

REAL ESTATE Development

PRINCIPLES
AND
PROCESS

Third Edition

Mike E. Miles

Gayle Berens

Marc A. Weiss



Urban Land
Institute

Meshing Public and Private Roles In the Development Process

Development in the United States has traditionally occurred through a conventional process in which the public and private sectors perform independent functions and therefore tend to remain at arm's length from one another. As a general rule, simple projects in strong markets have historically followed conventional modes of development, and any mix of function between the public and private sectors has been seen as a conflict of interest on the part of local government. As detailed in preceding chapters, the public sector was expected to perform the functions of regulation and broad planning, providing the needed services—schools, roads, water, sanitation, fire and police protection—to support new development. The private developer originated projects based on information about the market and formulated a specific plan for a project with public policy in mind—all without the public's direct involvement in stages one and two of the process. Consequently, the public sector did not assume any of the entrepreneurial risks or absorb any project-specific costs typically borne by the private sector.¹

The authors are indebted to Lynne B. Sagalyn, PhD, Earle W. Kazis and Benjamin Schore director, MBA Real Estate Program, and professor, Graduate School of Business, Columbia University, for her extensive revisions to this chapter.

Portions of this chapter appeared in Chapter 8 of John R. White, ed., *The Office Building: From Concept to Investment Reality* (Chicago and Washington, D.C.: Counselors of Real Estate, Appraisal Institute, and Society of Industrial and Office Realtors®, 1993).

This development scenario underwent a dramatic transformation in the late 1970s with a proliferation of new-style real estate projects defined by their special public/private status. Various referred to as partnerships, joint developments, codevelopments, or just public/private deals, these projects have reshaped the conventional development process by expanding the public sector's traditional sphere of activity. In a number of ways—as developers, lenders, equity investors, land lessors, and, in selected cases, operators—public agencies have become more active in the development arena and, in so doing, have assumed new risks.

Several forces contributed to the public sector's heightened engagement in the development process. In particular, cutbacks of federal urban aid in the 1980s pushed local governments to innovate and improvise to meet their city planning and economic development objectives.² At the same time, local pressures compelled local governments to search for new sources of funds after a rash of tax-cutting referenda (beginning in 1978 with California's Proposition 13) made raising taxes or going to the voters for approval of new bond issues a political risk. In an environment of fiscal restraint and rising land values during the 1980s, local governments came to view development as a strategic resource that could be harnessed to revitalize downtowns, capture hidden land values, finance needed infrastructure, stimulate economic growth, and generate jobs. Even during the first half of the 1990s, when property markets were experiencing severe distress, public/private development lost none of its appeal as a strategy of economic development, although the deals were certainly fewer in number and harder to put together.

This chapter looks at the changing nature of interactions between government and private developers and the character of their joint projects. In particular, it examines:

- The objectives of public/private development;
- The process involved in forming public/private partnerships; and
- The practical problems and policy issues associated with public/private development.

The Objectives of Public/Private Development

Each decade since the 1940s has seen the promulgation of federal, state, and local public policies aimed at stimulating the development of projects that would otherwise not occur. The ways in which government has sought to influence private investment decisions span a wide spectrum of policy approaches. At one end of the continuum are “carrot-oriented” regulatory actions (incentive zoning and transfer of development rights) and programmatic assistance (tax abatements) through which local government provides subsidies to attract desired types of private investment. With these policy approaches, the benefits of public assistance are available to all who meet the qualifying conditions of entitlement.

At the other end of the continuum are more active public intervention strategies that rely on bargaining and custom-tailored negotiations with private firms over the terms and conditions of individual projects. In this instance, selective processes of competition rather than prescribed incentives determine private firms’ access to development opportunities.

Intervention in the market has successfully stimulated urban revitalization in center-city and suburban downtowns, inner-city neighborhoods, and waterfront districts through the development of mixed-use projects, retail centers, commercial buildings, stadia and convention centers, and residential clusters. Several cities have earned acclaim for their joint public/private efforts—Baltimore, San Antonio, Milwaukee, Philadelphia, New York, Boston, Indianapolis, San Diego, and Cleveland, among others. Each city has developed its own method of leveraging private investment to stimulate revitalization of that city’s economy. Some more “entrepreneurial” local governments have, through their own initiative and their willingness to take risks, become joint venture partners with private developers on some projects.

Baltimore, for instance, has entered into several joint venture agreements, both for the revitalization of its

well-known Inner Harbor and for other large and small development projects. Coldspring, for example, is an in-town planned community developed at the instigation of Baltimore’s Department of Housing and Community Development (HCD). In addition to complete master planning and overall coordination, HCD provided land, infrastructure, parks, public facilities, and financing in an agreement with the F.D. Rich Housing Corporation in 1978. In meeting its goals for the site, which was the last large undeveloped tract in the city, HCD specified the exact form of development that was to occur and limited the developer’s profit to 10 percent. Assuming a role as senior partner in Coldspring, HCD succeeded in meeting goals for affordable housing and other aims for the site. Both risk and reward for the developer were considerably lower than in conventional private developments.³

In another early initiative, the Philadelphia Redevelopment Authority entered into a joint venture in 1974 with the Rouse Company to develop the Gallery, a downtown retail/office project incorporating many of the attractive features of suburban shopping malls. Private developers were not interested in the site because of the perceived risk in revitalizing the Market Street area and the large number of funding sources involved. Acting as both joint developer and general contractor, the redevelopment authority provided \$18 million toward two-thirds of the costs of the shell. The Rouse Company provided \$20 million in equity for the project, covering one-third of the costs of the shell in a 99-year ground lease arrangement under which Rouse also finished the space and sublet it.⁴ Within a few years of the Gallery’s opening in 1977, city officials initiated an expansion of the project, which included a second retail phase (Gallery II), an office tower (One Reading Center), and a parking garage linked to transit improvements.

Public/private efforts in San Antonio led to the successful redevelopment of a deteriorated historic structure in the Alamo Plaza historic district. The San Antonio Local Development Commission (LDC) worked with a developer to couple special financing (an urban development action grant [UDAG] and matching funds from the LDC) with local tax incentives (a five-year reprieve on property taxes for renovated historic structures) to make feasible development of a hotel on the site of a former medical building. The terra cotta facade of the Gothic revival structure was preserved, and the new use—the Emily Morgan Hotel—capitalized on San Antonio’s burgeoning tourist trade.⁵

The success of early efforts spawned a second wave of public/private projects, many of which were even more ambitious in scope, such as the Brooklyn-based MetroTech complex (see Figure 14-1), or sought to

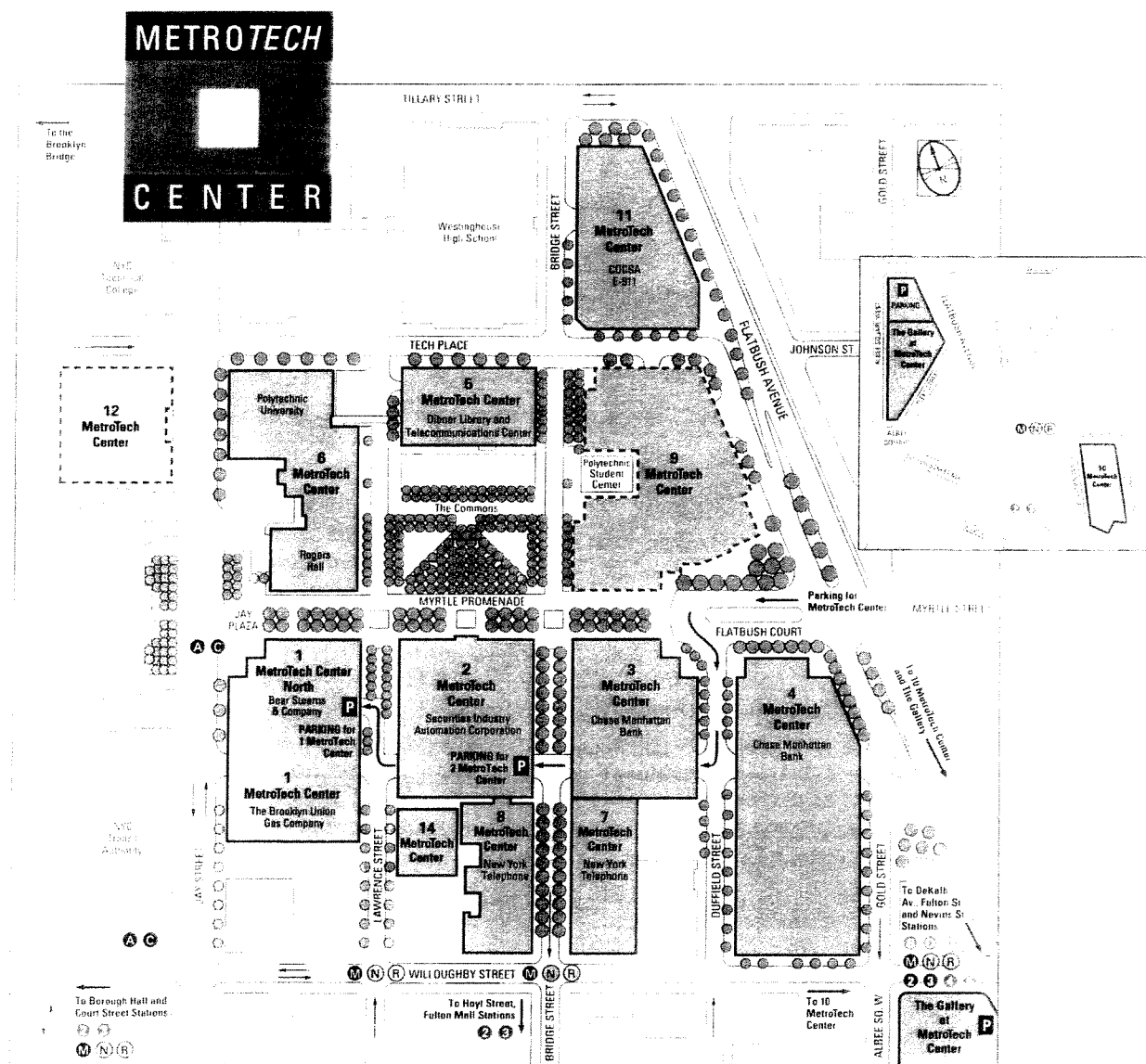
Figure 14-1

MetroTech Center—Economic Development in Brooklyn

MetroTech Center is a large-scale commercial, academic, and high-tech complex situated on a ten-block, 16-acre site in downtown Brooklyn. Developed through a partnership of the city of New York, Polytechnic University, and Forest City Ratner Companies, the \$1 billion project represents the fused interests of public and private capital investment.

Formally initiated in 1982 after several years of preliminary feasibility study by the city's public development agency (in response to Polytechnic's pressing concerns about the deteriorating environment around the school and its negative impact on recruiting faculty and enrolling students), the development of the MetroTech project was

continued on next page



The ten-block, 16-acre MetroTech Center required a variety of innovative approaches to develop this dense, intensely urban mixed-use project.

MetroTech Center—Economic Development in Brooklyn (continued)

part of then-Mayor Koch's so-called "outer-borough strategy," which sought to foster development of back-office space in areas beyond Manhattan. Through public development incentives, the city aimed to retain jobs that might otherwise be lost in corporate moves beyond the city's boundaries.

The city's investment took shape in two distinct forms. The first consisted of traditional redevelopment assistance for land acquisition, relocation, demolition, and infrastructure needed to ready the site for private development. The second consisted of an aggressive economic development package of tax incentives, discretionary benefits, and energy cost savings designed to lower occupancy costs for corporate tenants. According to the developer's projection, the package would result in a \$5.00 to \$15.00 per square foot rental cost advantage over Manhattan for new construction.

In combination with strong private investment, the development succeeded in attracting a critical mass of corporate tenants. The tenants occupying the first phase of the complex include the Chase Manhattan Bank, the Securities Industries Automation Corporation, Brooklyn Union Gas, and the district headquarters of the Internal Revenue Service.

In addition, as part of its obligations to the public development partnership, Polytechnic University built a new library and a Center for Advanced Telecommunications Technology (under the sponsorship of New York State) and renovated existing academic space. In all, the master plan calls for 8.1 million square feet of space in eight new and three renovated buildings—a significant presence with the capacity to become the third node in New York, following the commercial centers of downtown and midtown Manhattan. The MetroTech complex of six buildings totaled around 2.5 million square feet of office space as of early 1999.

MetroTech Center was one among a handful of large-scale public/private ventures started by big cities across the nation in the 1980s. Such projects were not going to develop by themselves. Private developers could not have gone it alone. The scale was too large and the risks too great. In the case of MetroTech Center, even with public support from New York City and New York State and a UDAG, private financing was unavailable from domestic sources. Credited with transforming Brooklyn's downtown, MetroTech Center stands as visible testimony to the strength of public/private partnerships. ■

extend the public/private model beyond downtown to meet neighborhood needs for long-undersupplied services, particularly retail space, as in the case of the Vermont-Slauson Shopping Center in south central Los Angeles (see Figure 14-2).

Over time as public/private projects developed strong performance records, public agencies, universities, school districts, and port authorities continued to expand the ambitions of their development activities, embarking on high-visibility public/private development ventures to build sports arenas, cultural facilities, and entertainment complexes. Entertainment-based projects such as San Francisco's Metreon (see Figure 14-3)—the centerpiece of the city's most ambitious redevelopment project, Yerba Buena Center, an 87-acre mixed-use project in South of Market—can be said to constitute a third wave of public/private projects.

Public/private projects are markedly diverse in scope. For any city, individual characteristics and history determine the types of projects and forms of assistance that best meet local public goals. Generally speaking, public entrepreneurship is most beneficial in the case of complex projects proposed for weak

markets if a city can capitalize on its resources and use incentives to make a real estate project feasible for both public and private participants. In contrast, in strong markets, the public sector may be presented with select opportunities to capture benefits from the rising values of publicly owned land.

Although the majority of public/private projects have involved revitalization efforts directed toward the urban cores and distressed neighborhoods of the nation's cities, in the 1980s the strength of local real estate markets prompted some suburban governments to enter into public/private development. A case in point is Fairfax County, Virginia. In 1987, the county board of supervisors entered into a development partnership with the Charles E. Smith Company and the Artery Organization Partnership to build a new \$83.4 million government center on 100 acres of existing county land at no cash outlay to taxpayers. Instead of floating bonds for the project, the county swapped 116 acres of its adjoining land (which would be zoned for commercial and residential development) in exchange for tenancy (and ultimately building ownership after 75 years), \$24.6 million in cash, and \$16.6 million in other forms

of compensation. The county had bought 183 of those acres for \$4.1 million in 1979, and the 116 acres involved in the land exchange were valued at \$42 million.⁶

Value capture as a fiscal objective distinguishes another set of public/private projects, typically those initiated by public transit agencies, which, as a residual of their primary function, often control desirable development parcels. The Washington Metropolitan Area Transit Authority, for example, manages transit-related site development through its joint development program, which was a pilot started in 1969 and then expanded in 1981.

From the perspective of city planning or real estate, joint development of transit-related sites often seeks close coordination of residential and commercial development at transit stations.⁷ From the perspective of transit, joint development aims to meet many goals—generation of additional sources of revenue, increased rail ridership, enhanced convenience for riders, a public amenity, and architectural distinction through direct physical connections between private building entrances and rail stations.

Whether for urban revitalization, economic development, or value capture, the growth of public/private development initiatives has been fostered by a shift in public values favoring entrepreneurial behavior. Further, the broad definition typically accorded “public purpose” provides a rationale that allows every type of public agency to become involved in real estate development: local governments, redevelopment authorities, transit agencies, port authorities, school districts, quasi-public development corporations—even the U.S. General Services Administration, the U.S. Navy, and the U.S. Postal Service.

The Process Involved in Forming Public/Private Partnerships

Public/private partnerships dramatically redefine the traditional roles of the public and private sectors in the development process. In such ventures, joint participation by the public and private sectors is a prerequisite to developing a project in which each partner shares risks and benefits. Even though joint efforts involve many steps similar to conventional development, they differ in several ways:

- Business agreements between private firms and government detail the terms and conditions of development and involve the private sector in the public planning process much earlier than is traditionally the case, even under conventional urban renewal.



San Antonio's Emily Morgan Hotel, a significant rehabilitation involving public/private efforts.

- Relatively limited public resources are used (leveraged) to attract larger amounts of private investment for community and economic development.
- Public commitments of financial resources to a project engender concerns about public accountability and create expectations for financial returns in exchange for the risks taken.
- The active involvement of the public, private, and community sectors creates more complex sets of public/private interactions.
- Public objectives (including community goals, design criteria, affirmative action, and hiring residents) must be considered in addition to private objectives.⁸

Public/private partnerships offer many advantages. Developers anticipate a more cooperative regulatory environment when a government agency is their part-

Vermont-Slauson Shopping Center

A prototype for inner-city neighborhood retail services, the Vermont-Slauson Shopping Center is a 154,021-square-foot (gross leasable area) community center developed as a public/private joint venture. The project occupies a 9.7-acre site in south central Los Angeles—a high-density, inner-city area characterized by low incomes and a high crime rate. Anchoring the development are two major tenants—a discount department store (Kmart) and a supermarket (Boys). Other tenants include a drugstore, two shoe stores, several restaurants and fast-food places, and a U.S. post office. With the help of exceptional security measures, the center has operated successfully since its opening in fall 1981. In the first full year of operation (1982), sales averaged \$239 per square foot, and the center is still performing well at 100 percent occupancy.

Public funding for the \$8.2 million project totaled approximately \$5 million, including a \$1.5 million Economic Development Administration grant, a \$2.5 million UDAG, and \$1 million from the city of Los Angeles. Private investment totaled approximately \$2.2 million; in addition, Sears donated a portion of the shopping center site, which was valued at \$1.2 million.

Since the 1920s, Sears had served as the anchor for retail activities in the community. In 1977, following a number of unprofitable years, Sears abandoned its location. Concerned about the negative impacts of the closing on

area retailing, local merchants approached the city of Los Angeles to explore possible solutions. When Sears indicated a willingness to donate its property to a nonprofit group, the city two years later established the Vermont-Slauson Economic Development Corporation (VSEDC).

The city commissioned an economic study and an architectural study on the site's development potential, focusing on the reuse of the Sears building. In 1978, the city approached the Alexander Haagen Development Co. about developing retail space at that site. The firm determined that, although the Sears building was structurally sound, it was obsolete from the standpoint of merchandising and recommended demolition of the structure and of several other buildings so that an entirely new retail center could be created on the site.

To develop the new community shopping center, Haagen Development (as general partner) and VSEDC (as limited partner) formed a limited partnership. VSEDC became the recipient of the federal and city grants and holds title to the property; Haagen Development holds a 90-year ground lease. The developer negotiated the various deals necessary to complete the land assembly, which was funded with the use of city block grant funds and completed without reliance on eminent domain. Sixty percent of the center's profits (following a defined return on investment of private sector money) flows to VSEDC and 40 percent to

ner.⁹ Developers perceive government entities as more apt to approve and often to accelerate the approval process for those projects in which public agencies have an investment. For the public sector, public/private partnerships afford more control over projects throughout the development process and enable cities to achieve a variety of social objectives, for example, affirmative action, use of minority contractors, and the creation of jobs for low-income residents. Public/private projects, however, typically involve increased public review and comment, specific contracting requirements, and attention to political concerns. Under most conditions, the receipt of public monies and the participation of a public partner also mean greater disclosure than that common in a private project. At the same time, politically active pressure groups are more likely to be a problem for private developers as a result of the publicity that usually accompanies public/private ventures.

Figure 14-4 describes how two levels of government worked together to execute the cleanup and redevelop-

ment of New York's 42nd Street, long known for its reputation as a center for vice, crime, pornography, and sleaze. In reviewing Figure 14-4, consider the private developer's perspective in terms of how different types of active public support may be enlisted, how many different constituencies may become involved in a project, and how a model of the development process takes on great importance in the complex world of public/private development.

Strategic Decisions in the Implementation Of Public/Private Projects

In implementing a public/private project, the public sector faces five fundamental tasks:

- Selecting a developer;
- Determining the terms and conditions of the opportunity for development, including forms of public assistance;

the private developer, who operates the center. VSEDC plans to use its proceeds for further development of the local community.

Adequate security was the primary concern in the planning and design of the project; it also affected the cost structure for the center. The site is surrounded by a six-foot-high wrought-iron fence, with access limited to two entrances and exits. These gated access points are locked at 11:00 p.m. and reopen at 5:00 a.m.; each access point has its own gatehouse for security personnel. Within the center, a uniformed, armed security force is on duty 24 hours a day, seven days a week. The 17-person force is supplemented by a two-person patrol assigned to an eight-hour day shift by the Los Angeles Police Department. The extra security has been a critical factor in the center's success, although the center's unusual common area expenses (the annual costs of security approximate \$1.95 per square foot) had to be offset by lower-than-normal rents. Nevertheless, the project's public funds ensured its economic viability despite below-market rents.

Experience has revealed that, for a public/private partnership to operate smoothly and efficiently, elected public officials must, at the outset of the project, clearly document what they want to accomplish and make certain that all public agency staff members are aware of and adhere to the stated objectives. A clear specification of

objectives helps expedite government review and approval, thereby avoiding major delays and cost overruns for the private developer.

From the perspective of the private developer, working in partnership with the public sector meant delays in funding, extensive contractual and sign-off requirements, frequent progress reporting, and complex bidding procedures. Decisions about what appeared to be comparatively simple items, such as the type of perimeter fencing around the site, stretched into a lengthy process.

The decline of good-quality, competitively priced retail services in inner-city neighborhoods is a longstanding, well-documented trend for which numerous causes have been cited. Combining private development expertise, public financing, and a community economic development initiative, the Vermont-Slauson Shopping Center represents an example of the successful return of retailing to inner-city areas. It also stands as a model neighborhood public/private initiative. ■

Source: ULI—the Urban Land Institute, “Los Angeles: Vermont-Slauson Shopping Center,” in *Inner-City Economic Development: Successful Projects in Distressed Urban Neighborhoods*, ULI Research Working Paper Series No. 632 (Washington, D.C.: Author, April 1994).

- Negotiating disposition and development agreements;
- Resolving problems and conflicts that arise throughout the development process; and
- Monitoring performance responsibilities and payments of project revenues due over the life of the agreement.¹⁰

From a strategic perspective, some of the decisions a city must make in the early stages of planning a public/private venture (often when city decision makers are least informed about a project's development potential or are still evaluating possibilities) ultimately come to shape both the agenda for negotiations and the tools available for managing the initiative. One such decision concerns the process of selecting a developer. The choice is typically between an auction-bid competition or a development-prospectus competition through which a parcel is offered for disposition and a developer selected on the basis of comprehensive re-

sponses to a request for qualifications (RFQ) or a request for proposals (RFP). For nearly all public/private ventures, the RFQ/RFP has been the preferred option; the auction-bid approach generally offers government less flexibility in controlling the development process and less control over the composition of the benefits package.¹¹

In attracting private developers' interest and specifying the ground rules for participation in the project, the RFP sets the stage for future implementation of the project. The RFP can be short and open-ended or long and detailed with respect to a project's land uses, design guidelines, and business terms; regardless of the RFP's length, however, it requires the public entity to assess its specific objectives for the project with an eye to broadly defining the character of the private development, identifying public roles and available types of assistance, structuring a set of project-specific planning conditions and business points to which developers must respond, and providing for an orderly and

Metreon in Yerba Buena Gardens

Metreon is a 360,000-square-foot entertainment/retail complex in Yerba Buena Center—an 87-acre mixed-use development in San Francisco's South of Market neighborhood. Yerba Buena Center is an undertaking of the San Francisco Redevelopment Agency, which has sought to ensure that the privately developed entertainment/retail center complements the other cultural and commercial uses in the ten-acre megablock dubbed Yerba Buena Gardens and provides revenue to the agency for operating and maintaining public spaces there.

The four-level entertainment/retail center shares the megablock with several other facilities: a 5.5-acre public park known as the Esplanade, the Visual Arts Center (52,000 square feet), the Performing Arts Theater (48,000 square feet), and two visually prominent cafés, as well as subsurface facilities for the nearby George R. Moscone Convention Center and the Marriott Hotel ballroom. On the adjacent blocks, the San Francisco Museum of Modern Art (200,000 square feet) was completed in January 1995, and plans are underway for a Jewish arts museum (to be put in a rehabilitated building across from MOMA) and a Mexican arts museum on Mission Street. In 1998, a three-acre children's center opened with an indoor ice-skating rink, a carousel (which was rescued from Playland at a Long Beach mall), a plaza with a small garden and playground, a 12-lane bowling alley, the Zeum multimedia teaching complex, a child development center, W Hotel, and other facilities. Multiple office developments are underway or newly completed in adjacent neighborhoods.

The Yerba Buena neighborhood was part of an early 1960s large-scale urban renewal project and had been in decline when the redevelopment effort started. Largely because of the redevelopment effort of the past decade, the area has turned the corner and a rich mix of urban uses—including Class A development of many types—has recently come into being.

The agency's 1992 RFPs identified two goals for the entertainment/retail center. The agency's primary objective was to create a mix of entertainment and related uses that would complement the area's cultural uses and enliven the neighborhood day and night. Its second objective was to establish a reliable, long-term revenue stream that could be used to operate and maintain the public facilities in Yerba Buena Gardens.

The city required that development proposals for the 120,000-square-foot site be for a project of at least 200,000 square feet that would include a cinema complex

no smaller than 45,000 square feet and at least one other destination use encompassing a minimum of 30,000 square feet. These minimum requirements were believed essential to achieve the critical mass that would draw the project's diverse constituencies—the residents of the city and the Bay Area, the 210,000 downtown workers, and San Francisco's 13 million annual visitors, including more than 1.3 million conventioners.

The agency believed that an expensive design competition would deter many developers from participating in the process and did not require competing developers to submit designs or allow developers to associate with an architect. The agency and the selected developer would jointly choose the project architect.

The challenge of design was to achieve a number of important objectives in the face of some complex development constraints—construction over the Marriott's underground ballroom, ingress/egress complications, venting problems, and the need to provide vehicular access to the Esplanade, the Marriott, and the convention center—while not compromising the marketability of the entertainment/retail center. Those objectives included:

- Creating a high-caliber design that would hold its own with world-class designs in the neighborhood—Romaldo Giurgola's Esplanade, Fumihiko Maki's Visual Arts Center, James Stewart Polshek's Performing Arts Theater, and Mario Botta's Museum of Modern Art.
- Developing entrances through the entertainment/retail center to the Esplanade that would welcome pedestrians coming from the office and retail core north of Market Street, from the convention center, and from the more than 1,000 residential units (many inhabited by older people) in the South of Market area.
- Harmoniously blending the eastern edge of the project with the western edge of the Esplanade, which is on a sloping grade.
- Activating commercial life on the Fourth Street frontage and along the edge of the Esplanade.
- Bringing sunlight into the Esplanade and mitigating prevailing winds.

The project's conceptual design was coordinated closely with the agency and the major retail tenants and was completed in summer 1994, at the same time that negotiation of business terms was concluded. After numerous delays, construction of the entertainment center, with



The ten-acre megablock dubbed Yerba Buena Gardens is an undertaking of the San Francisco Redevelopment Agency, which sought to ensure that the privately developed entertainment/retail center complements the other cultural and commercial uses in the project and provides revenue to the agency for operating and maintaining public spaces there.

Sony Retail Entertainment (a division of Sony Corporation of America) as its master tenant, began in May 1997 and was completed in mid-1999. From Sony's standpoint, the project is an attempt to seize the high ground in technology-based entertainment attractions. Sony Retail Entertainment will develop and operate some of the attractions in the center, sublease space to other tenants, and develop and operate some attractions as joint ventures with other entities.

The developer for Metreon is Yerba Buena Entertainment Center LLC, an entity 85 percent owned by Millennium Partners of New York and WDG Ventures of San Francisco (see the profile of developer Paula Collins in Chapter 12) and 15 percent by Sony Retail Entertainment. Millennium Partners is a New York-based entity that developed a similar retail/entertainment center as part of its 800,000-square-foot Lincoln Square residential/retail complex in Manhattan. WDG Ventures is a San Francisco-based and minority-controlled firm with almost 20 years of development experience. Its close familiarity with the approvals process in San Francisco and with the many interest groups in the city was an important asset for a development group whose other partner is based in New York.

The developer built Metreon in 3.3 acres of leased air space above the ballroom of the San Francisco Convention Center. The lease expires in mid-2046, with the right of the land tenant to renew for two additional periods of 18 years each. The agency will receive both fixed and contingent compensation as consideration for the lease. According to the agency's economic adviser, Keyser Marston Associates, Inc., the total present value of the income streams in the lease is \$21.5 million, of which \$15.6 million is accounted for by fixed (minimum-risk) forms of compensation. The balance is attributable to the potential receipt of percentage rent. This revenue will provide the agency with funds to operate and maintain the public spaces of Yerba Buena Gardens. ■

Sources: Robert Wetmore and Helen L. Sause, "Striking a Public/Private Deal," *Urban Land*, January 1995, pp. 25-28; Robert J. Wetmore and Helen L. Sause, "Sony Entertainment Center Breaks Ground," *Urban Land*, August 1997, pp. 24-25; and Gina Mackintosh, freelance writer.

clearly understood procedure for evaluating proposals. These tasks are roughly analogous in timing to the activities in stages one through three of the conventional development model. (Most of the detail covered in

Chapters 10, 11, 12, 16, 17, and 18 is relevant background for preparing the RFP.)

The level of specificity for each of these elements is often a matter of market conditions. For example, when

Figure 14-4

42nd Street at Times Square: Marshaling Public and Private Resources for a Transformation

One of the most visible examples of redevelopment that took advantage of public and private resources is New York's 42nd Street at Times Square—or the *new* 42nd Street as bespeaks its radical transformation in perception and reality. The emergence of the new 42nd Street has become a worldwide symbol of renewed optimism about the dynamics of city life in general and public/private projects focused on entertainment in particular. Long associated with a lengthy list of urban ills, conditions of social depravity, vice and high crime rates, and the easy availability of every form of sexual pleasure, West 42nd Street today is a vast construction site rapidly on its way to reemerging as New York's prime entertainment mecca, a drawing card for families, out-of-towners, and native New Yorkers alike.

When fully redeveloped by the turn of the century, this historic one-block stretch of midtown Manhattan, also the nexus of the city's transportation system since 1904 when the first of several subway lines to converge on Times Square was completed, will be the new home for corporate tenants such as Condé Nast Publications and Reuters, as four new office towers with more than 4.1 million square feet of space rise on corner sites at 42nd Street on Seventh

Avenue and Broadway. Already operating are three newly renovated theaters—New York's art nouveau masterpiece, the 1,800-seat New Amsterdam now operated by Disney; the city's first theater dedicated to children's programming, the 500-seat New Victory Theater; and the 1,821-seat Ford Center for the Performing Arts (refashioned from the combined Lyric and Apollo theaters) designed for musical productions. Joining these theaters, on the north side of 42nd Street, will be the new home for the Roundabout Theater Company and rehearsal studios for nonprofit arts groups (in the old Selwyn Theater) and E-Walk, a 193,000-square-foot entertainment/retail center that includes a 13-screen, 100,000-square-foot Sony/Loews theater complex and a 45-story hotel. Rising on the south side of 42nd Street in the space of three other theaters (the Empire, Harris, and Liberty theaters) is a 335,000-square-foot retail project that will include a 25-screen AMC multiplex cinema, the 60,000-square-foot Madame Tussaud's wax museum, and other retail attractions. The Times Tower, the 26-story tower built by the *New York Times* that gave the district its name and became its symbolic heart, now houses a new Warner Bros. store (across from the Disney store) in addition to being a billboard of electronic signs and a

The emergence of the new 42nd Street at Times Square has become a worldwide symbol of renewed optimism about the dynamics of city life in general and public/private projects focused on entertainment in particular.



the market is weak and the site untested, attracting the attention of qualified developers may require a detailed prospectus and thorough feasibility study. Conversely, when the market is strong, less documentation may be

needed, but correspondingly more attention must be devoted to other matters, particularly the detailed terms and conditions for the contemplated business deal. Differences in market dynamics, site character-

visual entry point for the eight-block stretch of Broadway—from 42nd Street to 50th Street—ablaze with a new generation of flashing neon, kinetic lights, and supersigns.

This vast transformation and cleanup of 42nd Street—a saga of stops and starts, 47 lawsuits, continual controversy, and market reversals over the course of nearly 20 years since the public/private project was initiated by the public sector—has been a joint undertaking by an unusually powerful coalition between the city and state. Under a memorandum of understanding signed in 1980, the city of New York and the state of New York through the entrepreneurial public development entity, the Urban Development Corporation (UDC), agreed to cooperate in the redevelopment of the 42nd Street block between Broadway and Eighth Avenue. The compelling force of this institutional coalition came from the singular combination of three powers only UDC could bring to the deal-making process: the police power of eminent domain to condemn land (the city's public development arm did not have clear statutory authority to undertake the power, and, though the city did, its process was viewed as terribly cumbersome and relatively slow), the legal status (as would-be landowner) to negotiate customized tax agreements for commercial projects, and a distinctive statutory power to override local land use regulations.

As part of the agreement, UDC accepted the lead role of implementing agency for the project. The city retained the rights of approval on financial terms and changes to UDC's *General Project Plan*, which governed the redevelopment land use program. Most significant, the public approvals that are the legal ballast to the project were undertaken pursuant to state regulations and therefore did not go through the city's traditional lengthy approval process.

In city-state agreements executed in 1988, 1991, and 1994, UDC agreed to transfer its interest and obligations to a wholly owned subsidiary whose sole activity would be development of the 42nd Street Development Project (42DP). Thus, although UDC was the original condemning authority, title to the properties lies with 42nd Street Devel-

opment Project, Inc. In addition, the city in 1988 created an independent nonprofit organization, the New 42nd Street, Inc., and charged it with long-term oversight of the renovation and ongoing operations of 42nd Street's historic theaters.

As the implementing agency, 42DP has been responsible for day-to-day management of the project (including property management, condemnation, relocation, and fee and fixture trials) as well as development of the plan, marketing, attracting tenants, and negotiations with developers. The city retained consent rights on all "material" actions by 42DP and UDC. 42DP's core activities have been funded through UDC, and were repaid directly by developers or will be reimbursed through developers' revenues related to site development.

From the perspective of implementation, at least two structural characteristics distinguish this project from other large-scale public/private efforts in the nation. The first was the city's policy mandate that it take no direct financial risk for the costs of acquiring, through condemnation, the 13-acre project area. It managed to do so through an innovative public/private deal structure designed to shift that risk to private developers (principally Prudential Insurance Company as the money partner behind Times Square Center Associates, the joint venture that held the development rights for the four office tower sites). The second was the public coalition between the city and state that was instrumental in carrying out the city's financial mandate and acting as a political bulwark against constant opposition that continuously delayed condemnation and troubled implementation of the project. In turn, when the real estate market collapsed in the early 1990s and effectively killed the initial concept of office/mart/hotel for the project, the leadership and resources of 42DP, in concert with the staying power of the public/private coalition, provided the basis for rescripting the project. It was a rare second chance for any large-scale redevelopment project. This new plan, with its clear and timely focus on entertainment-based activity, reinforced the historic and enduring thematic attraction of 42nd Street at Times Square. ■

istics, a given project's public objectives, and the legal alternatives available for designating developers are all important considerations when selecting a developer and thus make generalizations about the "best" approach inappropriate.¹²

When land for the public/private development is publicly owned, a second strategic decision is whether to sell or lease the parcel. A sale can generate substantial upfront revenues for use in other public projects, eliminate the risk of future nonpayment,¹³ and, under certain conditions, promise higher dollars for the public treasury than lease arrangements. In terms of controlling land use, restrictive covenants can be attached to property deeds as a condition of sale, as was the case with urban renewal dispositions. As a means for managing the development of large-scale public/private projects, however, many big cities have found that leasing affords more strategic advantages.¹⁴

Los Angeles's disposition of the land underlying California Center is illustrative. The last remaining parcel in the city's long-running Bunker Hill urban renewal project, the 8.75-acre site was also the only large parcel of land left in downtown when the Community Redevelopment Agency solicited development proposals in 1979. After two moribund decades, the market in downtown Los Angeles heated up, and to capture the benefits of its position as landowner, the agency decided to offer the parcel on a long-term lease basis. The RFP called for a mixed-use project of 3.5 million to 4.4 million square feet with a substantial allocation to housing uses; a major public benefits package, including a new, free-standing structure for the Los Angeles Museum of Modern Art, which was to form the focus of the entire development; and an adjacent 1.5-acre central park as well as other pedestrian open spaces to be provided, owned, and maintained by the developer. These public amenities would not substitute for direct financial returns—which, according to the RFP, should reflect prevailing market practices and include provisions for inflation-protected rents, escalations pegged to rising property values, and profit-sharing participations.¹⁵

Forms of Assistance

The nature of public investment in projects has taken the form of subsidies for land redevelopment and such capital improvements as infrastructure, parking garages, transit systems and stations, public amenities (e.g., outdoor plazas, pedestrian malls, other open space), and complementary facilities such as convention centers and stadia. Such improvements ready a site for private development, provide needed amenities, and or create an improved programmatic environment in

which a project is more likely to succeed. Indirect—or softer—forms of assistance designed to improve project feasibility can be passed on to developers in several ways: through density bonuses, government agencies' commitments or guarantees to lease space in a new development, transfers of development rights, land and/or building exchanges, air rights transfers, regulatory relief from zoning and building codes, reduced processing time for project approvals, coordinated design of projects in an area, arbitration of any disputes that might arise, and work with or organization of neighborhood and business groups. These public actions typically do not require an outlay of public money but provide the developer with savings in time and money, reduced risk, or increased opportunities for development (see Figure 14-5).

After the cutbacks in federal aid in the late 1970s, cities received fewer categorical aid dollars from Washington with which to fund their projects, yet they continued to support projects through the issuance of tax-exempt bonds—at least until the 1986 Tax Reform Act curtailed the use of such bonds for private-purpose projects. Continually pushed to rely more and more on local resources, cities established a broad inventory of incentive tools and financing techniques from which to fashion their assistance packages: tax increment financing, special assessment districts, tax abatements, dedication of sales or special-purpose taxes, UDAG loan paybacks, eminent domain, land writedowns, land swaps, ground leases, lease/purchase arrangements, second mortgage financing, loan guarantees and credit enhancements, loan subsidies, capital improvements, leases for office space, and value-creating tradeoffs based on zoning bonuses.¹⁶

In return for the increased risk associated with providing substantial assistance, the public sector can take a direct financial stake in projects to secure a specified percent of a project's cash flow (a pseudo-equity interest) through such mechanisms as participatory leases and profit-sharing agreements.

Although used with some frequency in the past, profit-sharing agreements have not produced substantial revenues for many cities. In one study of 16 cities that structured project financing around profit-sharing arrangements, only three projects were generating any cash for the city as of 1988.¹⁷ The economic logic of the subsidy in many downtown or inner-city neighborhood projects works against a big return. To kick off a project, the city invests funds early in the development process. Then, so as not to burden the project before it reaches an economically viable operating position, profit-sharing revenues typically are structured as triple-net revenues, with the city last in line to receive any

Figure 14-5

Strategies and Incentives for Public Assistance

Strategies for Enhancing the Risk/Return

Relationship of Private Investment

- Reduce capital costs
- Absorb demands for new or improved infrastructure
- Lower operating costs
- Increase opportunity for development
- Reduce debt service burden
- Reduce predevelopment risk of approval
- Enhance availability to private capital

Direct Financial Assistance

Land Assembly

- Acquisition
- Demolition
- Relocation
- Writedowns

Capital Improvements

- Infrastructure
- Parking garages
- Open space and amenities
- Programmatic facilities

Grant Assistance

- Cost sharing of private improvements
- Payment for predevelopment studies

Debt Financing

- Direct loans
- Below-market interest rates
- Loan guarantees
- Credit enhancements

Indirect Assistance

- Zoning or density bonuses
- Transfer of development rights
- Transfer of air rights
- Regulatory relief from zoning and building codes
- Reduced processing time for project approvals
- Quick take by eminent domain
- Design coordination in public/private projects
- Below-cost utilities if publicly owned
- Arbitration of disputes that might arise
- Government commitments to rent space

Financing Strategies

Intergovernmental Grants

- Community development block grants
- Section 108 guaranteed loans
- State economic development grants

Local Debt Financing

- General obligation bonds
- Revenue bonds
- Industrial development bonds

Off-Budget Financing

- Lease/purchase agreements
- Ground leases
- Land/building swaps
- Property tax abatements

Dedicated Sources of Local Funds

- Special district assessments
- Tax increment financing
- Earmarked sales or special-purpose taxes
- Reuse of UDAG loan paybacks

General Budget Revenues

cash flow. In other words, the cost-revenue account is likely to be negative for many years. Such was the case in Boston, where officials waited 17 years before realizing any profit from Faneuil Hall Marketplace. In that project, the city acts as a limited development partner, sharing a percentage of the development's net cash flow in lieu of collecting property taxes and relying on conventional lease terms.¹⁸

Notwithstanding the evidence to date, sharing profits affords cities other nonfinancial benefits. Although large public subsidies are always potentially controversial, profit-sharing arrangements in effect provide a

political solution to the buy-high/sell-low problem of writing down the cost of redevelopment. They offer political protection to city officials vulnerable to charges of giving away too much. Even if the anticipated revenues are small or expected far in the future, a financial agreement to share returns is perceived as a sign that the city is acting responsibly and effectively.¹⁹

Cities aim to be pragmatic in packaging assistance. Their objective is to create combinations of incentives that make a real estate investment feasible for both the public and private participants. In this case, feasibility means overcoming serious obstacles and problems—

land assembly, negative impacts of the surrounding area, excessive or premium costs, heavy upfront capital investments—that inhibit private development or renovation. Through diverse and numerous means, the public assistance package reconfigures the risk/return relationship of private investment through one or more financial tactics: reducing capital costs, absorbing the demands for new infrastructure, lowering operating costs, or reducing debt service burdens.

In determining whether significant levels of public assistance for development and financing will be required, public officials typically proceed through several steps.

1. Determine total development costs by project component.
2. Determine the level of private financing available (see Chapter 6) by:
 - Estimating the income-producing capacity of the project;
 - Capitalizing net operating income;
 - Determining loan value;
 - Determining available equity financing; and
 - Calculating total private funding capacity.
3. Identify the gap between project costs and available private resources.
4. Structure assistance to close financing gaps and to gain reasonable project returns.²⁰

Although the terms and conditions of public aid are tailored to the needs of individual projects, local governments structure assistance within the framework of three widely held (if informal) general policy principles:

1. Public aid should be delivered through cost-sharing mechanisms.
2. Investment of public dollars requires a return for risk taking apart from increased collections of property taxes, based on some form of loan recapture or profit participation in future project revenues.
3. The timing and conditions of public commitments should be linked to specific private obligations and responsibilities that must be performed.

In each instance, the public sector seeks to create binding ties in the form of mutually dependent commitments and business interests that establish incentives for the completion of an economically viable project. Generous upfront subsidies can carry risky projects through the first uncertain years, but experience has shown that they cannot turn weak projects into successful ventures. Beyond the task of making development feasible, the hard part of crafting public/

private deals is finding ways to ensure the efficacy of public investment in joint development ventures. When deciding on the measures to apply in helping developers close financing gaps, public entities must define and measure the public risk of and reward for their actions (see Figure 14-6).

Cities and states today have become more sophisticated about claims of benefits from private projects and are acting accordingly by critically scrutinizing the cost/benefit ratio attached to projects with large subsidies. One area where this scrutiny is most visible is the provision of publicly subsidized financing for stadia and arenas, especially when voters are being asked directly—through the ballot box—to pay the price. If voters want stadia, they often don't want to shoulder the costs or subsidize a team's owner, so voters' rejections of referenda on stadium-financing questions are not unusual. A "no" vote on stadium financing is not always the final word, however, and therein lies a big part of what is a nationwide fierce, tough, and controversial debate over municipal assistance to sports stadia.

With increasing regularity, sports franchises have used their monopoly-type power to pressure governments for a new or substantially refurbished stadium; the present stadium may be too old or too small or without the amenities, luxury boxes, and suites that raise the revenue to develop a top team. Alternatively, city officials may actively seek a franchise when the city has no sports team, or it may view an additional franchise as an element of its economic development strategy for downtown, in particular. In either case, cities have to figure out how much and in what form they should contribute to the building of a new stadium for a privately owned team, or risk losing that team to other cities who seem (at least during the heat of negotiations) only too willing to promise team owners a new stadium. Despite the trend toward public financing, the San Francisco Giants's new stadium, Pacific Bell Park, and the new MCI Center, a professional sports arena in downtown Washington, D.C., were built entirely with private funds.

The political stakes of such debates are high, with pros and cons targeting both economic and strategic issues (see Figure 14-7). Economists continue to cast doubt on the monetary benefits cities reap from subsidizing new stadia. Heavy public financial assistance is highly controversial, so how the public assistance package is put together is key to the political acceptance of a city's decision making. Sports stadia may rely on specialized types of "export" taxes, such as hotel and motel taxes, car rental taxes, or a tax on visiting athletes; cities also have created sports lotteries and put in place

Analyzing Financial Returns to the City

To accomplish goals for revitalization, cities are increasingly bargaining for better terms on paying back loans, lease arrangements, and land writedowns, and are requiring higher percentages of net cash flow for the risk they are taking in development. Their negotiating prowess, however, has resulted in increasingly complex deals, rendering financial analysis more complex as well.

Arizona Center, for example, is an 18.5-acre, \$515 million mixed-use development in downtown Phoenix that will ultimately feature 1.9 million square feet of office space, 450,000 square feet of retail shops, a 600-room hotel, a three-acre garden park, and parking for approximately 5,400 vehicles. Phases I and II, already completed, include two office buildings totaling about 750,000 square feet, 150,000 square feet of specialty retail shops, the garden park, and two parking structures. Completion of these portions of the project in November 1990 followed the city's RFP in May 1986 and selection of the Rouse Company of Columbia, Maryland, and the Phoenix Community Alliance, a private nonprofit developer, in August 1986 as the entities with whom the city would enter into exclusive negotiations. By December 1986, the city council was requested to approve the right to negotiate a disposition and development agreement with the developers based on the following terms. (The terms are as described in a memorandum of understanding between the city of Phoenix and the Rouse Company dated December 19, 1986, and might not reflect the terms of the final deal.)

Terms of the Agreement

1. *City's contribution.* Acquiring 1.85 acres through eminent domain. Vacating 4.71 acres of public right-of-way (streets and alleys). Subordinating its interest in the land and buildings to any project financing.

City's return. Land to be leased to the developer for 60 years for rental payments totaling the sum of 1) the

debt service required to retire land acquisition bonds for the 1.85 acres; and 2) participation in cash flow as follows: 8 percent on any cash invested by the city in the 600-space garage plus 7 percent on the value of the 4.71 acres in vacated streets and alleys so long as that amount does not exceed 17 percent of operating cash flow after certain defined expenses and returns to the developer and the city (the 8 percent on the garage). After the 15th year, the developer has the right to purchase the city's fee interest, in which case the 17 percent return would increase to 27 percent. If the developer does not exercise this right, however, the percents remain the same.

2. *City's contribution.* Abating all real estate property taxes for eight years. Making best efforts to obtain tax-exempt bonds or certificates of participation to finance the developer-funded garden park as well as certain improvements to traffic, sewer, water, and storm sewer systems to be built by the developer with tax abatements.

City's return. Upon the sale or refinancing of office buildings other than those built during Phases I and II, the city receives an amount equal to the capitalized tax abatement provided on those buildings after the payment of defined expenses and returns. Further, the project is to be completed according to the approved development plan, with the developer to fund the garden park as well as certain improvements to off-site traffic; the sewer, water, and storm sewer systems; and dedicated tax abatements toward repayment of bond obligations if the city does obtain financing. The developer is also to work with the Public Transit Department to develop an incentive program encouraging ridership on public transit and in carpools, and to develop a participation plan for including minority and women

continued on next page

a "temporary" sales tax or surcharge on an existing sales tax to partially finance stadium construction, in addition to the many other forms of assistance listed in Figure 14-5. The private side of the equation offers a number of special sources of funds: corporate sponsorships, stadium-naming rights, luxury boxes and charter seats, as well as concession rights, advertising revenues, and parking fees.²¹

The terms of assistance and conditions of development contained within public/private agreements are

complex. This complexity reflects the many tradeoffs made during the course of negotiations in which the public's set of objectives is reconciled with both its limited resources and the demands of private investment. Similarly, the roles adopted by the public sector—broker, facilitator, lessor, builder, lender, investor—reflect both the range of multifaceted issues (bureaucratic, financial, political) to be addressed and the conditions in local real estate markets at the time those roles are defined.

Analyzing Financial Returns to the City (continued)

business owners in the project. Future abatements are to be used to fund additional parking, maintenance of the garden park, and incentives for hotel and department store development.

3. *City's contribution.* Making the best efforts to obtain financing for the 600-space garage to be owned and operated by the city. (The parking requirement has been reduced based on calculations of shared parking.)

City's return. Eight percent return on any cash invested if the city obtains financing (see number 1 above).

4. *City's contribution.* Making best efforts to ensure certain traffic improvements, including the maintenance of two key streets as high-volume, two-way arterials, relocation of certain diagonals, and modification of travel on key avenues to improve public transit. Making best efforts to extend streetscaping.

City's return. No specific return.

5. *City's contribution.* Conveying ownership of the garden park.

City's return. The developer builds and maintains the garden park.

6. *City's contribution.* Rezoning the entire parcel, permanently waiving the permit requirements for outdoor activities, and changing the High-Rise Residential Incentive Overlay Zone, among others.

City's return. No specific return, but, on an overall basis, the project is expected ultimately to employ 10,500 people and be valued at \$515 million.

A careful reading of these terms, even summarized as they are, indicates the deal's complexity. In fact, the cover memorandum that accompanied the memorandum of understanding appears to have misstated the deal in assuming that, for example, the city's participation in cash flow would automatically increase to 27 percent in the 16th year, when in fact that event would occur only if the developer chose to exercise its option to purchase.

Analyzing Potential Returns

A city should consider several questions when analyzing the potential returns on a deal such as this one:

- What are the opportunity costs associated with the tax abatement on property of potentially rising value? Can increases in property values for areas surrounding the subject property be projected?
- How does the city account for its costs related to the project, including soft administrative costs?
- How critical to the city is the developer's purchase of the property? (It is the purchase that triggers an increase in the percentage of participation in cash flow.)
- Not counting the value of social goals such as minority employment, what is the net present value of the city's investment in the project? Have long-term financial pro formas been developed so that such value can be calculated? What discount rate should be used in calculating the net present value of the city's investment?
- What value should be placed on the projected new jobs to be generated by the project?
- What is the procedure, if any, for renegotiating any portions of the deal in the event of unforeseen circumstances?

Cities like Phoenix—and many others—are fine-tuning their skills in analysis and negotiation to leverage public dollars for revitalization. As the competition for public money increases and deals become more complex, however, cities will need to hone these skills even more to use resources as wisely as possible. ■

Sources: Phoenix Community Alliance, "Central Phoenix Project Update, Summer 1990"; and "City Council Report," cover memorandum, December 19, 1986, describing the memorandum of understanding for the project and memorandum of understanding between the city of Phoenix and the Rouse Company, December 19, 1986.

Organizations and the Public/Private Process

As public/private ventures have evolved, the involvement of state and local organizations has expanded in innovative ways. Various types of government structures, including an array of quasi-public government bodies, development corporations, and city departments with

expanded functions, have been organized to handle public/private development. Public/private development is frequently organized under a quasi-public institutional structure that permits an organization to operate with greater flexibility and fewer restrictions than a city agency involved in development. Though partially publicly funded, a quasi-public development organization can conduct negotiations in private—a par-

The Pros and Cons of Publicly Subsidized Financing for Sports Stadia and Arenas

Pros—New stadia:

- Foster local economic growth,
- Generate new jobs and new taxes,
- Stimulate spending in neighborhood restaurants, bars, and hotels,
- Create spillover opportunities for real estate development,
- Meet local citizens' desires for entertainment and pride of place for local sports team ("consumption value").

Cons—New stadia:

- Are poor economic development generators, as most empirical studies have shown, because:
 - The projected economic impacts rarely materialize,
 - Stadium-related jobs are often seasonal and pay low wages,
 - They only change the way people spend money on entertainment rather than generate new revenue,
 - The value of publicly subsidized financing is often distorted in economic studies,
 - The costs typically exceed the benefits;
- Cities have more pressing needs—schools, transit, infrastructure—for scarce public funds.

Three questions economic studies need to answer:

- How do the costs of a proposed stadium compare with its benefits? Who benefits and who pays?
- What is the impact of a new stadium on local per capita income?
- What is the likely impact of a new stadium on the rate of growth of the local economy?

Common critiques of economic studies:

- Impact or cost/benefit studies are rarely commissioned by "independent" players, and the results typically are consistent with the positions (pro or con) of their sponsors.
- Estimates of benefits (direct revenues and spillovers) are imprecise because data are limited and assumptions suspect or optimistic.



Coors Field in Denver, Colorado, is a traditional-style urban ballpark designed to complement the red brick buildings of historic LoDo.

- Multipliers—one of the key variables of any economic impact analysis—used by most studies are based on decades-old data.
- Econometric studies of economic impacts are also suspect, because economists disagree on methodological approach and conceptual models for measuring impacts are weak. ■

For an informed discussion, see David C. Petersen, *Sports, Convention, and Entertainment Facilities* (Washington, D.C.: ULI—the Urban Land Institute, 1996); and Roger G. Noll and Andrew Zimbalist, eds., *Sports, Jobs, and Taxes: The Economic Impact of Sports Teams and Stadiums* (Washington, D.C.: Brookings Institution Press, 1997).

ticularly useful feature as developers are reluctant to negotiate when the details of their financial dealings are made public. Examples of quasi-public organizations are the Centre City Development Corporation in San Diego and the Milwaukee Redevelopment Corporation (see Figure 14-8).

The Centre City Development Corporation (CCDC) was created in 1975 in connection with the increasingly complex redevelopment of the Horton Plaza project, San Diego's first post-World War II investment in a badly deteriorated downtown. As the city's sole representative in such activities as condemnation, relocation,

land acquisition, and negotiations with private developers, CCDC played an aggressive role in an extensive planning process that involved 13 contract revisions with developer Ernest W. Hahn, Inc.²²

A dedicated and specialized public development partner is crucial. The many responsibilities carried out

by the public partner—brokering regulatory approvals, negotiating with other public agencies, shepherding the development proposal through the environmental impact and community review processes, and providing financial assistance—can expedite progress through the inevitable hurdles encountered by these projects.

Figure 14-8

Milwaukee Redevelopment Corporation

The Milwaukee Redevelopment Corporation (MRC) is a private, nonprofit corporation working with the local government on major civic projects, particularly the revitalization of downtown; it is a “quasi-private” entity. Though a private organization with a board of directors comprising chief executive officers of major area corporations, the MRC works closely with the city and county governments.

The MRC was established in 1973 as a limited-profit development company and raised \$3 million in seed money by selling stock to more than 40 Milwaukee-based firms. Even though shareholders were told not to expect a rapid or market rate of return on their investment, the MRC reorganized as a nonprofit corporation in 1983 to reflect its actual performance. Operating funds now come from membership dues rather than from the sale of stock. Any return from the MRC’s development partnerships is reinvested in civic projects.

In its first two years of operation, the MRC met with business and government leaders to identify priorities and to establish an agenda for downtown revitalization. Among the targeted priority districts was the central retail area west of the Milwaukee River. A three-pronged strategy involved the development of a hotel, a regional retail center, and an office building.

To develop the hotel, the MRC made a cash equity investment in the project, while the city participated in landscaping and the construction of a skywalk. For the office building, the MRC optioned much of the land, and the city assembled a portion of the land. For the retail center, the MRC forged a coalition with the city and the Rouse Company—developer of the retail center—and developed the entire \$70 million project. It provided more than \$16 million of the equity, purchased two of the buildings used in the redevelopment, acquired other land in the project area, and executed a lease of the retail space with the Rouse Company.

Since its first three projects, the MRC has continued its work downtown. It became a joint venture partner in the development of the 354-unit Yankee Hill, the first major housing development in downtown Milwaukee in 20 years.

Completed in 1988, Yankee Hill is a market-rate rental project. The MRC is also working with the Mandel Group and WISPARK, the local electric utility’s real estate subsidiary, to develop a 20-acre project on the edge of downtown that will include more than 600 housing units. The development also includes a successful 40,000-square-foot supermarket and 17,000 square feet of neighborhood retail services. In partnership with the Trammell Crow Company, the MRC participated in the redevelopment of a historic building as the new home of the Milwaukee Repertory Theatre. As part of the project, the city restored the historic Pabst Theater, while Trammell Crow developed an adjoining hotel and office complex.

As compensation for its involvement in various projects, the MRC negotiates a percentage of the cash flow from the project as well as a percentage of the residual sales proceeds. A negotiated fee is also sometimes part of the MRC’s share of the deal.

The MRC has used both informal and formal processes to initiate deals. The theater project exemplifies the informal process. With the project still in the conceptual stage, Jon Wellhoefer, executive vice president of the MRC, contacted Trammell Crow to see whether he had any interest in the project. A similarly informal process guided the work with the Rouse Company on the Grand Avenue.

A more formal process involving a request for proposals brought about the Yankee Hill project. Letters to more than 60 local and national developers resulted in “something of a beauty contest” in which finalists submitted plans for the project in a competitive selection process. Both processes have worked well for Milwaukee.

The MRC’s agenda includes joint development of downtown housing, entertainment projects, improvements to the Grand Avenue area, participation in the new convention center, and assistance to the county in the development of a research park. ■

Source: ULI—the Urban Land Institute, *Downtown Development Handbook*, 2d ed. (Washington, D.C.: Author, 1992), p. 10.

And more so than with other types of development, the risks of public/private development are political. Gauging both the level of political commitment to carry through with a project and the government's ability (in financial matters and personnel) to deliver on agreements is central to a developer's qualitative assessment of project feasibility.

Practical Problems and Policy Issues

Shared Decision Making

The public interests at stake in joint venture projects draw governments into the management of development and the details of decision making associated with stages four through seven of the conventional development process—decisions typically left to the private sector. As cities share more of a project's financial risk, they ask for more control. When, for example, public interests take charge of developing parts of a project, as was the case in the \$95 million mixed-use Town Square project in which the city of St. Paul, Minnesota, built a park on the third level of a retail mall, it is clear that shared control is the most practical way to proceed. In that instance, while it was possible to settle some of the major issues early in the development process, St. Paul could not anticipate all the details well in advance of actual construction. Further, the demands of mutually dependent construction schedules that overlapped in time and space ruled out the hands-off control style of urban renewal. For St. Paul to cut a straightforward deal, prepare and transfer the property, and then merely monitor the developer's performance until the project was completed according to plan would have been practically impossible. The deal in St. Paul was an implied agreement to share both design and management decisions throughout the development period and to cope with problems by renegotiating any earlier understandings. Frequent trips back to the bargaining table helped move the project beyond unexpected obstacles.²³

The ground lease form of land disposition similarly creates an ongoing business relationship. For the developer, leasing minimizes the upfront capital investments and makes more efficient use of taxable deductions; for the government agency, retaining ownership of the land allows the public to benefit from rising land values through lease payments and percentage rents, thereby capturing the residual value of the built improvements. Alongside these benefits, however, lies the potential for conflict and tough lease negotiations, especially if the RFP does not include a sample lease

document that sets out terms and conditions affecting the developer's bid.

Structuring a ground lease that is acceptable to a long-term lender is the developer's major concern. In strong markets, government often does not subordinate the land; for reasons of both business and policy, public officials generally want participation in project revenues above a base fixed rent. To control its exposure to the political as well as business risks of assuming a proprietary interest in a private investment, the public sector seeks tight lease conditions and, through participation formulas, protection against charges that the developer is earning a "windfall." Both positions present problems to institutional lenders seeking protection from the potential loss of control through foreclosure by the government fee owner.²⁴

The city of Orlando's negotiations with Lincoln Property Company for the development of a new 245,000-square-foot city hall, a public park and plaza, 1 million square feet of commercial office space, ancillary retail space, and associated parking provide an example of the complexity and shared decision making that characterize public/private projects (see Figure 14-9).

The practical problems of implementing public/private development rule out anything but an active role in project decision making for the public sector. Attempting to anticipate upfront all conditions that might arise in the course of development would not only extend the process indefinitely, but also be unrealistic. Reconciling initial differences, finding efficient cost-sharing arrangements, coordinating public and private construction schedules, recasting the deal when crisis threatens the project, and managing the process in light of public review all call for flexibility in responding to the economic and political events that often challenge public/private projects. For private developers, participation in a public/private development means changing normal business practices to accommodate the demands of a politically accountable partner.

Conflicts and Accountability

As the public sector has become more involved in making deals, concerns have surfaced about its objectivity in regulating development. At a ULI policy forum in 1988, leading experts in the field of public/private development questioned whether public/private development leads to a conflict of interest for the public sector. Participants noted that the dual role of the public sector creates a two-hat dilemma: the potential conflict of interest inherent in the public sector's role as both land seller and land regulator. At its simplest, the conflict arises because a city's goals in selling versus regulating land

Orlando's City Commons

As Orlando's government outgrew its 1950s-vintage city hall, city operations were scattered among a number of buildings, resulting in inefficient service to the public. The city also faced escalating rental costs in privately owned buildings. Although Orlando could finance a new city hall without resorting to immediate tax increases or bond referenda, the mayor and the city council wanted to rely on an alternative scheme of funding.

To achieve that objective, the city chose to lease its land to a private firm, requiring the development of a large project designed to include significant commercial elements. The ground rents from the private development would partially offset the costs of constructing the city hall, and the developer could be persuaded to subsidize the costs of certain on-site amenities. Capitalizing on a strong market and a prime location, the city negotiated simultaneously with three finalists over six months. During that time, the competition even included the final details of the development and lease documents. Despite the extra time and effort, city officials believe that the benefits to the city, which also holds a reversionary interest in the project, were greatly enhanced. The important points of the final agreement with Lincoln Property Company, the developer, are as follows:

- The city retains fee simple title to approximately 2.5 acres of land (of the total seven-acre site) where the new city hall and a park/plaza will be constructed. The city will own the building outright in the conventional manner. (The city would have been willing under certain circumstances to rent the city hall from a developer to facilitate financing of the private portion of the project.)
- Lincoln Property Company is paid a negotiated development fee on performance of a guaranteed fixed-price contract to demolish the old building and construct the new city hall and park/plaza. This mutually satis-

factory arrangement gave Lincoln the opportunity to achieve some economies of scale in constructing a larger project. Lincoln is known for its cost-effective construction management, giving the city confidence in its ability to complete the project successfully.

- Lincoln and the city will jointly plan and design the project. Lincoln pays the planning costs and manages the process, assuming that the overall project conforms to the development practices of the private sector.
- Lincoln agrees to rent the remainder of the seven-acre site from the city in two phases—one beginning in 1992 and the other in 1996. The term for each parcel of land is 75 years. The city conservatively estimated and developed projected ground rents and equity participation to equal the city's bond service for the new city hall and the park/plaza within ten to 12 years.

Upon execution of the ground leases for the private phases, Lincoln will reimburse the city for the entire cost of the planned \$1.8 million park/plaza and for two-thirds of the cost of demolishing the existing city hall.

This project underscores the complexity of joint public/private development. The developer not only has to handle the complexities of a large-scale project but also must meet the government's many requirements: extensive public interaction, review and input from the community, the need to respond to several government constituencies, and compliance with statutory provisions regulating the selection and use of consultants, contractors, and other services. All these requirements mean that for a project to succeed, it must have true potential for development. ■

Source: Lewis Oliver and Eric Smart, "Orlando's City Commons: A Model Public/Private Venture," *Urban Land*, January 1990, pp. 21–25.

are potentially at odds and the city's role as seller might improperly influence its regulatory role (see Figure 14-9).²⁵ The following questions should be considered in examining whether such a conflict exists:

- Is the city overlooking longer-range public interest goals?
- Can cities make good deals, especially when bargaining with sophisticated private parties?
- Are regulatory concessions given away too cheaply?

- Are planners as deal makers focusing on short-term real estate development rather than on long-range comprehensive planning?
- Can traditional notions of due process be fulfilled when deals are hammered out behind closed doors?

The potential for conflict of interest is great, especially when real estate markets are strong. So far, however, conflicts have surfaced only infrequently, particularly given the large number of public/private projects. The

The Columbus Circle Project

The Columbus Circle project, initially a 4.5-acre development on the site of the old Coliseum on the southwest corner of New York City's Central Park, is an example of a court's characterization of a development transaction as a cash sale for a zoning bonus. That characterization reflected the trial judge's fundamental unease with New York City's dual role. In 1985, Boston Properties won a city-sponsored competition to develop the site. The design would have produced one of the biggest private buildings in the world, a 925-foot-high structure with 2 million square feet of office space, street-level shops, cinemas, several hundred luxury condominiums, and a 300-room hotel. The deal between the city and Boston Properties exchanged the publicly owned site (the Metropolitan Transit Authority is the parent owner of the parcel) and permission to exceed the zoning by 20 percent for a payment by Boston Properties of \$455.1 million and a commitment of up to \$40 million for improvements to the nearby Columbus Center subway station. With the bonus, the allowable floor/area ratio increased from 15 to 18, allowing 2.7 million square feet to be built. The city would have realized about \$100 million in taxes each year.

The Municipal Art Society, watchdog of the city's physical environment, filed suit, along with the metropolitan chapter of the American Planning Association and the New York Parks Council, asserting that the city's financial stake in the sale tainted the approval process and that environmental analysis of traffic and light and air quality was not adequate. In late 1987, the judge found that the city had exchanged density bonuses for money. The pivotal issue was the contractual clause that allowed Boston Properties to cut its payment by \$57 million should the city withhold the bonus of 448,500 square feet. In the decision (*Municipal Art Society of New York v. City of New York*, 522 N.Y.S. 800,803–04 [S.Ct. 1987]), the judge wrote that "government may not place itself in the position of reaping a cash

premium because one of its agencies bestows a zoning benefit upon a developer. Zoning benefits are not cash items."

Donning the hat of entrepreneur, the city attempted to generate the highest income from the sale of public land while simultaneously approving the use of a discretionary density bonus as part of its regulatory function. The singularity of the city's pecuniary motives was evident in the timing of its actions. The city incorporated the initial proceeds into the fiscal year 1987 budget before final approval of the sale and thus appeared to have granted the bonus to help balance the budget. Equally damaging was the city's RFP, which stated that the purchase price offered would be "the primary consideration" and that the developer would be required to "apply for and use its best efforts to obtain the maximum 20 percent subway bonus."

The intended disposition of the Coliseum site collapsed on itself under deteriorating market conditions and the withdrawal of the project's lead office tenant and joint venture partner. (Although efforts continued throughout the late 1980s and early 1990s to salvage the deal, the politics remained difficult. An agreement reached in the mid-1990s that would have allowed a scaled-down project to go forward also collapsed.) Nevertheless, the Columbus Circle case exemplifies the tension between the regulatory responsibility of a city and its entrepreneurial zeal in disposing of its property. It poses questions about priorities. Is good planning sacrificed when cities have a financial stake in a project? Does an inherent conflict of interest exist when the public sector wears two hats as developer and regulator?

Sources: Richard F. Babcock, "The City as Entrepreneur: Fiscal Wisdom or Regulatory Folly?" in *City Deal Making*, ed. Terry Jill Lassar (Washington, D.C.: ULI—the Urban Land Institute, 1990), pp. 23–29; and Lynne B. Sagalyn, "Public Development: Using Land as a Capital Resource," Working Paper (Cambridge, Mass.: Lincoln Institute of Land Policy, 1992).

Columbus Circle project (see Figure 14-10) stands out as a notable exception. Another instance of conflict of interest arose with the government center project in Fairfax County, Virginia (already described). In this case, the county was accused of selling the land at too low a price to develop its new building. Critics said the county should have held onto the land (which rose substantially in value after the trade) and sold bonds to finance the government center. The issue to consider is a question of public stewardship. Does gaining income

for the city through the disposition of city-owned land further the public interest?²⁶

Public-private deal making also poses difficult issues of political and financial accountability. With development agreements too complex to work out in public forums, meetings must be held behind closed doors. But for a local government to grant formal approval, the city council needs to understand the agreements; nonetheless, council members are not briefed on the choices and tradeoffs that are factored into the decision-making

process. The complexity of public/private deals also underscores the importance of balancing the need to provide timely information to both council members and the public against the need to protect the city's effectiveness in ongoing negotiations with private developers. In practice, the city council typically faces the choice of accepting a deal as it is or running the risk that a rejection would mark the council as the spoiler of a project that has been years in the making.

Ideally, a full accounting of costs and benefits should accompany the evaluation of a deal; with several different agencies involved in negotiations and cost sharing, however, it is often hard to track all the direct costs and indirect subsidies. Certain aspects of a deal are simply too difficult to value. Although design amenities, subway improvements, and below-market loans can be valued by referencing market equivalents, other benefits such as employment preferences and environmental mitigation commitments have no obvious market prices. These differences make it hard to standardize evaluation techniques and to define the value of tradeoffs in a public/private deal. As a result, public officials must devote substantial time and resources to effectively communicating the objectives of public/private development and to disclosing public commitments, risks, and expected returns.

Summary

The shift to public/private development evolved from the efforts of local government to manage the redevelopment process with greater control than that afforded by regulatory strategies and arm's length relationships with private developers. The success of public/private development has made it an important strategy for stimulating local economic development and financing selected items of capital infrastructure. It is also a means of implementing complex redevelopment projects. The highly visible record of public/private projects in the 1980s reshaped the landscape of downtowns across the country. The tangible results of this type of development approach contrasted sharply with the legacy of political controversy, acres of cleared but eerily vacant land, and years of frustration that had resulted from failed urban renewal projects developed under a strategy of command and control. The strong record offers tangible evidence that the public/private approach is a pragmatic solution to the earlier bureaucratic problems that beset the federal urban renewal program, proving that it is a strategy extremely well suited for coping with the complexity and risks of attracting the types of projects officials have wanted to revitalize their

cities. Consequently, city governments, public authorities, and other special-purpose agencies have strong incentives to continue forging relationships with developers who understand, from observation and experience, how to play by the new rules.

The public financing environment for public/private development is tougher today, however. On the public side, local government continues to operate on its own. The 1986 revisions to federal tax legislation cut back the availability of tax-exempt financing for private-purpose projects, while budget cutbacks in discretionary spending have reduced even further the funds available for domestic programs. On the private side, during the first half of the 1990s, depressed fundamentals of supply and demand in most product markets, as well as an overall lack of capital for the industry in general meant that development opportunities were few and far between. Yet these conditions—the need for inventive responses to fiscal pressures and shared resources for risky ventures—were not unlike those that gave rise to widespread use of the public/private strategy. High-priority public/private projects did succeed in getting off the drawing boards, particularly when political support and leadership were present.

The future is likely to differ in the scope and focus of urban public/private development activity—in the type and locus of such project initiatives. Building on past experience, much of which was concentrated on large-scale building of downtowns, cities are likely to focus more on smaller-scale projects targeted at rebuilding neighborhoods and a continued strategy of seeking job-based economic development. In turn, there is little reason to expect that the drive for off-budget financing of public infrastructure and civic amenities among suburban governments will abate. Land-owning public authorities as well are likely to continue to pursue efforts to capture value through joint development. Hence, even if the market is more demanding, the motives for pursuing public/private development remain strong. That fewer opportunities may exist will only make that handful of opportunities the intense focus of limited resources for both public and private sector players.

Given that the management of development from the public perspective is so difficult, public bodies should do everything within their power to facilitate strong and consistent management. Particularly important is coordinating all public agencies to avoid undue time delays.

Terms

- Disposition and development agreement
- Financing gap

- Investment tax credits
- Joint development
- Land leasing
- Leveraging
- Municipal bonds
- Public/private development
- Quasi-public
- RFP
- RFQ
- UDAG
- Urban renewal
- Value capture

Review Questions

- 14.1 What are the opportunities for working in a public/private partnership for a city? For a developer? What are some of the practical problems or points of tension in such a business relationship?
- 14.2 Describe the five key decisions the public sector faces in implementing a public/private project.
- 14.3 Why is city assistance, both financial and organizational, needed to facilitate public/private development projects?
- 14.4 The Vermont-Slauson Shopping Center is considered a prototype for neighborhood retailing services in inner-city locations. What are the special issues that such a shopping center faces, and how did the Vermont-Slauson Economic Development Corporation deal with them?
- 14.5 What are some of the financial techniques that cities can use and have used to accomplish their goals for revitalization and for reducing their risk?

Notes

1. Robert Witherspoon, *Codevelopment: City Rebuilding by Business and Government* (Washington, D.C.: ULI—the Urban Land Institute, 1982).
2. See Lynne B. Sagalyn, "Explaining the Improbable: Local Redevelopment in the Wake of Federal Cutbacks," *Journal of the American Planning Association*, 1990, pp. 429–41.
3. For a more complete description of Coldspring, see *ULI Project Reference File*, Vol. 9, No. 9, April–June 1979.
4. For a more complete description of the Gallery, see *ULI Project Reference File*, Vol. 8, No. 4, January–March 1978.

5. For a more complete description of the Emily Morgan Hotel, see *ULI Project Reference File*, Vol. 16, No. 20, October–December 1986.

6. Richard F. Babcock, "The City as Entrepreneur: Fiscal Wisdom or Regulatory Folly?" in *City Deal Making*, ed. Terry Jill Lassar (Washington, D.C.: ULI—the Urban Land Institute, 1990), pp. 9–43; and Ralph J. Basile, Jim Furr, and Charles Thomsen, "Leveraging Privatization in Real Estate Development," *Urban Land*, January 1987, pp. 6–11.

7. ULI—the Urban Land Institute with Gladstone Associates, *Joint Development: Making the Real Estate-Transit Connection* (Washington, D.C.: ULI—the Urban Land Institute, 1979).

8. Witherspoon, *Codevelopment*, pp. 8–9.

9. Babcock, "The City as Entrepreneur," p. 14.

10. For a detailed discussion of the steps involved in the process of joint development, see Witherspoon, *Codevelopment*.

11. Empirical studies of auction dispositions for housing in both Boston and New York, for instance, revealed critical limitations—low levels of rehabilitation investment and immediate property tax recidivism. See Christine A. Flynn and Lawrence P. Goldman, *New York's Largest Landowner: The City as Owner, Planner, and Marketer of Real Estate*, Report for the Fund for the City of New York, 1980; and H. James Brown and Christopher E. Herbert, "Local Government Real Estate Asset Management," unpublished report for Lincoln Institute for Land Policy Seminar, September 1989.

12. See Witherspoon, *Codevelopment*, p. 18; and ULI—the Urban Land Institute, *Downtown Development Handbook*, 2d ed. (Washington, D.C.: Author, 1992), pp. 41–43, for an extended discussion.

13. The infusion of cash can be duplicated with prepayment of rent, and the risk of nonpayment can be nearly eliminated with the purchase of a riskless government security, as was the case for Copley Place, a large-scale mixed-use project in Boston.

14. See Lynne B. Sagalyn, "Leasing: The Strategic Option for Public Development," Working Paper (Cambridge, Mass.: Lincoln Institute of Land Policy, 1993); Robert Wetmore and Chris Klinger, "Land Leases: More Than Rent Schedules," *Urban Land*, June 1990, pp. 6–9; and Lynne B. Sagalyn, "Negotiating Public Benefits: The Bargaining Calculus of Public/Private Development," *Urban Studies*, December 1997, pp. 1955–70.

15. Community Redevelopment Agency of the City of Los Angeles, "Development Offering: Remaining 8.75 Acres of Bunker Hill, Downtown Los Angeles," September 1979.

16. See ULI, *Downtown Development Handbook*, 2d ed., pp. 55–70.

17. Bernard Frieden and Lynne B. Sagalyn, *Downtown, Inc.: How America Rebuilds Cities* (Cambridge, Mass.: MIT Press, 1989).

18. Lynne B. Sagalyn, "Measuring Financial Returns When the City Acts as an Investor: Boston and Faneuil Hall Marketplace," *Real Estate Issues*, Fall/Winter 1989, pp. 7-15.

19. Lynne B. Sagalyn, "Public Profit Sharing: Symbol or Substance?" in *City Deal Making*, ed. Lassar, pp. 139-53.

20. See ULI, *Downtown Development Handbook*, 2d ed.

21. David C. Petersen, *Sports, Convention, and Entertainment Facilities* (Washington, D.C.: ULI—the Urban Land Institute, 1996).

22. See Jacques Gordon, "Horton Plaza, San Diego: A Case Study of Public/Private Development," Working Paper No. 2 (Cambridge, Mass.: MIT Center for Real Estate Development, 1985).

23. See Frieden and Sagalyn, *Downtown, Inc.*, pp. 140-42, for a more complete description of Town Square; and *ULI Project Reference File*, Vol. 11, No. 15, July-September 1981.

24. In the case of percentage rent, lenders hesitate because they fear a reduction in the amount of income to be capitalized when a large percentage of the income stream is committed to a ground lessor. In the event of foreclosure, the valuation impact would be substantial unless the lessor had agreed to subordinate the percentage provision in the lease. For a detailed case discussion, see ULI, *Joint Development*, pp. 76-81.

25. Lassar, *City Deal Making*, p. 3.

26. *Ibid.*