MERCATUS CENTER
George Mason University

RESEARCH SUMMARY

Land Use—Retail or Residential? Better Studies Will Lead to Better Decisions

Cost-of-community-service (COCS) studies are often used to promote retail rather than residential development in urban areas. They claim that housing (especially multifamily housing) loses money for city treasuries because more residents need more public services like libraries, police, parks, and firefighters. Offices and shops, on the other hand, pay for themselves because they require fewer city services and produce more taxes.

Land use decisions based on COCS studies reduce the supply of housing and increase residential costs. This outcome is popular with current residents because it increases the value of their property. However, it prices renters and new (particularly young) potential home buyers out of the market.

John Estill and Tom Means address these matters in "Does Land Development Pay for Itself? A Critique of Cost-of-Community-Service Studies." They argue that COCS studies suffer from several shortcomings and that increasing housing density is not as costly as those studies claim.

FOUR FLAWS OF COCS STUDIES

- *They fail to incorporate market responses to land use decisions*. COCS studies typically use static comparisons and do not account for market adjustments in land values. For example, the construction of multifamily housing might increase demand for local K–12 schools. The COCS study result would say this outcome would generate insufficient property tax revenue to cover the higher cost of education services. The COCS study, however, fails to account for the possibility of potential landowners or tenants increasing (bidding up) home prices to reflect this provision of public education.
- *They violate basic assumptions necessary to compare projects using benefit-cost analysis*. For comparisons between projects to be of value, the projects must be independent and mutually exclusive. That is not the case when it comes to retail and residential development. Retail projects can generate local sales tax revenue only if they have customers nearby—that is, sufficient demand to make the retail uses profitable. Tax revenues generated by housing and retail projects are not independent.
- *They do not distinguish between the costs of allocating private goods and those of allocating public services*. The cost per unit of consuming certain public services decreases with the quantity of services consumed. These are services where consumption by additional people adds little or nothing to costs, such as parks or fire and police protection.
- *They rely on average costs rather than the additional costs of increasing service levels*. Related to point #3, sometimes the actual total costs of providing additional services owing to housing growth are not proportional to population growth. The added cost per unit will be less than the average cost if the service

can be provided to more users without a significant increase in productive inputs used. This will also be the case if there are significant startup or fixed costs to providing the service.

KEY TAKEAWAY

As currently structured, studies consistently undervalue the merits and overestimate the costs of multifamily housing projects. Better studies that more accurately assess the benefits and costs of multifamily residential development will help address the growing housing imbalance that is rewarding current homeowners at the expense of renters and new home buyers.