

Municipal Setting Designations: A New Tool for Reducing Environmental Risk and Cost Effects on Property Values

by Thomas O. Jackson, PhD, MAI, and Jennifer M. Pitts

Previous editions of “Environment and the Appraiser” have examined a number of regulatory options for achieving site remediation objectives and reducing the adverse effects of environmental risk and uncertainty, as well as remediation cost effects. These have included innocent landowner programs,¹ the use of institutional controls,² and remediation through monitored natural attenuation.³

The relationship between regulatory tools and the effects of contamination on property value has been discussed with reference to the general valuation framework introduced in Advisory Opinion 9 (AO-9): “The Appraisal of Real Property That May Be Impacted by Environmental Contamination.”⁴ As set forth there and in a subsequent “Environment and the Appraiser”⁵ column, this framework can be depicted in the following equations:

$$\begin{aligned} \text{Impaired Value} &= \text{Unimpaired Value} \\ &\quad - \text{Cost Effects} \\ &\quad \quad (\text{Remediation \& Related Costs}) \\ &\quad - \text{Use Effects} \\ &\quad \quad (\text{Effects on Site Usability}) \\ &\quad - \text{Risk Effects} (\text{Environmental} \\ &\quad \quad \text{Risk/Stigma}) \end{aligned}$$

Property Value

$$\begin{aligned} \text{Diminution} &= \text{Cost Effects} \\ &\quad (\text{Remediation \& Related Costs}) \\ &\quad + \text{Use Effects} \\ &\quad \quad (\text{Effects on Site Usability}) \\ &\quad + \text{Risk Effects} \\ &\quad \quad (\text{Environmental Risk/Stigma}) \end{aligned}$$

Accordingly, regulatory tools and compliance options that reduce the risk and cost effects of environmental contamination would tend to mitigate or reduce the adverse property value effects of contamination. Potentially significant effects on property values involve the risk and uncertainty of future remediation requirements and costs. This is where programs such as those reviewed in this article may be helpful. If state regulatory agencies can limit the uncertainties faced by prospective purchasers of contaminated properties, then the market may react positively by reducing risk premiums on return requirements and thereby increase sale prices and property values.

Municipal Setting Programs

In general, municipal or urban setting designation programs relieve a property owner of certain

1. Thomas O. Jackson and Jennifer M. Pitts, “Innocent Landowner Programs and their Effects on Environmental Risk and Property Value Impacts,” *The Appraisal Journal* (Spring 2006): 117–124.
2. Thomas O. Jackson and J. Michael Sowinski Jr., “Institutional Controls and Contaminated Property Valuation,” *The Appraisal Journal* (Fall 2006): 328–332.
3. Thomas O. Jackson, “Case Studies Analysis: Environmental Stigma and Monitored Natural Attenuation,” *The Appraisal Journal* (Spring 2004): 111–118.
4. Appraisal Standards Board, Advisory Opinion 9, “The Appraisal of Real Property That May Be Impacted by Environmental Contamination,” *Uniform Standards of Professional Appraisal Practice*, 2006 ed. (Washington, DC: The Appraisal Foundation, Washington, DC, 2006).
5. Thomas O. Jackson, “Appraisal Standards and Contaminated Property Valuation,” *The Appraisal Journal* (April 2003): 127–133.

cleanup requirements for remediating contaminated water because of the availability of other potable water sources such as a closed municipal system. Institutional controls through deed restrictions⁶ are required to ensure that this restriction is maintained. This arrangement can reduce the adverse effects of contamination in two general ways.

The first way that institutional controls through deed restrictions can reduce the adverse effects of contamination involves the costs that might be borne by a prospective purchaser for remediation applicable to regulatory standards. These costs, if borne by the buyer, reduce property values through cost effects. If these costs were reduced because active remediation of contaminated groundwater was not required in a designated area, then these effects would be negligible.

The second way that institutional controls through deed restrictions can reduce the adverse effects of contamination relates to the risk associated with these properties. The risk-related effects would be reduced since there would be greater certainty with respect to future requirements for environmental compliance, adding certainty and mitigating risk effects on property value. With this general framework in mind, the details of two such programs in Texas and Ohio are reviewed.

Texas's Municipal Setting Designation Program

The Texas Municipal Setting Designation (MSD) law,⁷ which became effective on September 1, 2003, offers a new alternative to protect the public from exposure to contaminated groundwater at a specific property. In many cities, groundwater is a source of potable water, or water used for drinking, showering/bathing, cooking, or irrigating crops intended for human consumption. Prior to the law creating MSDs, state regulations usually required groundwater contamination to be investigated and remediated to drinking water standards.

However, in some locations, groundwater is not used as potable water because another public water source is available. In this situation, an MSD is now a viable option for properties with contaminated groundwater. An MSD certifies that designated groundwater at a specific property is currently not used as potable water and will not be used as potable

water in the future. The MSD law requires a city ordinance or restrictive covenant prohibiting potable water use at the property, and this restriction overrides or limits the existing state regulatory requirements for investigation and cleanup. By eliminating or reducing state regulatory requirements, an MSD may encourage development and redevelopment of properties affected by groundwater contamination.

Eligibility Requirements

An MSD may consist of a single property, multiple properties, or a portion of a property. To be eligible for an MSD, a property must be within the corporate limits or extraterritorial jurisdiction of a municipality with a population of 20,000 or more. In addition, a public drinking water supply system that meets state requirements must be capable of supplying drinking water to the MSD property and to all properties within one-half mile of the MSD boundary.

Application

If the two eligibility requirements are met, an MSD application may be submitted to the Texas Commission on Environmental Quality (TCEQ). There are no restrictions on who may apply for an MSD. Any person, including a city or local government, may apply. The application must contain the following items:

1. The applicant's name and address
2. A legal description of the proposed MSD boundaries and identification of the groundwater that will be restricted
3. A statement as to whether the impacted cities and retail public utilities (RPU) support the MSD
4. A description of the known contamination
5. Proof of notice
6. A copy of the city ordinance or restrictive covenant
7. An affidavit affirming all information provided
8. An application fee of \$1,000

Support

For an MSD to be certified, the application must have firm support. The city where the MSD property is located must adopt a resolution in support

6. For a more detailed discussion of institutional controls, see Jackson and Sowinski Jr.

7. See the *Texas Health and Safety Code*, 361.801-808; *Texas Local Government Code*, Section 211.003, Subsection (a); and *Texas Local Government Code*, Section 401.005.

of the MSD application. In addition, a resolution of support must be passed by all cities within one-half mile of the proposed MSD boundary; all cities that own or operate a groundwater supply well within five miles of the proposed MSD property; and all retail public utilities (RPU) that own or operate a groundwater supply well within five miles of the MSD boundary.

The city where the proposed MSD is located must also pass a city ordinance or approve a restrictive covenant that prohibits potable use of the groundwater at the MSD property both currently and in the future. The city may choose to establish additional requirements or procedures to follow when an applicant is seeking city support.

Without the support of all parties involved, an MSD cannot be certified. Cities and RPU have no obligation to support an MSD application; this decision is left to their discretion.

Groundwater Contamination

An MSD applies to all contamination in the designated groundwater within the MSD boundary, even if this contamination originates from more than one source. If a potable water well exists within one-half mile of the proposed MSD property, then the contamination beyond the MSD boundary must be determined and may have to be remediated according to state regulations. If there is no well within the area, assessment and remediation of the contamination may still be required for other concerns unrelated to potable water use, such as the inhalation of vapors or wildlife's exposure to contamination.

Notice

Notice letters must be mailed out before or at the same time the MSD application is submitted. Notification letters must be sent to the city in which the proposed MSD property is located, to any city within one-half mile of the MSD boundary, to any city or RPU that owns or operates a groundwater supply well within five miles of the MSD property, and to all owners of private water wells located within five miles of the MSD property. Notified parties then have 60 days to file comments with the TCEQ.

Certification

An application must be certified or denied by the TCEQ within 90 days from the time it is received. An

application may be denied if the eligibility requirements are not met, the application is incomplete or inaccurate, or the TCEQ determines that the MSD would have a negative impact on current or future water resource needs.

Ohio's Urban Setting Designation Program

The Urban Setting Designation (USD) program⁸ in Ohio is similar to the Texas MSD program. Like Texas, Ohio recognized that many properties with contaminated groundwater are located in highly urbanized areas with alternative public water systems, and the groundwater at many of these properties will never be used for potable purposes. In these situations, a USD may be obtained, which eliminates the requirement for clean groundwater at the property at drinking water standards. Like an MSD, other non-potable exposures to the contaminated groundwater must still be assessed and possibly remediated.

Eligibility Requirements

A property must meet the following four eligibility requirements to be considered for a USD:

1. The property must be located in a city or township with a population of 20,000 or more.
2. At least 90% of the parcels within the city or township must have access to a community water system, or 90% of the parcels within one mile of the proposed USD boundary, must have access to a community water system. This community water system must be capable of meeting future water supply needs.
3. The property cannot be within an Ohio EPA-endorsed wellhead protection area, or an area submitted for endorsement.
4. There must be no potable water wells within one-half mile of the property boundary. If the property is above a sole source aquifer or a sand and gravel aquifer producing more than 1,000 gallons per minute, there must be no reasonable expectation that any potable water wells will be installed within one-half mile of the property boundary.

Application Process

A certified professional must prepare the request for a USD. The written request must include the name and address of the applicant, the location of

8. *Ohio Administrative Code*, Rule 3745-300-10(D), "Urban Setting Designation Criteria and Process."

the property for which a USD is sought, a legal description of the property, an indication as to whether the local government supports the designation, and proof that the proposed USD property meets all eligibility criteria.

The written request must be submitted to the Ohio EPA director. The applicant must also reimburse the agency for all costs incurred in reviewing the USD request.

Notice

When the written request is submitted, the local government in which the proposed USD property is located, as well as all local governments within one-half mile of the property boundary, must be notified of the USD application. This notice letter must inform recipients that the EPA director will contact them regarding the USD. The letter must also encourage recipients to provide written comments or any information relevant to the consideration of the USD. Residents and other interested parties may also submit information to the EPA director.

Certification

After a written request is received, the EPA director may request additional information and a public meeting may be held if significant interest is shown or if public concerns are raised. Before approving a USD request, the director must confirm that all eligibility requirements have been met, that the USD will not likely have a negative impact on surrounding jurisdictions or regional water resource needs, and that the USD will not likely expose people to contaminated groundwater now or in the future. The director will approve or deny the USD request within 90 days after he has consulted with the city or township where the property is located.

Conclusion

Both the Texas MSD and Ohio USD programs can benefit properties and communities in a variety of ways. For many properties with contaminated groundwater, these programs may significantly reduce the costs and time associated with satisfying

regulatory requirements. Cities and local governments can use these programs as tools to promote economic development. These tools can be especially useful in encouraging the redevelopment of brownfields.

From an appraisal perspective, these programs improve property values over what they would be without such programs. The programs provide flexibility and eliminate cleanup requirements that do provide additional benefit the public in municipal settings. Over the past few years in Texas and elsewhere, there has been the adoption of remediation standards and creative approaches to site cleanup that are protective of public health and safety while accommodating investment and development activity. Appraisers and others should be aware of these programs, and valuation assignments that involve properties with these types of issues should realistically reflect the reduced risk and cost effects.

Thomas O. Jackson, PhD, MAI, CRE, is a clinical associate professor in the Department of Finance of the Mays Business School at Texas A&M University, where he teaches real property valuation in the Land Economics and Real Estate Program. In addition, he is the president of Real Property Analytics, Inc., based in College Station, Texas, where he specializes in analyzing the effects of environmental contamination on real property. **Contact: T 979-690-1755; E-mail: tomjackson@real-analytics.com; Web site: www.real-analytics.com**

Jennifer M. Pitts recently received her master's degree in land economics and real estate from Texas A&M University. She also has a bachelor's degree, summa cum laude, in finance from the Mays Business School at Texas A&M. At Real Property Analytics, Inc., she researches environmental issues and their effects on real estate markets. **Contact: T 254-760-0847; E-mail: jennifer@real-analytics.com**