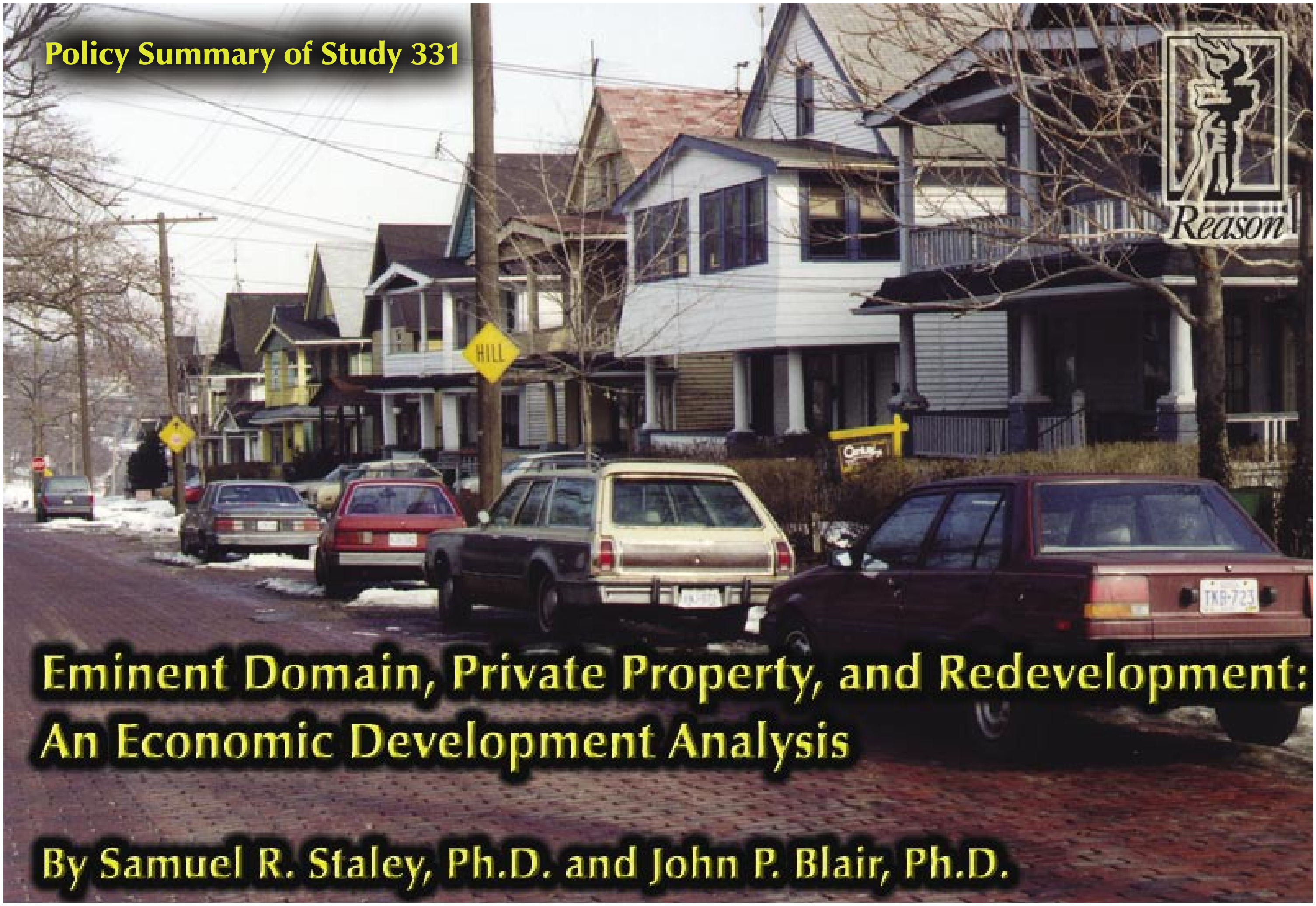


Policy Summary of Study 331

Eminent Domain, Private Property, and Redevelopment: An Economic Development Analysis

By Samuel R. Staley, Ph.D. and John P. Blair, Ph.D.

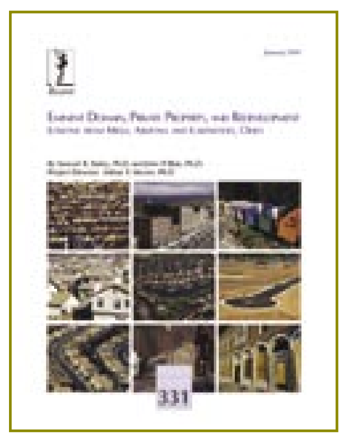
INTRODUCTION

Eminent domain is the power governments have to forcibly confiscate, or "take," private property as long as it is for a legitimate "public use" and property owners receive "just compensation." Traditionally, public use has meant activities for public use such as roads, canals, or parks. Cities offer these services and programs for the use of the public at large with equal access. The power was reserved for government, under specific circumstances, and was not intended as a tool for private individuals and businesses to dispense with private markets and compel others to sell their land to them. Yet, as the cases below demonstrate, this is often what happens.

Within the last fifty years, "public use" has been interpreted more broadly to be "public purpose," which is subsequently reinterpreted by public officials as "public benefit" and has now become a primary vehicle for transferring property rights and ownership from one private owner to another. More and more of these cases involve projects where private parties benefit substantially from government seizures of private property under the banner of economic development or urban redevelopment.

The result of the broadening discretion cities have enjoyed regarding eminent domain may be exemplified by *Kelo v. The City of New London*, a case before the U.S. Supreme Court where property owners are challenging the decision of New London to seize their homes because the city decided

This is a summary of *Eminent Domain, Private Property, and Redevelopment: An Economic Development Analysis*, by Samuel R. Staley, Ph.D., and John P. Blair, Ph.D., www.reason.org/ps331.pdf



redevelopment for commercial purposes would generate higher property values and taxes. The city has targeted a 90-acre section for redevelopment, and condemned 115 properties in the Fort Trumbull neighborhood to clear the way for new offices and luxury apartments that would complement a recently completed research facility developed by Pfizer, Inc.

Economic development planners and city officials justify using eminent domain based on a belief that redevelopment could not happen without an ability to consolidate property and comprehensively redevelop it. They also claim that eminent domain is only used as a last resort after less intrusive and aggressive approaches have failed. This study examines real cases to determine whether that claim is true and whether other means may have been more appropriate.

In *Kelo*, the city of New London, Connecticut is using its eminent domain powers to seize an entire neighborhood based on the potential fiscal benefits of redeveloping the property to a higher-valued use. The traditional constitutional restraints—that eminent domain be used sparingly and under limited conditions—are largely absent. As the cases in this study reveal, eminent domain's primary effect is often to forcibly transfer property among private parties and interests. The practice of eminent domain has nullified individual property rights, leaving land, home, and business ownership to be transferred at the discretion of the political majority on city councils. Given the constitutional protection individuals have, how can local governments use such authority?

Case law sheds light on this question. In a boost to eminent domain in the 1980s, the Michigan Supreme Court ruled that an entire neighborhood could be seized for the sole purpose of economic development. In *Poletown v. the City of Detroit* offered to seize and clear an entire neighborhood so General Motors could build an automobile factory on the site. Since economic development—the creation of jobs—was the sole purpose for taking private property, cities quickly learned that this could be a powerful tool and new incentive for encouraging redevelopment.

Residents of Poletown thought this was an abuse of local government power, so they sued. The Michigan Supreme Court ruled in favor of the city of Detroit and General Motors, arguing that the goal of economic development outweighed the rights of its residents to live in their homes as long as they were compensated by the government.

Policy Implications of Case Law

The Kelo case is a direct descendant of the judiciary's "hands off" approach to eminent domain proceedings when public policy issues are concerned. Case law, such as the judgment in *Poletown v. the City of Detroit* in the mid-1980s, has broadened the power of local governments and given them license to void individual property rights as delineated in the U.S. and state constitutions. The Poletown case, in particular, was important because the Michigan Supreme Court allowed a city to raze an entire neighborhood to accommodate a new General Motors plant in order to meet an explicit economic development goal.

While *Poletown* was a state court decision, the implications were substantial. Building on federal law that granted increasingly broad scope to state and local governments, cities and states across the nation began using eminent domain to seize private property and hand it over to other private property owners using economic development as a justification. The Michigan Supreme Court, fortunately, overturned *Poletown* in *the County of Wayne v. Edward Hathcock* in 2004, but the effects are unclear because eminent domain is so pervasive in economic development policy. Thus, the U.S. Supreme Court's decision in *Kelo* carries even more importance.

The beneficiaries of eminent domain used by local governments don't have to be big corporations:

- Randall Bailey's Brake Service was condemned by the city of Mesa, Arizona after the owner of a local hardware store decided Bailey's property would be a better location for his expanded operation.
- Carol Pappas's apartment building was condemned to make way for a parking garage for eight privately owned and operated casinos in Las Vegas.
- New Rochelle, New York offered to condemn 15 acres of land housing 200 residents to the Swedish furniture giant IKEA to boost retail development in the city.
- The city of Lakewood, Ohio wanted to condemn the entire West End neighborhood of well-kept, moderately priced homes because planners and the city council decided a complex of private retail and commercial businesses was more suitable for the site.

Eminent domain is a key ingredient of urban redevelopment projects. City and planning officials acknowledge as much. The Institute for Justice, a Washington D.C.-based public interest law firm that defends property owners in eminent domain cases, estimates that eminent domain was used to threaten or "take" more than 10,200 properties nationwide between 1998 and 2002 where a primary beneficiary would be another private property owner.

The change in attitudes toward property rights among urban policymakers has corresponded with changing the legal definition of public use and the scope of activities that could fall under eminent domain. Even though governments are still responsible for paying "just" compensation when private property is seized, they often don't. Local officials often attempt to minimize payment for the property. Cities have been found to:

- hire appraisers that will low-ball property valuations;
- use the threat of eminent domain to intimidate property owners to sell at below-market rates;
- compensate property owners at assessed valuation even though market values are significantly higher;
- avoid paying relocation costs for businesses and homeowners;
- ignore the value of "good will" and other intangible value implicit in a business's reputation or location; and/or
- underestimate start-up and marketing costs involved after a business moves.

This policy shift reflects a fundamental difference in the way the judiciary views property rights and public policy. Professor of Law at Notre Dame Nicole Garnett notes that eminent domain no longer gets "means-ends" scrutiny from the courts that ensures a compelling government interest must be shown to justify eminent domain. The courts "don't even bother to check to see if the government is advancing a public use," she notes. "They don't ask if economic development could be done another way." The judicial standards for weighing property rights, as a result, have become far more arbitrary.

Nineteenth century law gave property rights equal status with other rights (e.g., rights to speech, religious freedom, due process). The utilitarian position rooted in cost-benefit analysis does not. On the contrary. Property rights are subject to cost-benefit analysis or, more accurately, net fiscal impact.

TWO CASE STUDIES: MESA AND LAKEWOOD

Two cases—Mesa, Arizona and Lakewood, Ohio—help evaluate this thesis and the role eminent domain currently plays in urban redevelopment. Both cases reveal that eminent domain has become just another strategy in the redevelopment tool box and is invoked even when substantial evidence contradicts the public justifications for invoking the power.

Bailey's Brake Service provides a case in point. Randall Bailey had been operating his family-owned and operated business on Site 24 for decades. He remained the principal tenant (and landowner) even after Redstone Property began purchasing the businesses and land around him on behalf of Lenhart's ACE Hardware. As other buildings were purchased by Redstone and left vacant, Bailey kept his business open and thriving at the location based on references, reputation, and an intergenerational client base. Neither Lenhart nor Redstone Development approached Randall Bailey about purchasing his property. In fact, when Randall Bailey approached Redstone Development to discuss the possibility of incorporating his business into the redevelopment plan, representatives showed no interest in discussing this proposal. Instead, they referred Bailey to the city of Mesa, which was acquiring property for the redevelopment project.

The memorandum of understanding (MOU) for Lenhart's ACE Hardware stipulated that the city of Mesa would acquire twelve lots constituting about two-thirds of the proposed site. In the case of Palm Court Investments, another developer interested in Site 24, the city's MOU called for acquiring nine lots. Of the 26 lots in Site 24, the city was using eminent domain to acquire 21.

The total assessed value of Site 24 was almost $3 million in 2002. Together, Palm Court and Redstone acquired only about half of the assessed value of the property. While Redstone Investment had acquired six parcels in its proposed project area, or about 41 percent of the proposed project area, these properties comprised only about one-third of the total value of the property. Thus, Redstone was using the city of Mesa to forcibly acquire property worth two-thirds the value of land needed for its portion of the project.

In the case of Mesa, land assembly through eminent domain was the primary, and perhaps only practical, redevelopment tool. The city took advantage of the broad discretion given to it by statute to condemn private property and transfer it to other private developers even though the evidence showed clearly:

- The properties being seized were viable and growing;
- Private investors relied on the city to acquire and negotiate the sale of land; and
- Direct subsidies to private developers could be substantial because the city agreed to sell the properties to developers at rates substantially below the market price.

Mesa's case may be unique in that the city relied almost exclusively on eminent domain to achieve its redevelopment objectives. The mechanisms used, however, are common in the redevelopment community. In fact, the statutory requirements for using eminent domain—initiate a planning process, adopt a redevelopment plan, acquire the property, then transfer the property to a private developer—could serve as a template for other communities across the nation.

A detailed analysis of city procedures revealed:

- Eminent domain was a tool of first resort, not last resort;
- Properties targeted for redevelopment were identified by potential private investors, and the city then proceeded to condemn the properties in order to sell them to the private developers;
- The city's redevelopment agreement with private developers would have amounted to effective subsidies ranging from \$176,000 to \$592,000 dollars.
- Existing small business owners and homeowners were effectively shut out of the negotiations and redevelopment decisions; and
- Many properties seized were viable and growing. Property values in the neighborhood increased by 19.3 percent between 2000 and 2002.

The case of Site 24 provides a unique glimpse into the internal workings of the redevelopment process and the role eminent domain plays in subsidizing private developers. It also shows how increasingly broad definitions of public use and blight have significantly weakened private property rights.

As long as Mesa had an approved development plan, and had adhered to procedures for determining blight, the city could effectively seize one person's property and transfer it to someone else. In the process, the beneficiary of Mesa's redevelopment process would receive substantial benefits in the form of subsidies to the project.

In the end, after years of litigation, the Arizona Court of Appeals upheld Bailey's right to keep his business and property, but the decision was very limited and did not implicate the redevelopment techniques used by the city of Mesa. The city's use of eminent domain was struck down because the only significant beneficiary of the project was another private party (in this case Lenhart). Moreover, the ruling stipulated that eminent domain cases needed to be reviewed on a case-by-case basis, and did not set a new precedent for limiting the scope of eminent domain beyond the narrow circumstances surrounding Randall Bailey's case.

If the primary purpose of the land condemnation was to transfer private land into the public realm for a clear public purpose, as in the case of the jail or community center, the project might constitute a public use in the traditional sense the term is used—a project with public benefits and access that would not be provided by the private sector at a sufficient scale or level to meet the public need. In the case of Site 24, however, the city became merely a pass-through for private parties to use eminent domain to satisfy their own need to expand and become more profitable in a competitive market. Easy access to eminent domain became a tool for achieving a competitive advantage over other free market players by reducing development costs. How this occurred is important to understanding the practical consequences of allowing eminent domain to be used in the redevelopment process.

Lakewood, Ohio

The city of Lakewood, Ohio, a "first tier" suburb immediately adjacent to Cleveland, provides another telling example of how eminent domain has become a cornerstone of city redevelopment initiatives. Lakewood, like Mesa, isn't one of the suburban communities mired in decline. On the contrary, the average home sells for \$146,605, 15.9 percent higher than Cuyahoga County and almost on par with suburban Cleveland communities. The city's assessed valuation increased by 15 percent between 1994 and 2000 according to the Cuyahoga County auditor, significantly faster than

the average for Cleveland's suburbs. Despite being boxed in by surrounding communities, the city managed to issue 1,645 residential building permits between 1999 and 2000 as well. By all significant indicators, Lakewood has a robust economy.

Nevertheless, like most cities, not all neighborhoods fare equally well. The West End is one neighborhood like that. The West End consists of 31 acres on the western edge of Lakewood. The area has substantial scenic value, looking over the Rocky River protected by the Cleveland park system. Almost 3,000 people lived in the neighborhood in 2000, occupying more than 1,700 housing units.

The West End neighborhood was developed primarily in the decades spanning the turn of the 20th century. Almost all the non-apartment residential and commercial buildings were built between 1897 and 1925 and the area exhibits the structural limitations common to older buildings and roads.

During the summer of 2002, planning consultant D.B. Hartt and architectural consultant Square One, Inc. conducted surveys of the buildings in the West End. Surveys of the buildings and city records led them to conclude that the West End neighborhood had "sufficient deficiencies...which together are detrimental to the public health, safety and welfare and which impeded the sound growth, planning and economic development of the City of Lakewood" and "that substantial portions of the" community development area met the definitions of blight as defined in the city's ordinances. The consultants also believed that these conditions had deteriorated to the point where the city could use eminent domain to declare the area blighted. One of the primary reasons given for the desire to condemn what is known as the West End section is the claim that it meets either criteria for blighted or deteriorated and deteriorating areas consistent with the standards set forth in Chapter 153 of the city of Lakewood, Codified Ordinances. Yet, is the West End actually deteriorating?

Importantly, the consultants' report does not provide evidence that the majority of structures in the West End neighborhood meet the criteria for blight. The conclusions rest on inferences from small samples of buildings and a fundamental belief that older buildings are inherently inferior to new, comprehensive development. The comprehensive development plan discusses area-wide concerns without linking those concerns to properties in general, let alone to a majority of properties. In fact, there is virtually no evidence presented regarding ill health, transmission of disease, infant mortality, and juvenile delinquency, or moral hazard in the West End, which is the criteria for blight set forth in the city's Codified Ordinances. Almost all the evidence presented highlights features of buildings and sites typical of neighborhoods eighty years old outside the primary growth path of a region. While crime appears to be higher in the West End, the data were not adjusted for the mix of land uses (commercial areas normally have more crime) or for population densities (higher density areas typically have more crime per acre).

Indeed, significant differences appear to exist in different areas of the West End. These differences would be expected where some areas are characterized by very high densities and others by lower densities. Moreover, this kind of diversity is part of the natural evolution of neighborhoods.

More troubling, perhaps, was that the planning consultants rely primarily on determinations of economic and functional obsolescence to support the city's proposal to comprehensively redevelop the West End neighborhood. In an era where increasing emphasis is placed on rehabilitation and renovation activities, many of the criteria used appear arbitrary and subjective. In short, homes and buildings built in the early 20th century did not conform to the city of Lakewood zoning code in 2002, and these discrepancies became evidence that the homes and businesses should be razed and redeveloped according to plans created by the city.

An analysis of trends in the neighborhood found:

- Property values in some parts of the West End were increasing faster than for the city as a whole, suggesting a strong real estate market;
- Residential vacancy rates for homeowners were falling faster in the West End neighborhood than for the city as a whole;

- Homeownership rates had increased in the West End neighborhood between 1990 and 2000; and
- The West End neighborhood was healthy, growing, and stable using standard criteria of neighborhood development.

The city's primary motivation for redeveloping the site, it appeared, was the potential for substantially increasing its tax base. The city's redevelopment plan for the area estimated that the total value of real estate in the West End could increase from $31.3 million to $131.1 million by transforming the area from an older, affordable residential neighborhood to a mixed-use "lifestyle center" with offices, high-end restaurants, luxury apartments, and movie theaters. Significantly expanding the commercial mix of the land and replacing the existing affordable homes with upscale housing would increase the total value of real estate to between $79.8 million and $131.1 million dollars. Real estate taxes would triple and income taxes would double. Redevelopment could boost city tax revenues from just $638,694 to as much as $1,657,733.

In razing the affordable housing and the small businesses that serve that neighborhood (generally convenience stores, fast food, and discount establishments), the city of Lakewood sought to fundamentally change the character of the neighborhood, shifting it from an affordable residential neighborhood to an upscale commercial mixed-use area. The agreement is instructive in that it lays out the content of the development and provides an important contrast to land uses in the current neighborhood. The West End currently consists of small homes on small yards with a scattering of neighborhood businesses and cheap office space. The city intended to develop the neighborhood as an open-air "lifestyle center"—a commercial destination that would draw from throughout the region. Few of the businesses would target the everyday needs of the neighborhood. In fact, the agreement prevented neighborhood businesses such as inexpensive restaurants, conventional fast food, convenience stores, or discount pharmacies.

Thus, it appears that the city of Lakewood was trying to kill two birds with one stone: get rid of the poorer section of town and raise its tax base with more commercial ventures. This is in direct contradiction to the stated goals of redevelopment and in defiance of the accepted criteria for use of eminent domain.

Like Mesa, Lakewood used eminent domain as a crucial tool for promoting redevelopment within the city. Like Mesa, it employed a very conventional, almost textbook approach to redevelopment—it identified a "problem," it "studied" the problem, then adopted a redevelopment plan to provide a framework for revitalizing the area. Eminent domain became a crucial component for implementing the redevelopment plan. The city's efforts, however, followed more of an outline of the redevelopment process than a substantive investment in information gathering, cost-benefit analysis, and evaluation of alternate scenarios. Of course, the property rights of existing property owners were not even factored into the process except possibly as a line item where their compensation was considered a cost of development.

HOW EMINENT DOMAIN CORRUPTS ECONOMIC DEVELOPMENT POLICY

The redevelopment cases of both Mesa and Lakewood provide important insights into the urban redevelopment process, the role eminent domain plays, and the ways both public officials and private interests game the system at the expense of small land owners.

In both cases, redevelopment policies tended to:

- Be arbitrary, driven by local politics rather than standards and objective criteria;
- Be inequitable, giving large and well-connected property developers an advantage over existing homeowners and business;
- Serve private purposes, effectively becoming a legal way private developers can circumvent the conventional real estate market and force other property owners to sell their property to developers while reaping substantial

financial gains; and

- Lack substantive limits, because statutory criteria for blight determinations are so broad they fail to constrain eminent domain's use for redevelopment purposes;

Since the public planning process is subordinate to facilitating the expansion of a select set of private companies, the primary benefits of redevelopment accrue to the private investors selected during the RFP process. In Mesa's case, the public benefits were small. The city justified its role in the redevelopment process based on sales tax revenue, not whether the project achieves the basic goals of the redevelopment plan. In the case of Lakewood, the benefits were potentially large to the scale of the project. The fiscal benefits to the city were substantial as well.

The implications for urban development are much broader than the impact on the property owners targeted in these cases. Economic development policy is essentially an ongoing stream of negotiations between public officials and private developers. In the long run, this approach undermines the climate for private investment in urban areas.

Private investment requires a reasonable expectation of return on investment. This expectation can only occur in a business climate with established and respected rules for investment. Planners and economic development specialists understand that uncertainty erodes a healthy business climate. In fact, one of the justifications for using eminent domain is to allow local officials to reduce uncertainty for their client.

Yet, public officials following this line of reasoning are missing the forest for the trees. Cities develop as a result of hundreds, and often thousands, of investment decisions, not just the chosen few selected to participate in a development project. The decisions are made by small and big businesses alike. Eminent domain destabilizes the investment climate for everyone except those negotiating directly with the city for a piece of the development project. Even in these cases, investors cannot be certain their investment and property are safe. If the neighborhood or commercial area continues to decline, or fails to achieve the investment objectives established by the redevelopment plan, their property rights will be at risk as well. In fact, based on the conventional wisdom in the economic development community, cities would be obligated to reinitiate the redevelopment process, putting each property at risk again. Few people will invest in homes or small businesses if they are unsure if they will be in the home or neighborhood for long. Yet, this is the climate the broad-based use of eminent domain for redevelopment purposes creates.

Cities increasingly think of redevelopment as large-scale, comprehensive projects. Under this framework, an incremental approach to redevelopment is discouraged even when a project's timetable for completion (build out) may be 10 or 15 years.

An alternate approach is to look for more incremental and property-rights-friendly approaches to redevelopment.

CONCLUSION

Eminent domain has become part of the lexicon of economic development policy. As the courts have tolerated increasingly broad definitions of the public purpose clause of the Fifth Amendment, state and local governments have seized on opportunities to expand their own power of land and property within their jurisdictions. As a result, property rights no longer serve as a meaningful check on government authority in land.

For some, most notably planners and economic development officials, this change represents an opportunity. They are not bound by legal or substantive constraints as they promote redevelopment plans and projects. The ability to define virtually any action by government as a public purpose gives policymakers and redevelopment officials discretion unavailable when they were unable to seize property except for clear public uses. Moreover, the willingness of the courts to allow private parties to benefit directly from this relaxed approach to property rights has allowed community officials to focus on the needs of specific clients, such as Costco, WalMart, IKEA, General Motors, or even ACE Hardware.

Without a doubt, the economic vitality of the nation's urban areas is a pressing issue. Major cities continue to lose population and businesses, and high poverty and crime rates put urban tax bases at risk. Persistent economic decline has prompted local public officials to make economic development a centerpiece of state and local public policy. Local officials, not surprisingly, have embraced as many tools as possible to promote revitalization, job growth, and reinvestment in declining areas.

Economic development tools and strategies, however, are not equal in their impact or political legitimacy. While

many agree that local governments should pursue public policies that encourage reinvestment and a climate supportive of economic development and growth, many would not support economic development initiatives that undermine private initiative, neighborhood development, and democratic governance.

Alternatives to Eminent Domain

Eminent domain has the potential to wreak this kind of destructive impact on cities. In more and more cases, eminent domain is effectively putting government interests ahead of private rights. Some cities have in effect made private property rights a privilege granted by the local government through their arbitrary and unrestrained use of eminent domain.

The rhetoric surrounding the Kelo case may give the impression that eminent domain is the most important tool for revitalizing and redeveloping cities. In fact, dozens of other tools exist, including:

- Upgrading roads, sewers, public transit and other infrastructure;
- Implementing zoning regulations that restrict land uses to certain types and densities;
- Employing tax rates, tax abatements, and tax incentives to promote certain types of development;
- Reforming zoning codes to allow faster and streamlined project approvals;
- Incentive zoning to encourage private sector development of specific types of projects;
- Landscaping and streetscaping;
- Offering loans, grants, and direct subsidies to developers and builders; and/or
- Voluntarily purchasing land.

EIGHT PRINCIPLES FOR URBAN REDEVELOPMENT POLICY

Citizens and local policymakers must take a fresh look at how the economy repositions itself in an information-driven, globally competitive world market and what, if anything, public policy can do to influence these shifts. The following key observations and principles may help redefine how public officials approach redevelopment in urban areas.

1. Focus on the Achievable. Any elected official's first inclination is to create and implement a positive program for change. Unfortunately, reality, political and economic, often gets in the way of grand plans. Vision is not enough. A practical key to successful economic development policy is the ability of local leaders to be realistic in their expectations and in the programs they create to achieve them.

2. Learn from the Private Sector. Over the past two decades, economic development specialists have recognized that good projects almost always have a significant private sector component because entrepreneurs have a better grasp of market conditions and the long-term viability of certain kinds of projects. Public officials, however, must make sure that economic development policy is, in fact, serving a public purpose, not providing a mechanism for private interests to circumvent market processes.

3. Provide Core Services Efficiently for Long-Term Success. Local governments should provide services and products the private sector cannot or will not provide. A core service, however, should not be using the public process to nullify core principles of governance such as the protection of private property.

4. Create Sustainable Economies through Private Investors. Government investment does not create long-term job growth. Certain types of investments, such as road and sewer infrastructure, help lay a broad-based foundation for private investment. The vast majority of jobs come from local small businesses starting up, expanding and diversifying over time. These are the businesses hurt the most by

eminent domain proceedings and large-scale redevelopment plans catering to the wants of large developers. Local officials rarely can pick and choose among those private businesses to determine which will be successful.

5. Lead with Focus, Drive and Simplicity. A more effective strategy has been for local leaders to identify two or three key areas and goals, and then develop a timed, phased action plan to achieve them. The results are easier to measure, and implementation is clear and more likely to succeed.

6. Respect the Rights of All Citizens. Eminent domain and large-scale redevelopment projects provide narrow, not broad-based benefits. Government should focus on providing core services that serve the broad-based citizenry and avoid the trap of believing the biggest or wealthiest citizen has more rights or more to offer than the hundreds of homeowners and businessmen that make up the city's foundation.

7. Encourage Voluntary Investment and Redevelopment. Some states—North Carolina and New Hampshire for example—rarely use eminent domain to achieve their economic development objectives. Most redevelopment projects are implemented in phases, and few projects depend on all properties being acquired in order for them to be successful. Cities should work with developers to accommodate property rights protections to create a business climate more supportive of property rights, greater investment certainty, and a more cohesive community.

8. Evaluate the Process Rigorously. A more rigorous definition of "blight" or "deteriorating" would provide guidance regarding which neighborhoods do in fact degrade community welfare. Public officials should also be required to consider the feasibility of accomplishing the project's goals by less aggressive means. ■

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