Financing Strategies to Overcome Barriers to Smart Growth in Rural Communities

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The traditional economies and ways of life upon which many rural communities were founded have been eroded by fundamental changes in agricultural production, globalization of agricultural markets, economic displacement, and urbanization. Rural communities face significant changes in demographics, land use and development patterns, and demands for social services and infrastructure. Smart growth principles provide solutions to the challenges that arise from these changes. However, when exposed to smart growth alternatives, many rural communities are reluctant to consider them due to real and perceived concerns about fairness in land use and other local policies that affect land values.

This paper sets forth a possible framework for discussion of financing strategies that can be used to overcome these barriers. The paper does not attempt to outline specific details associated with these types of strategies or provide a comprehensive inventory of applicable approaches, but is intended to foster dialogue about communities’ experiences with rural financing strategies and find new solutions to this issue.

The significant economic and demographic shifts rural communities face have a fundamental effect on the way that land is valued. In edge communities (communities at the edge of growing metropolitan areas), working lands that were once valued for their agricultural productivity are increasingly valued as real estate for new development. This shift from valuing land as a productive asset to a source of capital can affect whether smart growth principles take root in these communities.

Policies that guide growth in areas with existing infrastructure while attempting to preserve rural character in other areas can have broad, long-term benefits for a community. However, when rural land is viewed as a developable asset, such policies can be seen by rural landowners as diminishing the value of their land. For families who can no longer rely on working lands for a living, smart growth strategies can be perceived as eroding their remaining source of potential income and their legacy for future generations. In tight-knit rural communities, such concerns can translate into community-wide opposition.

Smart growth strategies can offer real benefits to rural communities by preserving the history and character of these communities, making them attractive places to live, work, and visit. These characteristics can underpin sustainable economic development, offer diverse and affordable housing choices, and foster healthy communities. However, if rural communities are to realize
these benefits, issues associated with real and perceived inequities must be addressed and must be done so in a way that recognizes the real fiscal constraints rural communities face.

Framing the issue using the language of economics, smart growth strategies can lead to more efficient land use with overall societal benefits. These strategies can also result in distributional effects, with winners and losers. One way to overcome the barriers to smart growth in rural areas would be to explicitly capture some of these benefits—either the efficiency gains or the benefits accrued to specific groups—and use these benefits to compensate those who are negatively affected by land use and other policies.

To pursue this idea further and establish a structured approach for analyzing policy alternatives, it is useful to define the different economic actors and the extent to which the benefits of smart growth can be monetized. Key economic actors and measurable economic benefits and losses include:

- **General population** (residents, business owners, workers) – Smart growth policies that take advantage of existing infrastructure and encourage diverse, mixed-use town centers and villages can have measurable, positive fiscal impacts, including avoided capital and operational expenditures and increased tax revenue. Other benefits of smart growth (e.g., fostering economic and cultural diversity) may be difficult to value and, thus, may have limited ability to address inequities.

- **Individual landowners** – Smart growth policies can affect the market value of developable land:
  - **Landowners in areas with existing development** (e.g., town centers, villages) – Policies that encourage denser, mixed-use development and create attractive neighborhoods, town centers, and villages can increase the value of the land, directly benefiting landowners.
  - **Landowners in areas with little existing development** (i.e., rural working lands) – Policies that discourage the development of existing or former working lands can have a negative impact on land values in the short term relative to land use policies that allow for denser development or less restrictive land use.

These considerations suggest two types of approaches for compensating landowners in areas slated for less dense development:

- **A fiscal/budgetary approach**, whereby avoided costs and/or revenues are used as a source of funds for compensating negatively affected landowners; and

- **A market-based approach**, whereby gains realized by one group of landowners is used to compensate losses realized by other landowners.
Implementation of either or both of these approaches would require designating parts of the community as growth areas and conservation areas. The specific characteristics of these designations would be established based on a community’s vision for these areas. Generally, growth areas would be designated for denser, mixed-use development, typical of a rural town center or village. Conservation areas would be designated for development patterns that preserve the rural and natural landscape. These designations would establish the basis for benefits and compensation relative to status quo land use regulations.

Within this structure, the following types of approaches could be considered:

- **Fiscal/budgetary approaches** – Registered voters could be offered two alternative budgets, one with and one without development and conservation designations. Some fraction of the projected incremental savings associated with the former (designated areas) would be used to establish a funding mechanism for purchasing development rights from landowners in areas designated for conservation. Such mechanisms could include:
  
  o **Land preservation funding** – The local government would accumulate funds as a percentage of tax revenues in a land preservation fund, which would then be used to purchase development rights.
  
  o **Tax abatement** – The local government would issue tax credits against future tax liabilities as a means for purchasing development rights.

- **Market-based approaches** – Market-based approaches could include different forms of conservation banking. Gains realized by some landowners would be directly used to compensate other landowners. One such approach could involve the transfer of development rights, where developers could exercise their option for higher densities in areas designated for growth by purchasing development rights. Development rights could be purchased directly from landowners in areas designated for conservation or through a conservation banking program established by the local government. The effectiveness of such an approach would depend on the magnitude of the change in market value of land in areas designated for development.

These approaches could be supplemented with other policies that encourage development and conservation in a manner that conforms to the community’s vision until the above funding mechanisms and/or markets become self-sustaining. These could include approaches such as use value taxation, where undeveloped land in conservation areas is assessed at a lower rate, or standards and penalties, where developers who choose to deviate from the community vision would pay penalties that could be used to fund conservation.

Communities throughout the country have used the options outlined above as effective approaches for realizing the benefits of smart growth. These approaches can be combined in ways that recognize fiscal constraints of local communities and limit the need to raise revenue through general taxation. When pursued with the explicit, well-communicated intent of addressing inequities associated with changes in land use and other policies, these approaches
could be used to overcome barriers to implementing smart growth strategies in rural communities.

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