

## Amortization of Nonconforming Uses

By Margaret Collins, AICP

**A**mortization is a technique for removal of nonconforming land uses after the value of the building or structure has been recovered—or amortized—over a period of time. Some zoning ordinances include set time periods for phasing out different types of nonconforming uses. Because the value of the use has been amortized, no compensation is payable after the expiration of the period. The U.S. is the only country in which this technique has been used.

The process of determining amortization periods is not merely a matter of accountancy, it is rather a balancing test, weighing the private cost against the public gain.

The beginnings of amortization can be traced to the birth of zoning ordinances in 1916, but it wasn't until the early 1950s that it became widely adopted. The technique was used sporadically by local governments from the 1950s until 1965, during which time it became apparent that amortization was most effective in eliminating uses having structures with relatively low values, like nonconforming signs or sheds with outdoor storage. The use of the technique was curtailed in 1965, when Congress adopted the Highway Beautification Act, which required local governments to provide cash compensation for removal of nonconforming billboards on federal highways. In 1978, Congress amended this act to specifically prohibit amortization of nonconforming billboards on federal highways. While only eight states expressly authorize amortization of nonconforming uses, some courts have held that a statutory general welfare provision may confer the power to amortize.

### Validity

Amortization has been described as more of a postponement than a solution. It has the virtue of cushioning the economic shock; it has the vice of delay. Courts have held that the validity of application of amortization technique need not depend on exact compensation for all economic loss. In order to be a *reasonable* exercise of the police power, the termination process must mitigate the private loss by allowing the owner a reasonable period to recoup his investment in the nonconforming use.



Marva Morris

*Given the lengthy time periods needed to amortize major land uses, municipalities now use the tool primarily for the removal of nonconforming signs.*

The process of determining amortization periods is not merely a matter of accountancy, it is rather a balancing test, weighing the private cost against the public gain. It is not required that the nonconforming property have no value at the termination date.

There are two principal steps to be undertaken in calculating amortization periods:

- The costs to be amortized must first be established. These are called “unrecoverable costs.”
- The amortization period to recover these costs must then be established.

## Basis for Unrecoverable Costs

As in conventional property value appraisals, there are three main approaches to determining unrecoverable costs:

- The owner's investment in the premises
- The fair market value as determined by recent sales of comparable properties
- The replacement cost (for amortization, this is defined as the cost of comparable premises in a different location)

Even when applied to the same case, these three methods can yield very different results (see Table 1).

Municipalities generally either stipulate in an ordinance which method is to be used to determine costs, or they choose from these three methods on a case-by-case basis depending on the use and its value. The advantage of the case-by-case approach is that it gives the zoning authority flexibility in choosing a method best suited to the individual circumstances. Establishing a uniform basis for all cases by ordinance, however, reduces vulnerability to charges of arbitrariness. Amortizing the owner's initial investment costs is the most common method used to amortize nonconforming signs.

**TABLE 1**  
**THREE ALTERNATIVE METHODS TO ASSESSING**  
**THE BASIS FOR UNRECOVERABLE COSTS OF**  
**A HYPOTHETICAL STRUCTURE**

### FAIR MARKET VALUE

Fair market value of building .....	\$100,000
Minus the value of the land .....	(\$10,000)
Minus salvage value of building .....	(\$15,000)
<b>Base unrecoverable costs .....</b>	<b>\$75,000</b>

### OWNER'S INVESTMENT

Owner's investment in building .....	\$70,000
Minus the value of the land .....	(\$10,000)
Minus salvage value of buildings .....	(\$15,000)
<b>Base unrecoverable costs .....</b>	<b>\$45,000</b>

### REPLACEMENT COST OF PREMISES

Land at new location .....	\$10,000
Construction costs .....	<u>\$50,000</u>
Base costs .....	\$60,000
Minus salvage value of buildings .....	(\$15,000)
Minus resale value of land .....	(\$10,000)
<b>Base unrecoverable costs .....</b>	<b>\$35,000</b>

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## Establishing Reasonable Amortization Periods

There are two principal methods for determining the amortization period:

- The fixed-period approach
- Case-by-case methods, the most common of which is the "Recoupment of Investment" approach

Long amortization periods have been shown to discourage investment and maintenance in structures, further exacerbating their blighting influence on the surrounding neighborhood.

The fixed-period approach has been applied to signs and other modest structures in which there is relatively minimal investment. Fixed amortization periods for more substantial structures can range up to 60 years. The recoupment of investment approach has been used successfully in some cases to retire uses with more substantial buildings. The amortization provisions in APA's *Growing Smart<sup>SM</sup> Legislative Guidebook* (available at [www.planning.org/research](http://www.planning.org/research)) permits local authorities to use either or both methods, depending upon the case. Ways to determine the amortization period using both the fixed period and case-by-case methods are examined below.

*Fixed Periods.* Traditionally, conventional amortization provisions have not been based on sophisticated financial analysis. Provisions for amortization in most zoning ordinances set up schedules specifying varying periods for categories determined by use or by the value of the nonconforming structure. As has been discussed, uses such as signs, open storage, or others with minimal investment in structures and nonconforming uses in conforming buildings have been relatively easy to amortize. High-value structures have presented thorny problems because of the long periods required to amortize them, which render conventional amortization approaches ineffectual in terminating these uses. Attempts to amortize high-value buildings have been limited to cases where they constitute a severe nuisance.

Nonconforming uses in conforming buildings have typically been amortized in one to five years. Periods upheld for minor structures and outdoor storage have ranged from six months for a riding stable in a residential area of Dallas up to seven years for dog kennels in an Omaha neighborhood. A limited number of more major structures have been successfully amortized. These have been deemed to constitute a substantial nuisance to their environs and have been given periods ranging from 10 years for gas stations and up to 20 years in the case of a cement plant.

In the middle of the 20th century, most major cities adopted ordinances calling for comprehensive application of amortization to the full gamut of industrial and commercial structures. This became almost nonsensical for major uses which were granted extremely long amortization periods (e.g., 40 years in Los Angeles' 1954 ordinance; 60 years with a delayed start of 15 years in the case of Portland, Oregon's 1956 ordinance).

Since the mid-20th century, most municipalities have ceased attempting to specify set periods for high-value nonconforming structures. Some municipalities found that long amortization periods could entail more liabilities than benefits. Granting a 60-year life to a use that constitutes a nuisance in a neighborhood can be a serious deterrent to investment in conforming structures. Moreover, long amortization periods have been shown to discourage investment and maintenance in structures, further exacerbating their blighting influence on the surrounding neighborhood. Within a time frame of 30 to 60 years, an area could be totally altered and thus, the public purpose served by amortization, like the pot of gold at the end of the rainbow, may have disappeared at the end of the amortization period.

Today, the amortization provisions in the zoning codes of most municipalities are confined to nonconforming signs. In Boulder, Colorado, and in Palm Springs, California, amortization periods from one to 10 years are established for signs of varying values. In San Francisco, periods are assigned to nonconforming signs according to the type of sign; wall, wind, gas station, flashing, moving, roof, freestanding, and freeway signs are distinguished among for the purposes of assigning amortization periods.

*Case-by-Case Approaches to Determining Amortization Periods.* Fixed amortization periods are appropriate for nonconforming uses with little or no investment in construction as well as for those in conforming buildings. But, as we have discussed, they are of little practical use in terminating high-value nonconforming structures that may have a serious blighting effect on the neighborhood.

Amortization of major structures should be limited to uses that pose serious health, safety, or environmental threats to neighboring residential areas. In these extreme cases, the amortization period should be determined on a case-by-case basis to enable the zoning authority to establish a reasonable termination schedule that considers the circumstances of the business affected and the options open to it in terms of recoupment of recoverable costs. In addition, case-by-case methods generally provide shorter amortization periods than fixed periods set by type of use or structure. This section looks at the merits and drawbacks of two such methods that have been proposed.

*Recoupment of Investment Method.* The most commonly used case-by-case method is the Recoupment of Investment method, which uses basic financial calculus to determine the amount of time necessary to realize the value of an investment plus any return that is required by the investor.

A hypothetical example of how this method can be used to establish a reasonable period for a business to recoup its investment involves a car repair shop on the ground floor of an apartment building (see Table 2). The initial investment in equipment and improvements to the premises was \$200,000. The useful life of the improvements is seven years for IRS purposes. The zoning change was made three years ago, so the depreciated value of the improvements is now \$114,285, using the straight-line method of depreciation. The annual net income generated by the shop, at 15 percent of the investment, is \$30,000. With a required return on investment of 15 percent (including a 5 percent cost of capital and a 10 percent risk factor), it will take four years to amortize a unrecoverable costs of \$114,285 with a required return of 15 percent; that is, a period of four years is sufficient for both return *of* investment and return *on* investment. The amount of unrecoverable costs amortizable will, of course, be adjusted by other factors; e.g., the salvage

**TABLE 2**  
**RECOUPMENT OF INVESTMENT MODEL FOR DETERMINING AMORTIZATION PERIODS FOR NONCONFORMING USES**

$$n = \frac{\log n (1 - P_i/A)}{\log n (1/1 + i)}$$

where,

n = amortization period

P = base cost (adjusted value of business investment)

A = Annual Income

i = rate of return

**HYPOTHETICAL CASE ASSUMPTIONS**

**Nonconforming use: Car repair shop on the ground floor of an apartment building**

Investment: ..... \$200,000

Date of zoning change: ..... 1997, three years ago

Useful life of equipment: ..... seven years

Method of depreciation: ..... Straight line

Depreciated value: ..... \$114,285

Annual income from shop: ..... \$30,000

Required return on investment: ..... 15%

**Amortization period prescribed: ..... four years**

value of the equipment (if the business is closing) or (for operations which are relocating) the moving cost and the difference in prices for premises at the new location.

Although it is more complicated than setting fixed periods for categories of uses and structures, customizing the above approach to each individual case should maximize judicial approval of amortization periods and minimize spurious claims that specific amortization periods are arbitrary and unreasonable. Amortization periods based on return-on-investment analysis have the added advantage of being shorter than amortization periods based on the economic life of the nonconforming structure, thus eliminating the nuisance occasioned by the use sooner than would fixed periods. There are three reasons for this:

- Some nonconforming uses will earn monopoly profits, particularly those that are local-serving; this will expedite the return of investment.
- A shorter amortization period will mean that the owner can take accelerated depreciation for tax purposes, thus increasing his cash flow and providing him with a quicker return on investment.
- A 25-year amortization period normally will fully return the investment in any structure. Yet most structures have “useful economic lives” in excess of 25 years.

Even if the required rates of return and income from nonconforming uses cannot be determined with absolute precision, courts have upheld most amortization periods. Courts have traditionally held that decisions by zoning commissions carry a strong presumption of validity. The person challenging a zoning decision has the burden of proving that the zoning commission’s action was wholly arbitrary and unreasonable and

was not related to the public health, safety, morals, or general welfare.

Courts have supported the view that:

- the owner of a nonconforming structure may be required to accept some loss upon termination of his business, and
- as the benefit to the public from such termination increases, the owner's loss may also increase.

This is fundamental to the application of amortization to substantial uses and structures.

### Alternatives to Conventional Amortization

A number of ideas for innovative alternatives to and hybrids of amortization have been advanced the recent literature of amortization. Three are presented below. With the exception of amortization agreements, we are not aware of cases in which they have actually been used.

*Amortization Agreements.* Amortization agreements between property owners and municipalities have been used in California to expedite termination of nonconforming uses. A decision by the courts there upheld an agreement under which a municipality granted a special permit to allow expansion of a nonconforming caravan court in return for the operator's promise to abandon the use in three years rather than in the five years permitted by the ordinance. This is a very interesting approach, particularly for sites with high-value redevelopment potential.

*Alternative Hybrid Approaches with Compensation.* Subscribing a fixed time period for amortization of nonconforming uses has obvious advantages of administrative simplicity for the enforcing body, however, as we have discussed, it has the disadvantage of entailing extremely long periods for major uses.

In cases where the nuisance impact of a nonconforming use is severe, it has been suggested that amortization be combined with partial compensation to remove the use as quickly as possible. One author has suggested that shorter period could be assigned to major uses if the remaining useful life of the structure could be counterbalanced by compensation. This approach calls for compensating the owner for the remaining utility of the building after the expiration of the amortization program. This alternative hybrid approach combines the police power of amortization and the compensation required by eminent domain.

Rodney Cobb, former staff attorney for APA, has examined an innovative technique involving shorter amortization periods and partial compensation with the parties who are benefitting from termination of the use paying the compensation. This has been somewhat inelegantly labeled "ZSAFED" – zoning by special assessment financed eminent domain. If, for example, the surrounding neighbors benefit most by removal of a nonconforming use, then compensation would be financed by a special assessment levied on those surrounding properties. If, on the other hand, the community as a whole benefits from the termination of the use, then compensation should spring from the community's general funds.

*Conformity Inducements.* Other alternatives to conventional amortization approaches have been used to induce onsite conformance. In cases where it is feasible for an owner to alter a use to the extent that it will be brought into conformance with present zoning, a municipality may induce them to conform to the zoning ordinance by granting special rights or concessions. These increased rights might include the transferring of development rights, the granting of a longer amortization period, permitting and licensing concessions, and property tax concessions.

### Summary and Conclusions

There is no single, agreed upon method of determining amortization periods in the U.S. The methods presented in this paper have emanated out of litigation, rather than from any specific guidelines.

Amortization provisions in zoning legislation should be as specific as possible in defining the following terms:

- The basis for valuing the property or the relocation of the business
- Unrecoverable costs
- Depreciation/useful life spans for different classes of uses
- When the depreciation and amortization periods begin
- Residual property values
- "Recoupment" of unrecoverable costs.

These are potentially very ambiguous terms. Vagueness about defining them could lead to charges of arbitrariness in application of the ordinance. On the other hand, legislation should provide for enough flexibility to allow authorities to chose the best approach to calculating amortization periods on a case-by-case basis.

Fixed amortization periods can be appropriate for uses involving only minor investment in improvements, but the very long periods required to amortize the high-value structures make fixed periods an ineffective way to terminate them. Instead, a well-based case-by-case approach should be taken for major structures. The best approach is probably the Recoupment of Investment model.

In generating estimates necessary to gauge whether or not an owner's recoverable costs have been amortized, enforcing authorities should be as conservative as possible in estimating factors that will hasten the amortization period, and they should be equally liberal in estimating factors which will increase it. This will enhance the appearance of reasonableness and reduce the vulnerability to claims of being arbitrary.

Finally, it is important to keep in mind that amortization does not purport fully to compensate a property owner for all actual and potential actual and opportunity costs, such as future profit potential. It is merely a way of cushioning the economic blow that must be experienced by the private owner to compel him to cease an operation that infringes on the rights of other property owners. Courts have held that the owner of a nonconforming structure may be required to accept some loss upon termination of his business. It is recognized that, as the public benefits of amortization increase, the owner's loss may also increase.

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