708	\$117,579
Year 8	\$536,988	\$19,409	\$136,988
Year 9	\$557,125	\$20,137	\$157,125
Year 10	\$578,018	\$20,892	\$178,018
Year 11	\$599,693	\$21,676	\$199,693
Year 12	\$622,182	\$22,488	\$222,182
Year 13	\$645,514	\$23,332	\$245,514
Year 14	\$669,720	\$24,207	\$269,720
Year 15	\$694,835	\$25,115	\$294,835
Year 16	\$720,891	\$26,056	\$320,891
Year 17	\$747,925	\$27,033	\$347,925
Year 18	\$775,972	\$28,047	\$375,972
Year 19	\$805,071	\$29,099	\$405,071
Year 20 - Ending Value of Home	\$835,261	\$30,190	\$435,261

EACH HOMEOWNER'S GAIN: **\$435,261**

BUILDER/DEVELOPER  
PROFIT FOR 100 HOME  
COMMUNITY: **\$6,319,450**



# IDENTIFY THE PROBLEM

## Policy-Created Financial Impediments

### WHO REALLY PROFITS FROM NEW DEVELOPMENT?

[Who actually makes the money to be taxed for infrastructure?]

**BUT, to compare “apples to apples,” one would have to multiply the individual homeowner profit by 100 to match the 100 homes built by builder/developer**

EACH HOMEOWNER'S GAIN:

\$435,261

BUILDER/DEVELOPER PROFIT FOR 100 HOME  
COMMUNITY:

\$6,319,450

100 HOMEOWNERS' PROFIT (FOR WHOLE  
COMMUNITY):

\$43,526,080

The homeowners thus have **>7 times** the “bonding power” to finance schools and transportation infrastructure in a development district

# **IDENTIFY THE PROBLEM**

## **Policy-Created Financial Impediments**

### **Final Problem to Note for this Session: SSP and Permitting Fees paid “in advance” versus “in arrears”**

WHY DO WE MAKE LAND USE DECISIONS (and assess development taxes) BASED ON PRONOSTICATIONS OF FAR OFF FUTURE EVENTS (such as automobile trip generation in 30 years) --- which are likely to be 100% inaccurate (especially when modeled off of current conditions that will be obsolete in the future) --- when we could make flexible land use decisions (and tax collections) that adapt to actual future conditions that would be 100% accurate?

Who can say how much gain there will be for Apple Computer in the year 2020? In the year 2030? Who can say what gain there WAS in 2013?\*

*\*\*APPL gained \$11.99 (from \$549.03 to \$561.02) or a gain of 2.18%*

# HYPOTHESIS

## BECAUSE OF WHO REALLY PROFITS FROM DEVELOPMENT

In our example, County SSP policy would tax developer **OVER 40%** of profit for school and transportation capital infrastructure investment (simply cost-prohibitive, so never built and County never gets the SSP payment).

SSP Payment of: ~\$540,000

On projected profit of: \$1,172,500

# HYPOTHESIS

## BECAUSE OF WHO REALLY PROFITS FROM DEVELOPMENT

**But what if we asked the new homeowner's to contribute just 5% of their profit (after the fact) toward school and transportation investment --- a so-called proposed "Capital Infrastructure Reinvestment Surtax" ("CIRS")?**

***Rationale: Hardly arguable that at least 5% of home value's gain can be attributed to preservation of quality schools and quality transportation mobility provided by the County.***

# HYPOTHESIS

## BECAUSE OF WHO REALLY PROFITS FROM DEVELOPMENT

Hypothesis: Additional Infrastructure from CIRS Program

Bondable Amount (20 year)	
Per Residence Gain:	\$15,000
Per Residence CIRS Percentage:	5.00%
Per Residence CIRS Payment:	\$750.00
Aggregate of all Residences:	\$75,000.00
Bond Int Rate/year	4.00%
Number of Annual Payments	20
<b>Bondable Amount</b>	<b>\$1,019,274</b>

***Compare to SSP Payment of: ~\$540,000***

# **HYPOTHESIS**

## **SAME RATIONALE FOR EXISTING HOMES**

Hypothesis presumes Capital Infrastructure Reinvestment Surtaxes would not be assessed on existing homeowners until **AFTER 5 YEARS** of gain realized. That is, CIRS payments would be paid by homeowners ***IN ARREARS***, based on previous 5 year average annual gain.

# HYPOTHESIS


## SAME RATIONALE FOR EXISTING HOMES

### EXISTING HOMES (Assumptions)

Average Annual Gain/20 years	3.75%
Percent of Gain Toward CIRS	5.00%

### MACRO ANALYSIS

Type of Property	Taxable Base of ~90% of County	Annual Gain	Exempting Homes in Bottom Quartile (Non-Exempt ~85% of Value)	Capital Infrastructure Reinvestment Surtax (CIRS)
Residential	\$45,700,000,000	\$1,713,750,000	\$1,456,687,500	\$72,834,375
Commercial (APTS)	\$5,500,000,000	\$206,250,000	\$206,250,000	\$10,312,500
Commercial (General)	\$15,500,000,000	\$581,250,000	\$581,250,000	\$29,062,500
Industrial	\$3,900,000,000	\$146,250,000	\$146,250,000	\$7,312,500
Agricultural - EXEMPT	\$22,500,000	EXEMPT	\$0	\$0
Other - EXEMPT	\$887,700,000	EXEMPT	\$0	\$0
TOTAL ANNUAL CIRS PAYMENT:				\$119,521,875
Bond Underwriting		75.0%	\$89,641,406	
Bond Interest Rate		4.5%		
Number of Years		20		
<p><b>5 Year Capital Bondable</b>  <b>Amount: <u>\$1,166,049,716</u></b></p>				
About 25% of 5 Year CIP Budget				



# **TEST (FATAL FLAW ANALYSIS)** **OF HYPOTHESES**

**NOW IT'S TIME FOR YOU TO WAKE UP  
AND PARTICIPATE IN THE CRITIQUE OF  
THE HYPOTHESES IN THE HANDOUTS  
AS ALTERNATIVES TO EXISTING SSP.**



# THANKS TO THOSE OF YOU WHO STAYED AWAKE FROM THE COFFEE!



To criticize, ridicule, lecture, or simply disagree with me (as so many do), please feel free contact me:

**Jonathan M. Genn**

Percontee, Inc.

[jonathan@percontee.com](mailto:jonathan@percontee.com) (very creative email, yes?)

Office: **301-622-0100**

Mobile: **410-935-2599**