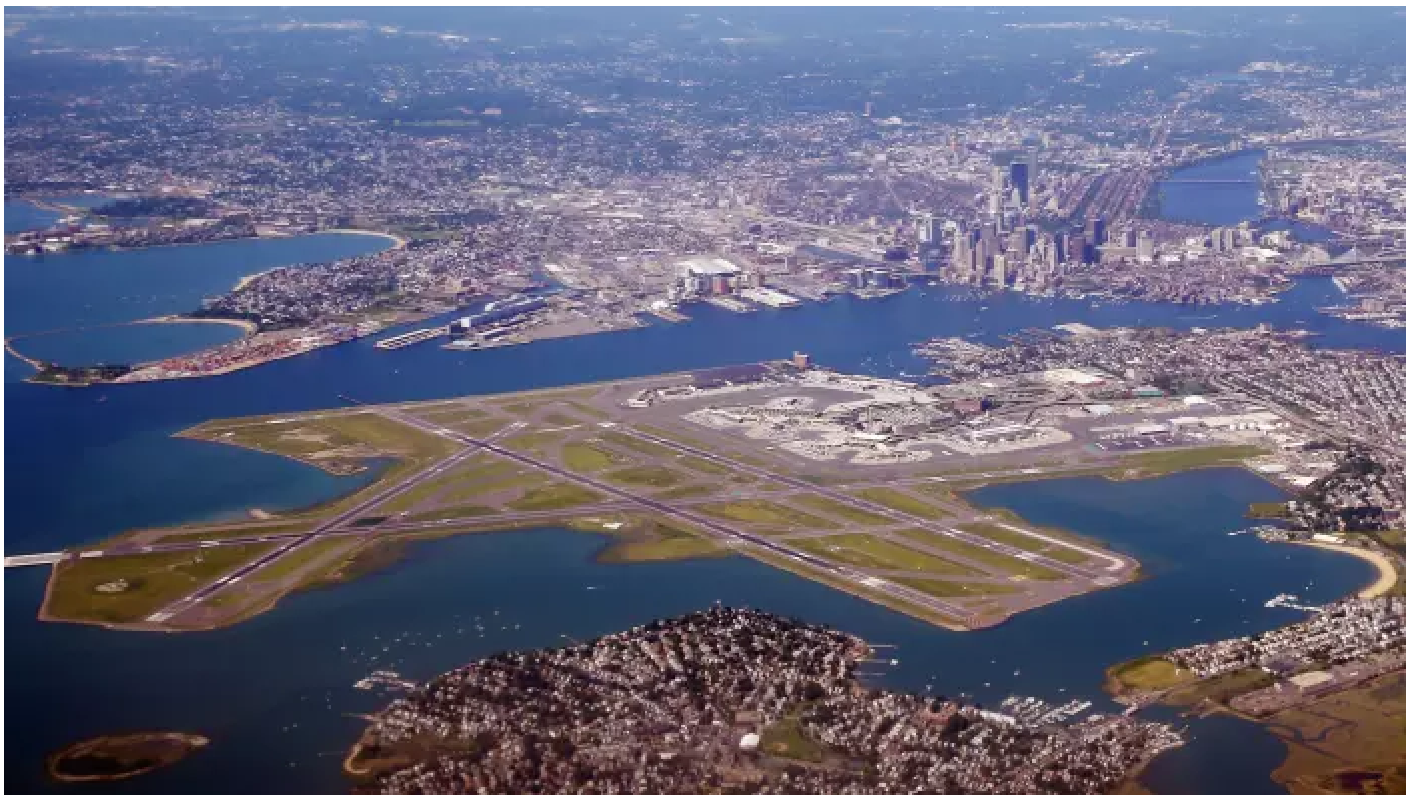
Property funds

US cities must unlock the value of the land they sit on

There is an answer to local governments' pension obligations and under-investment

On Wall Street



Boston's Logan International Airport sits on almost 1,000 hectares of waterfront property © Getty

AN HOUR AGO by: Matthew Klein

Boston's Logan International Airport was built in the wrong place. Instead of occupying undesirable plots on the outskirts of the city, it sits on almost 1,000 hectares of easily accessible waterfront property close to the urban core. The land should be home to condos and office towers, not take-offs and landings.

The question is whether it's worth paying the high cost to move the airport for benefits that will not be realised for decades. Nobody knows. Today's politicians will be long gone by then and have no incentive to explore whether the move would make the city better off in the long run.

The financial system provides a way round this problem: wise cities can use the market as a time machine to reap rewards today for good decisions about future investments. This would require cities to adopt the accounting and governance standards sought by activist investors in hoteliers, retailers and chain restaurants. In particular, cities should separate their real estate assets from the services they provide to their residents.

The potential rewards would be enormous. Excluding public parks, local governments own about a fifth of all the land within many US cities' limits. It is worth at least $25tn, according to Dag Detter and Stefan Fölster in *The Public Wealth of Cities*. That figure dwarfs the $3.8tn in municipal bond debt and $7.5tn in accumulated pension obligations collectively owed by the US's states and localities. Capturing this value and boosting yields by even a tiny amount could generate more than enough income to pay benefits to retired workers, invest in maintenance and develop additional infrastructure to accommodate growing populations.

Governments could start by figuring out the real value of what they own. Weirdly, the Governmental Accounting Standards Board thinks doing this for physical assets is too hard and "may negatively affect timeliness of financial reporting". The result is that municipalities publish balance sheets with implausibly low estimates of their net worth. The Massachusetts Port Authority, which owns Logan airport, claims its landholdings are worth just $226.5m and that its total capital assets net of depreciation are worth about $3.1bn. A rough estimate suggests the value of the land under the airport alone could easily be worth tens of billions if dollars.

The next step would be transferring ownership of these assets to what Detter and Fölster call an "urban wealth fund". Ideally, all publicly owned assets in a given city would be placed in the fund, regardless of whether they technically belong to the county, the city, the school system, the state or some other entity.

The local governments would each have shares in the fund proportionate to the value of the assets they contributed. These shares would be reported as assets on the municipal balance sheets.

Independent managers with experience in real estate and finance would be charged with maximising the value of the portfolio. Cities would receive dividends from their stakes in these commercial properties and have the option to borrow against or sell their shares if desperate for cash.

Public officials would then have to decide whether it makes sense to pay fair market rents to stay in their properties. Moving offices might be inconvenient for government workers but the potential gains for taxpayers and citizens who depend on government services would be far greater. Leasing space in subway stations to shops might detract from the "historic" character of the US's barbarous public transit systems, but the revenues could fund needed improvements, such as ventilation, without the need for debt or higher passenger fares.

The urban wealth fund wouldn't have to be run purely for profit. Segments within the portfolio could have separate goals as long as they are simple and quantifiable. Public housing, for example, could be boosted by increasing density on existing plots and funding improvements by developing some of the freed-up land to sell at higher prices, as Andrew Adonis, head of the UK's National Infrastructure Commission, has suggested.

Boston can afford to leave money on the table because the local economy has been booming and the city's general obligation bonds have the country's highest credit ratings. Other cities, such as Chicago, are being forced to cut services and raise taxes because of financial stress. Yet they, too, have enormous stocks of untapped wealth. With better governance, professional asset management and a little financial engineering, they could raise the money they need and invest.

matt.klein@ft.com

@M_C_Klein