

# **Leasing: The Strategic Option for Public Development**

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In the 1980s, public entrepreneurship in real estate development evolved as the policy of choice for big cities. Stimulated by the most favorable market conditions in decades and pressed by continually tight budgets and cutbacks in federal funds, city officials seized upon the opportunity to capture benefits from the rising value of land. They did so by reworking existing strategies for the disposition and development of significant publicly owned property. In particular, in place of land sales many chose lease arrangements.

Cities such as Philadelphia, Milwaukee, Cincinnati, and Louisville used leasing in the conventional way of urban renewal, to subsidize a developer's capital costs much the same way as if they had made grants or loans, the key difference being long-term site control. Other cities used leasing to retain ownership of sensitive historic structures (Faneuil Hall markets in Boston) or to manage development of key waterfront locations (Inner Harbor in Baltimore). A certain set, however, used leasing in more ambitious ways—to implement complex master plans for large-scale public projects (Battery Park City in New York City; Pennsylvania Avenue in Washington, D.C.), to generate fiscal returns for future public development activities (Boston), or to finance major public amenities (Los Angeles, San Francisco).

In no case was the lease a passive disposition by which the city turned over site control to a developer who then would build what was called for under the terms of the contract. Rather, the agreements provided a means by which cities might participate in program, design, and management decisions throughout the development process. And they specified in detail direct proprietary returns—revenue streams and in-kind capital improvements—cities would capture from the economic value of their lands. In the early 1980s, cities that ventured to use publicly owned sites in this way—for entrepreneurial risk-taking—were few in number, but they were notable enough to signal a shift in city behavior.

The intent behind the choice to lease rather than sell publicly owned land was as strategic as it was commercial. Cities sought to link their business interests with their planning objectives. Leasing afforded public agents the opportunity to transact and trade on the rising value of their land resources, without losing control over the asset in the short-run (during development) or in the long-term (when the lease expired). The combination was powerful and productive, financially risky and politically complex. It gave certain cities the financial

ability to implement ambitious public agendas without allocating scarce city budget funds or seeking taxpayer approval through bond-financing referenda.

Linked as it was to strong market conditions, the strategic use of leasing also signaled a change in cities' bargaining position vis à vis private developers, from that of a buyer of investment to a seller of development opportunity. Like the waterlot grant of the nineteenth century (Hartog 1983, 60–68), the land lease functioned as a tool of governance, in sync with the political economy of fiscal strategies for the post-cutback era (Sagalyn 1990a). This essay discusses how leasing empowered cities to use their position as owners of land assets to shape city development and finance public objectives, and explains why it satisfied a lot of political needs certain entrepreneurial officials grasped.

## Affirmative Control through Property Rights

As the practice evolved in the heady real estate markets of the 1980s, government leasing of urban land marked a sharp turnaround from past practice. Historically, leasing represented a prime example of the public-sector “fall-back position”—taking on new responsibility only when there had been a clear failure of private initiative. The turnaround can be credited more to a change in economic opportunities and political values than to logic because the utility of leasing land has always been financially advantageous, for both city and developer.

By retaining ownership of land, cities benefit directly from the fiscal returns of urban growth through escalating rents and then, at the end of the lease term, through capture of the residual value of the built improvements. (Visionaries, and accountants, also cite the savings of not having to reacquire land in the next cycle of renewal.) In turn, by leasing land developers minimize their up-front investments and make more efficient use of federal tax deductions (Solomon 1978). Under federal urban renewal, legislation authorized loans for leasing—in theory, allowing cities to choose their own policy for land disposition. In practice, however, the arguments in favor of leasing became academic. They were overwhelmed by the practical problems of financing projects built on leased land and a strong bias against municipal land ownership among federal bureaucrats.<sup>1</sup> As a result, leasing evolved a policy of last resort—the only way to develop publicly owned property when the city actively solicited purchasers but no firm bidders came around.<sup>2</sup>

The opportunities and constraints of leasing had not changed by the late 1970s. If anything, without the federal urban-renewal loans to subsidize land acquisition and finance its long-term hold, cities absorbed the full bill themselves if they chose to lease rather than sell publicly owned sites. Moreover, in terms of public policy, the choice to lease still went against the norm that, absent special circumstances, the best place for publicly owned property is in private hands and on the tax rolls.<sup>3</sup>

Leasing's emergence as a policy of choice stemmed from the new vision of public entrepreneurship which came into focus during the early 1980s (ICMA 1983, Fulton 1985, Bellone 1988). The option had always been around, but it took a combination of strong market conditions<sup>4</sup> and maverick public entrepreneurs for leasing to be used aggressively—as a strategy for public development—not merely as an ancillary means of assisting private investment.<sup>5</sup>

A case in point is Los Angeles' disposition of the land underlying California Center, a \$1.2 billion project of office towers, residences, and cultural facilities whose size gave it prestige as one of the largest redevelopment projects in the nation. The last remaining parcel in the city's long-running Bunker Hill urban-renewal project (see Exhibit 1), the 11.35-acre site was also the only big parcel of land left in downtown when, in 1979, the Community Redevelopment Agency (CRA) solicited development proposals. The market in downtown Los Angeles was hot, after two moribund decades, and the agency—now in a position to dictate terms—intended to capture all the market would allow by offering the parcel on a long-term lease basis.

With a simply sketched design concept presented in its *Development Offering* (RFP), the CRA solicited proposals from prospective private developers.<sup>6</sup> The RFP called for (1) a commercial project of 3.5 to 4.4 million square feet with a substantial (30 percent) allocation to housing uses; (2) major public amenities including a new, free-standing structure for the Los Angeles Museum of Modern Art, which was to form the focus of the multi-phase development and attract people downtown; and (3) an adjacent 1.5-acre central park, as well as other pedestrian open spaces to be provided, owned, and maintained by the developer (Los Angeles Community Redevelopment Agency 1979, 18–26). At a minimum, the city required the developer to commit 1.5 percent of the total projected development cost to the museum in lieu of the CRA's requirement for works of fine art.

This would be a get-from, not a give-to, public-private deal. While the detailed business terms of the lease would be negotiated with the developer later on in the process, from the start agency officials made it clear that those terms had to match prevailing practices in the private sector. This meant inflation-protected rents, escalations pegged to rising property values, and a share in the profits of the commercial and residential components. Further, the agency would take a no-risk position by not subordinating its 99-year land lease to mortgage financing for the project, and, as with the purchase option used in private transactions, the developer would have to "pay something" during the "holding period" of predevelopment and construction. Through these ground rules the CRA set a policy of using its proprietary land interests to generate long-term fiscal returns.

There were no local precedents for such a transaction. As they went along, the agency officials and attorneys who drafted the offering and later negotiated the deal improvised, applying conventions of private real estate transactions to public deal making. According to one, they wanted a "tight" agreement with few "out" opportunities for the developer: "The land was just too valuable for the agency to provide lots of flexibility" (Weiser 1989).

The yield from the decision to sell rather than lease the land, as seen by city officials and urban commentators alike, would be a "windfall" for the city. "What we are doing is maximizing our asset of land and tying ourselves to the developer's cash flow to provide the city a hedge against inflation," remarked the CRA's deputy administrator for downtown (Kaplan 1981). The policy decision involved a trade-off, however. The city would be deferring near-term sale proceeds—an estimated \$58 million over the decade of phased development—for less certain, but significantly larger, future returns from rising land values and strengthening project performance—\$627 million under projections for the first thirty years of the lease term (City of Los Angeles, 1981a, 1981b).



The participation formula meant that the city would be sharing the development team's risk as well as its cash flow. Based on a "likely" economic scenario of project performance, the CRA's advisors, Keyser Marston Associates, estimated total land rent to the CRA in the first ten years of the lease would be \$11 million; \$100 million in the second ten years; \$516 million in the third ten-year period (see Exhibit 2). Overall, three-quarters of this return depended upon "participation rent," the key variable being rents the developer could charge in the three office towers, which accounted for the overwhelming proportion of income-producing space in the project.

This potential "upside," of course, would have to be balanced against the possibility of slower than expected rises in property rents<sup>7</sup> as well as the risk of default in the event that parts of the project failed. Still, the handsome inflation-protected returns were likely to entice even the most conservative city official. (By the year 2001, the fixed-base and escalation rents would amount to 80 percent of fee-sale proceeds, in nominal dollars.) Reporting on the transaction shortly before it was to do before the city council for review and final action, the *Los Angeles Times's* urban affairs critic, Sam Hall Kaplan, offered unusual praise for the CRA's decision (Kaplan 1981):

That the CRA consciously chose to forego an immediate profit for a larger profit in the future and continued participation in what will be the largest project ever built in Los Angeles indicates a sophistication the city long has been in need of among its planning and development agencies.

More than money was at stake. As in the case of Yerba Buena Gardens (YBG) unfolding simultaneously in San Francisco, the financial deal for California Plaza integrally linked its return to the city's downtown development strategy. The city wanted cultural, retail, and entertainment facilities to provide a "sought after center of downtown, a true regional focus" (Community Redevelopment Agency 1980). It would get them—a new museum and other cultural facilities, a hilltop park, and an associated network of pedestrian open space—as "products" of the deal. The CRA also wanted new housing downtown, something unlikely to be delivered by the market on its own—or at least within the time frame desired by the city. As planned in San Francisco, the agency got these benefits by leveraging the value of its land resource.

The turn to leasing in Los Angeles and other big cities signaled an experiment in the public's use of property rights, in place of regulatory powers, as a means of shaping and controlling urban development. Using the master lease as a development contract, cities exerted tighter control over multi-phase projects than with a sale-disposition agreement. Negotiating long-term leases with private firms for the development of significant sites afforded cities wide latitude to implement their policy objectives, and the flexibility of the lease contract readily accommodated divergent interests. By tying the price and conditions of land occupancy to specific development responsibilities and standards of performance, cities designed agreements that matched developers' financial needs with their own diverse and politically driven needs for inflation-protected revenues and profit shares, quality design, public amenities, open space, housing, and targeted employment for local residents and minorities.

Assuring performance was key. If cities sought only to control the use of land, they could have done so by attaching restrictive covenants to land deeds as conditions of sale, as they did under federal urban-renewal dispositions. But acting as mavericks, a handful of big cities used the lease-disposition agreement to (1) gain access to decisions typically left to developers and (2) control over the private provision of public amenities in large-scale mixed-use projects. Both served as levers for managing the risks of aggressive public development, restrictive covenants having proven to be notoriously difficult to enforce.<sup>8</sup> Through such affirmative control cities also captured an important new source of public funds whose spending could be directed into discretionary channels of off-budget decision making. In short, by exercising the option to lease rather than to sell their land, cities aggressively sought greater control and financial degrees of freedom with which to implement land policy.

## Selling a Development Opportunity

In the 1980s, public leasing did not represent land banking, nor did it represent an ideological commitment to municipal ownership. Rather, it evolved as a pragmatic strategy for meeting the diverse demands embedded in a city's proprietary interests in land. In short, leasing satisfied a lot of political needs.

A land disposition and development agreement (DDA), whether linked to a sales agreement or a long-term lease, serves several purposes. On one level, it acts as a planning and development document by specifying uses (and densities) of land and standards of design through its legal terms, covenants, and conditions. At another level, it allocates fiscal responsibility; first, by shifting part or all of the burden of public action to the private sector through developer obligations; and second, by defining the amount and timing of the public return on investment through scheduled payments and profit participations. At yet another level, it defines social distributions by targeting public priorities such as minority and resident employment and establishing mechanisms for their enforcement through covenants and financial penalties. Whatever the balance—and it varied across cities and across projects—this was the agenda of public interests cities pursued through their negotiated disposition policies (Sagalyn 1992).

More than land *per se*, what cities sold (and developers bought) was a development opportunity—rights to build hedged with complex obligations to perform and responsibilities to produce. Meeting the terms of a DDA required developers to follow through with affirmative behavior, including nonmarket actions such as the construction of housing (often simultaneously) with construction of office, retail, and hotel components. While the DDA's time-denoted performance schedule permitted some flexibility, generally it was not so elastic that developers could "buy a market position" years in advance and wait until the "right" time to build, that is, right by their reasoning alone. Also, while the development opportunity had marketable value, as a standard practice cities protected their interests with anti-speculative covenants and conditions limiting transfer by the designated developer.

For developers, building on a large and often unique site represented an opportunity to buy a long-term market position, provided they were willing to gamble by taking on the risks inherent in such projects.<sup>9</sup> One way to do this was with difficult "mega-projects" which could not be duplicated, at least in the near-term—high-stakes projects, yet projects made more

feasible because they were supported by special financial inducements or positioned to go through the development process with a public-sector partner.

Developers did not see these projects as competition-proof, but at least one noted how it gave his firm an edge: "There's an advantage to being first, to establishing a neighborhood in which you're able to produce something," said Albert Ratner, developer of a half-dozen "mega-projects" and President and CEO of Forest City Enterprises. "If it works well, people look at you differently" (Bloomfield 1990, 44).<sup>10</sup> If successful, developers might have a quasi-monopoly in a locational market—for a period of time.<sup>11</sup> The play entailed great uncertainty, but therein lay the profit opportunity: "What developers really prefer, remarked Leonard Chazen, a former attorney for New York City, "is a situation which has uncertainty, or at least the appearance of uncertainty, because, maybe, in those situations, there's just the chance of getting a decent deal on a piece of land, and making some money from it" (Exploring the Metropolis 1988, 13).

Similarly, for the public sector, the opportunity in large-scale development was one of long-term gain, the chance to play for revenue streams which would grow over time and yield returns greater than those from a one-time sale. Packaging a development opportunity could also produce additional benefits for a set of constituent interests beyond those of concern to government's budget monitors and fiscal watchdog groups. As a practical matter, proposals for development on public land balanced price against nonfinancial returns. In New York City, for example, under a "standard rule," the city had the right to negotiate with any bidders who offered at least 75 percent of the price of the highest bidder. In these situations, other criteria set by an agency such as good design and infrastructure improvements, would enter into the equation (Hack 1992).

If revenue generation had been the sole objective, cities might have auctioned their significant sites, selling them to the highest bidder. Competitive bidding on price alone, however, limits the ways in which government can use its land resources. While it removes the hint of impropriety and presents an easy solution to the difficult problem of selecting between competing developers, empirical studies of housing-auction dispositions in both Boston and New York revealed critical limitations—low levels of rehabilitation investment and immediate property-tax recidivism. The process had been efficient in returning property to private ownership, but it often proved to be inefficient in returning those properties to productive use (Brown and Herbert 1989, 47).<sup>12</sup> While the disposition of city property for housing raises a distinct set of policy issues, when key policy priorities are at stake, cities perceive a common need for affirmative control to maximize public interests. In these situations, an auction-type process, like regulatory intervention, rarely becomes the strategy of choice for managing the development of significant sites.<sup>13</sup>

Exercising affirmative control over the development process, in practice, means four things: (1) selecting who will build and what will be built; (2) linking when private development takes place with the priorities of public policy; (3) converting the value of publicly owned property into a package of financial returns and public goods (the composition of which depends on how much assistance the city or public agency contributes to the project in its role as landlord, co-developer, lender, or economic-development catalyst); and (4) maintaining control over potential income streams into the future, an important bargaining chip to public officials in big cities where public funds are scarce. In each instance, the public sector lev-

erages its position as property owner and extends its influence on private decision making beyond the bounds of regulatory interventions, even incentive zoning where an explicit trade-off exists between building density and financial gain (Kayden 1978).

The opportunity for government to capture equity-type returns from private development exists, in part, because the city can create value not only through its land-use powers (the incentive-zoning model), but, through its willingness to internalize the start-up speculative risk faced by developers (the landowner model). By bringing a property as close to “development readiness” as possible,<sup>14</sup> cities position themselves to capture the market value created by their actions.

Entrepreneurial activity, as in the case of internalizing the risk of “early” development, characterizes the thrust of public development. If what is being sold is not just land per se but a complex development opportunity linked to public investment, government’s “pricing” of that package—a mix of long-term lease revenues, public amenities, and social benefits—should reflect the market value of the land as a development parcel and include a return for its risk-taking activity, above and beyond its entitlement to property-tax collections. Policy and procedures for land disposition might be set in advance, in broad terms, but because future outcomes remain uncertain, by definition, every step of the development process cannot be choreographed in advance, as with regulatory intervention, without losing the strategic advantages of entrepreneurial behavior. Nor can the public’s total financial return be guaranteed or projected with absolute certainty. In this risk-taking context, affirmative control over the development process—through long-term leasing—becomes as much a means of protecting the public’s speculative investment as a rationale for extracting maximum long-term public benefits.

## Benefits by Contract

The strategic attraction of public development lay in its potential, in strong markets, to leverage the public’s proprietary interests in land (primarily, in downtown) and extract a package of financial benefits and social returns. The ways in which land value could be realized were many and malleable, if worked creatively. Developed for commercial use, prime urban sites generated long-term revenue streams, contractual future obligations against which bonds could be issued to finance capital investment or, alternatively, which could be used on an annual basis to meet operating-budget expenses. In place of cash, land value could be traded for in-kind capital contributions, such as developer-provided infrastructure, open space, or public amenities. Also, as a basis for selecting a developer, the demand for prime sites could be converted into firm commitments to build nonmarket uses such as housing, restore historically sensitive structures, or deliver other social goods. In this regard, the cities’ agenda for large-scale projects on publicly owned land differed from that of specialized port authorities and quasi-autonomous transit agencies which typically managed their real estate assets with an eye on maximum financial return. While the specifics of individual project agreements varied, a combination of fiscal constraints and planning ambitions imprinted upon public-development projects across the country a commonality evident in the character of the benefit packages.

The composition of this public-benefits package became a pivotal point in negotiations with private firms, as did the guarantee of their delivery—by contract. City officials would take risks to achieve their goals, but they needed devices for managing their financial exposure in any individual public-private project and for building political support for their aggressive, entrepreneurial behavior. In other words, a financial deal needed to be politically feasible (and credible) to survive the course past city hall, city council, affected interest groups, and citizens at-large.

The long-term lease agreement gave public officials several tactical levers of control. First, delivery of benefits could be controlled by tying what the city wanted (amenities, housing, jobs) to performance-based releases of what the developer needed (development rights and/or public investment). Second, compliance on an ongoing basis could be managed through its rights of review as landlord. Third, by building in the ability to escalate returns accruing from rising property values (through rent increases and profit-sharing provisions), a lease's financial arrangements could provide political protection against the charge that city officials "gave away too much" (Sagalyn 1990b).

As an enforcement mechanism, the lease held at least two definite advantages over a sale disposition agreement. First, while it might impose upon developers requirements no different from those found in restrictive covenants of sale agreements,<sup>15</sup> these limitations might, in fact, prove to be more readily enforceable with a lease since termination and re-entry by the public agency was a more effective sanction than the forfeiture remedy of a sale contract (*Yale Law Review* 1958, 1431; Weiser, 1993). Second, and most important in terms of implementation, the terms and conditions of the lease could be structured in ways that created mutual business interests between the public entity and private stakeholders over the life of a project. This especially appealed to city officials because, in strong markets, it afforded greater control over the development process and its product—the private provision of public benefits.

## Assuring Delivery

The deal negotiated by the Los Angeles Community Redevelopment Authority (CRA) for California Plaza is illustrative. After seven months of marathon round-the-clock negotiations, the business terms hammered out with the developer, Bunker Hill Associates (BHA),<sup>16</sup> defined an overall structure of interlocking pieces which remained firm, even as its complex details changed over time. The deal covered (1) the scope of development (uses, scale, three-phase organization, and responsibilities of the CRA and the developer); (2) the overall financial framework for compensating the CRA for its land which, in turn, comprised three elements: (a) rent formulae for the leased commercial uses, (b) disposition terms and payments for the sale of the residential parcels, and (c) responsibilities for funding and construction of the public amenities; and (3) the scheduled phasing and timing of development (see Exhibits 3 and 4).<sup>17</sup>

The last piece was crucial because it tied the private sector's commercial development opportunity (three office towers, hotel, retail space) to the city's agenda for cultural uses, housing, and open space. To get what it wanted, the CRA anticipated making some trade-offs, in the form of reduced or foregone land returns, but it took a tough stance on performance obligations (including a complex set of financial penalties), as these were the control devices for delivery of the public-benefits package.

The public-benefits package—estimated at \$50.6 million (in 1981 dollars)—consisted of (1) a 100,000-square-foot Museum of Contemporary Art (MOCA), including an annual operating subsidy to be paid by the developer; (2) an outdoor performance center; (3) a hilltop park and open-space network of gardens, mini-parks, and integrated water elements encompassing 5.5 acres; (4) funds for the operation and maintenance of “Angel’s Flight,” a once-famous city landmark to be reconstructed by the CRA; (5) development of an Angel’s Flight Cultural Museum; and (6) a financial commitment to a Minority and Women Business Enterprises (MWBE) Participation program.<sup>18</sup>

To assure provision of these benefits (the economic burden of which was linked to the revenue-producing components of the multi-phase project), the deal tied construction of successive phases of the project to completion of specific elements in earlier phases. For example, as part of Phase 1 the developer was obligated to construct the MOCA, approximately 20 percent of the open-space program, and the first residential phase. Until that construction conformed with the contractual agreement, the second or third commercial phase could not start.<sup>19</sup> In addition, the developer could not evade these obligations by selling his development rights in future phases because the DDA (and lease) incorporated major anti-speculation provisions limiting the transferability of that interest.

However much the developer anticipated conditional requirements on commercial development, the same could not be said for those imposed by the CRA on the public-benefits package. First, the agency took a firm position that the project’s major public amenity, the MOCA, would be built as part of the initial phase of development along with the first office tower. Second, in a novel and aggressive move, it insisted that the pricing of the deal account for “imputed economic benefits” accruing to the private investment from the inclusion of the public spaces and cultural amenities in the project.<sup>20</sup> Both became contentious issues in the negotiations because they imposed heavy up-front risks upon the developer (Weiser 1989). The first amounted to a disproportional burden laid on the initial phase of commercial development. (Phase 1-A commercial included nearly 30 percent of the office development allowable in the three office towers of the project while it carried about 50 percent the extraordinary development costs. (City of Los Angeles 1983, 5–6). The second ultimately meant a “recoupment” adjustment of \$19.8 million to the pricing of the development opportunity, as shown in Exhibit 5.<sup>21</sup>

Though the developer “balked,” both of the CRA’s negotiating positions held. Compromises to resolve the developer’s risks of moving forward in this way are to be found in complex adjustments to other business terms of the deal between the agency and the developer, but not in the timing of delivery of the MOCA. Close to schedule, development proceeded. “One California Plaza,” the project’s first phase consisting of a 44-story office tower, retail space, and the MOCA, started construction in 1983, after a year’s delay due to difficulties in securing long-term financing, and opened in 1986.<sup>22</sup>

The contractual obligations of these benefit arrangements might be iron-clad, but details change over the life of a large-scale multi-phase development project. Because the public benefits ride piggy-back on the economic feasibility of the profit-producing elements of commercial projects or, in the case of housing, remain subject to uncertain market acceptance, some slippage and readjustment is inevitable. In terms of managing public development within these constraints, however, the interlocking elements in a deal create financial incen-

tives for a developer to move from one phase to another and contractual benchmarks for the public sector to monitor potential slippage. In the case of California Plaza, financial penalties existed if the developer failed to deliver. "Walking" on any of these obligations would not have been without cost. And because they were integrally linked to the DDA for the entire project, the lease agreements for the individual commercial parcels locked the incentive structure into a contractual enforcement vehicle. Moreover, tying MOCA to the project's first phase assured the city that whatever uncertainty might jeopardize the future build-out of the project, its prized cultural amenity would be in place.

## Minimizing Risk

With a strong real estate market in its favor, the CRA negotiated an aggressive business deal for city, deferring part of the financial return by taking it over time, in exchange for heavy front-end investments in the MOCA and related public amenities. Alternatively, and more in keeping with the traditional formula, the city could have sold the land (or bonded the lease revenues) and used the proceeds to build these facilities themselves, directly, as in the case planned for YBG in San Francisco (Benson and Flaster 1991). The decision in Los Angeles this time turned on risk, rather than control, and the agency's desire to avoid the problems and liability of bricks-and-mortar development.

For one, the task of constructing the museum and the project's amenities differed substantially from conventional public-works projects. While developing specifications for the bricks and mortar might be the same, public agencies must follow detailed and rigid bidding and construction processes ill-suited to fitting within the demands of commercial private development. In addition, the CRA had no experience with commercial projects.

Second, potential construction cost overruns loomed large in the minds of the agency and its attorneys, as did likely problems of keeping the project's scope in line, particularly if the CRA, as builder, was negotiating with the major donors and board of directors who endowed the MOCA and would fund its interior furnishings. Safer to shift those responsibilities to the private developer and tightly watchdog the developer's performance from the sidelines. "We felt better," said Herb Weiser, the CRA's attorney, "knowing that the agency's contribution is finite, that the maximum risk is known. Public agencies' big ambition is not to take on blue-sky risk" (Weiser 1993).

The third consideration was technical. Since the development's master plan called for physical integration of the museum and public amenities with the private office towers, parking structures, and residential buildings, the demands of mutually dependent construction procedures overlapping in time and space ruled out parallel operations. The MOCA, for example, would be built on air-rights over the privately owned parking garage. To avoid the complications of working through the technical and legal issues of joint responsibility for physically integrated construction, the agency shifted ownership and the management burden to the developer who held the obvious efficiencies from economies of scale and experience.

Whether to build the public amenities directly or require their provision by developers remains a judgement call, its relative desirability conditional on the priorities, politics, and risk tolerance of individual cities and their development agencies. Experience varies.<sup>23</sup> In

the case of California Plaza, private provision of the public amenities seemingly enhanced delivery at minimal risk to the public sector. The decision simplified construction management without loss of control over the process, because the lease agreement contained contractual enforcement devices. More to the point, the CRA's decision to delegate direct responsibility symbolized its proprietary objectives as a public developer—to be an aggressive landowner with potential “upside,” but a passive development partner with limited liability.

This choice raises a critical, broader question of public policy: Is the development process the most appropriate means to determine priorities regarding capital investment? Speaking from his years of experience with public development in New York City, Carl Weisbrod, currently president of the city's Economic Development Corporation, framed the issue clearly (Weisbrod 1993):

The government could be negotiating a terrific business deal on a particular development project which requires the public or private partner to invest in the immediate area through either a capital investment or amenities package. If the government is making a direct capital investment, at least there is some effort to consider that investment in the context of other choices. The same cannot usually be said for amenities packages. If the city is getting a “privately” funded (or built) library or school or theater or park as part of a major public/private development, it is unlikely that the amenity was considered in the context of other competing city needs. Should lower Manhattan get a new park (as opposed to the South Bronx) simply because the publicly-owned land in lower Manhattan can attract private investment?

The issue is one of public governance and stewardship: Who should decide how government's returns from its proprietary land interests should be spent? Where is the locus of accountability for these types of decisions? Before addressing these questions, we need to understand how public development's particular institutional arrangements—deal making through quasi-independent public agencies—shape the context of such decision making.

## Fiscal Autonomy for Discretionary Decision Making

In aggressive pursuit of benefits from public-development strategies, politics drives public officials to make trade-offs that deviate from a strict financial calculus. The process requires them to shape the public perception of what they are doing in ways that meet both the limits of what the market (aided by government) can deliver and voters' expectations for broadly distributed benefits. As a matter of political economy, the return extracted from publicly owned land—especially when in the form of long-term lease revenues—comes less from its fiscal role as a source of “corporate” or municipal revenue and more from its political value as a means to enhance the powers of local government, particularly, the quasi-independent redevelopment authorities and public development corporations which act in its name. The fiscal authority that comes from proprietary control over public land resources expands the range of discretionary decision making by these agencies. Tapping the value of the land frees them from the need to use taxpayer monies. And real estate development



gives them opportunities to achieve public objectives that otherwise might be beyond the reach of mayors and city councilors who must allocate scarce resources through entrenched annual budget processes.

In using publicly owned property as a form of capital, big cities act to overcome the political difficulties of public intervention, what political scientists Michael Danielson and Jameson Doig identified as constraints on their ability to concentrate resources. In *New York: The Politics of Urban Regional Development*, they argued persuasively that the complexity of political action among the many competing constituent interests and the broad functional scope of services in cities made the achievement of development goals intensely problematic for city governments compared to their suburban counterparts.<sup>24</sup> The development initiatives that were most successful in overcoming this structural hurdle were those carried out elsewhere beyond the domain of general-purpose governments, the region's public authorities being instructive examples. Also crucially important to public authorities in the region were "elements providing insulation," which included (Danielson and Doig 1982, 328):

control over revenues generated by their tolls and rents, and some ability to remain aloof from the wide-ranging constituencies that press demands on city hall and at state capitals, attempting to carry off bit-by-bit those resources that might have been husbanded and used on major development projects.

Though public-development agencies typically lack the fiscal independence which comes from the ability to raise capital based on user-fee revenues, in an analogous way, a few of the more aggressive ones have used publicly owned property to build a road toward such autonomy. Boston's Redevelopment Authority (BRA), the city's most independent agency, is a case in point.

Established by the Commonwealth of Massachusetts in 1957 to administer community development and urban-renewal projects, and, in 1960, given the role of the city's planning agency, the BRA combines the city's zoning, planning, and development functions. Historically, the city had funded the majority of the BRA's operating budget. Although authorized to issue revenue bonds and notes (which would not constitute indebtedness of the city), the agency has financed its capital projects through (1) a combination of federal and state grants, (2) the proceeds of general obligation bonds issued by the city, and, increasingly, in a reversal that reflected changes in local policy as much as in federal funding for cities, (3) revenues from the disposition of its land assets.

Capitalizing on the downtown building boom which began in the early 1980s, the BRA leased its large significant sites under financial terms designed to augment its already formidable planning responsibilities and political powers.<sup>25</sup> Among those completed in the 1980s were the mixed-use developments of Rowes Wharf, Marketplace Center, and Charlestown Navy Yard. On the agency's agenda for the 1990s were Sargent's Wharf, redevelopment of the New England Aquarium site, Custom House, Kingston/Bedford garage site, and the single remaining parcel in the Park Square Urban Renewal Area (Boston Redevelopment Authority, *FY90 Work Program*).

Evidence of the superagency's growing fiscal independence appeared formally, in characteristically quiet fashion, in the agency's \$29.9-million financial plan for fiscal year 1987. After extensive reorganization and adoption of its first modern budget, the BRA's director, Ste-

phen Coyle described the agency's "unprecedented fiscal vitality" in terms of its independence from city hall (Boston Redevelopment Authority 1986):

Revenues have improved as rental rates on Authority property increased 12 percent and disposition revenues increased 133 percent over FY 1985. While federal funding has decreased significantly . . . no increase has been required from the City . . . Funds from the city were reduced by over 50 percent from \$6.4 million in Fiscal Year 1984 to less than \$3.0 million in Fiscal Year 1987. Projections based on this trend indicate that no funds for administration will be required of the City in FY 1988.

Subsequent audited figures showed success in meeting that goal: More than 55 percent of the agency's actual revenue intake of \$23.1 million for fiscal year 1987 had come from disposition proceeds of development sites (22.5 percent) and rentals from leased property (32.6 percent). For fiscal year 1988, a year when private development investment going in the city hit an all-time high (on an inflation-adjusted basis) of \$1.24 billion,<sup>26</sup> the self-funded proportion of the BRA's very enlarged budget of \$37.6 million (combined operating and capital expenditures) reached 64 percent. Figured on an operating-budget basis only (by excluding capital outlays), internally generated revenues from land resources covered 68 percent of expenditures in fiscal year 1987 and 94 percent in fiscal year 1988 (Boston Redevelopment Authority 1987, 1989). Moreover, the majority of lease-revenue dollars had come from just three large-scale projects: Charlestown Navy Yard, Marketplace Center (200 State Street), and Rowes Wharf.<sup>27</sup>

By bringing in property revenues, the BRA more than secured its financial independence from city hall, it reversed the flow of funds—to the consternation of some city councilors who worried about that independence. A total of \$849,000, about four percent of the BRA's fiscal year 1987 budget, would go to several city agencies, including the Mayor's Office of Neighborhood Services and the Office of Jobs and Services. Coyle justified the contributions on the basis of the services performed by city departments for the BRA, for example, gauging neighborhood feelings about BRA projects and monitoring construction contractors' compliance with city-hiring requirements. If financial independence brought a price, however, Coyle wanted to cap future outflows to city agencies at no more than five percent of the BRA budget (Reinert 1987, 4).

Extracting new revenues from the sale and lease of publicly owned downtown sites meshed well with the Flynn Administration's plans to aggressively manage new development projects—following a logic of pragmatism. Its actions represented calculated support of large-scale commercial projects as means of improving the neighborhoods and living standards of the city's working-class constituency. The super-charged development environment in Boston during the mid-1980s presented the administration with a prime opportunity to combine tax-generating economic growth and redistributive policy (Dreier and Ehrlich 1991, 363–367). And the legacy of a fiscal crisis in the early 1980s, which pushed the city close to bankruptcy, forced accommodation with business and financial interests.

In 1984, one month after Coyle took office, the BRA announced a "pipeline review" of all projects currently under consideration for approval. The intent—regulated growth through explicit control over the flow of new projects to reach the market; the goal—reduced supply

and a low office vacancy rate to drive up the value of those fewer projects approved (Boston Redevelopment Authority 1984; Powers 1986).<sup>28</sup> The returns to the city—higher property taxes and a share of the increased value for a variety of programs, including linkage fees to build affordable housing and “voluntary” contributions to the city’s Neighborhood Development Bank.

Rooted in the BRA’s historically tight control over the development-approvals process, the Pipeline Project Review embodied a robin-hood regulatory approach to capturing public returns from private development by managing, in “orderly” fashion, the pace and density of new office construction. Its carry-over to publicly owned land transactions was straight-forward: The BRA reopened preliminary agreements for the sale of several city-owned garages (originally put on the block because of budget exigencies) renegotiating them for bigger benefits. For publicly blessed development sites in a city short on such supply, top-dollar bids for the garages were expected, initially, a total of \$32.5 million. Ultimately, they grossed \$84.7 million.<sup>29</sup>

In a highly publicized policy-driven disposition several years later, the BRA unveiled a “Parcel-to-Parcel Linkage Program.” The first of its kind in the nation, the pilot program tied an opportunity to develop a BRA-owned site in downtown to an obligation to develop a comparable amount of space on a publicly owned site in the economically depressed neighborhood of Roxbury. In an effort to promote “balanced growth, neighborhood reinvestment, and job and business opportunities for its residents,” Mayor Flynn explained the city’s redistributive motive (cited in Boston Redevelopment Authority 1988, 4):

Boston has become a regional economic center attracting enormous amounts of capital. Since mid-1984, Boston has approved \$3 billion in private downtown development projects. But these gains have not reached our low- and moderate-income residents. People are asking: why should the city grow, if its citizens receive no gain?

The BRA’s parcel-to-parcel linkage policy makes explicit cities’ political agenda for using their land resources as a form of political capital. Much as the economic rationale gives public-development agencies legitimacy and flexibility to manage the disposition of publicly owned land and concentrate resources, the drive for development becomes a tool of governance when the benefits a city receives from its proprietary interests are linked to affirmative actions as a condition of private development.

The new sources of income—sale proceeds and, more importantly, stable long-term lease revenues—expand a city’s discretionary spending. Not only do they free up budget funds that might otherwise be spent differently, they may alter the context for such decision making.

Agency self-funding, as in the case of the BRA, does an end-run around the city council, which would otherwise pass on the city’s spending priorities through its approval of the city budget. As a state-authorized public authority, the BRA answers directly to its six-member Board of Directors which has the sole power to approve the BRA budget. The mayor, however, can generally exercise control over the BRA through his appointment of a majority of the Board. Policies that channeled financial returns from sale and leasing dispositions through quasi-independent, off-budget agencies and programs that used economic develop-

ment strategies as agents of social change (as did Boston's parcel-to-parcel linkage program), offered mayors great flexibility in targeting the returns from land to meet the interests of specific constituencies.

## Long-Term Revenues for Short-Term Exigencies

The economic and political benefits of land leasing catapulted to local prominence in 1990 when New York City, once again, tapped the revenues of Battery Park City (BPC). In need of a quick influx of resources, initially due to the loss of \$338 million from the pending sale of the Coliseum site (Sagalyn 1992, 18–22), and then to recessionary declines in tax revenues, New York City began to search and exploit aggressively opportunities to “deploy its bonding capacity in order to bring additional one-time revenues into its operating budget” (Office of the State Comptroller 1987, 8). Many of the biggest lay dormant within its real estate assets, in particular, the claims to revenues generated by Battery Park City's office towers and residential buildings.

Under the terms of the agreements between the city and the Battery Park City Authority (BPCA), a portion of the excess revenues generated by the authority's existing long-term leases is paid to the city each year—in the form of payments-in-lieu-of-taxes (PILOTs)—and is used for operating expenses; the smaller balance is used for other “jointly agreed purposes.”<sup>30</sup> Given the project's well-known financial success, these anticipated revenues presented a prime pot of money, ratably secure and highly marketable to bond investors. Earlier, in 1987, \$210 million of Housing New York City Bonds had been issued on the strength of these revenues, and later, more than \$600 million in additional commitments made for the city's \$4.2 billion Ten-Year Program to build 252,000 units of low- and moderate-income housing (*Housing New York Corporation* 1987).

With few such sources available, BPC's revenue stream became the “cornerstone” of the city's fiscal year 1990 Gap Closing Program. Under special state enabling legislation, the authority sold \$223 million of 30-year Budget Relief Revenue Bonds which provided \$150 million in unrestricted state aid to the city.<sup>31</sup> As a result of this and other nonrecurring revenue transfers, the city actually closed out the fiscal year with a surplus of \$288 million, which it used to help close the larger gap projected for the fiscal year 1991 budget (Office of the State Comptroller 1990b, 2).

The ink was hardly dry on the 1990 agreement<sup>32</sup> before the mixed reviews appeared. On the one hand, the Financial Control Board, the fiscal monitor set up by the state in the aftermath of city's mid-70s crisis, concluded that the transaction was a crucial response to a “critical situation” in which the city was “faced with no secure alternative,” though, under “normal” conditions, it would be “unacceptable” (New York State Financial Control Board 1990, 26). On the other hand, in a sharply critical assessment of this one-time infusion, the Deputy State Comptroller for the City concluded “it is unfortunate that this questionable transaction has gone forward,” since “it has been clear for some time that the City could balance its budget and even generate a surplus without these funds.”

The controversy lay in the policy arena, in the opportunity costs of the one-time exchange: The city was surrendering its claim to about \$530 million in *recurring* future BPC revenues

(Bachrach 1990), which would be used to pay debt service on the bonds—a clever variation on the classic gambit of capitalizing operating expenses. As the Deputy State Comptroller's earlier evaluation of the transaction noted critically (Office of the State Comptroller 1990a, 31):

The City could not do this on its own because State law prohibits the City from selling bonds directly and using the proceeds for operating expenses. The transaction can take place only because the bonds are being sold by BPCA, which is a State authority and is not bound by the same law.

The budgetary solution presented by asset-based “one-shots,” nonrecurring sources of revenue used to balance the operating budget, represents a politically expedient, though flawed, fiscal action. “They simply postpone the day of reckoning; they don't prevent the day of reckoning,” says Raymond D. Horton, president of the Citizen Budget Commission, the non-profit watchdog group financed by business (Kolbert 1991). The problem, as fiscal experts see it, is that one-shots, by definition, work only once: If government uses a nonrecurring revenue to pay for a recurring expense, it is going to face the same shortfall the next year. Further, when new revenues are created from complex debt refinancings or asset transfers among public entities, as many one-shots are, the transaction typically “yields short-term gain but long-term pain.” By selling long-term bonds to free up funds that will be used for operating expenses, the burden of today's services gets loaded onto the backs of future taxpayers who will pay the costs of servicing the new debt (Office of the State Comptroller 1989, 22–23, New York State Financial Control Board 1991, 40–43).<sup>33</sup>

The argument surrounding the use of one-shots is not simply an arcane issue of budgetary policy. Underlying the controversy is a set of questions concerning public norms about the appropriate use of the public's real estate assets. How should the public benefit from its land resources? Should it seek financial returns, and if so, how should any “excess profits” be spent? If public developments become successful real estate projects, should the public sector sell out of what is an essentially private business activity and apply the gain to other public priorities? Or are publicly owned lands a public trust inviolate in ownership, regardless of current land values or fiscal pressures? And where should the locus of power be for making such decisions, the authority which owns the land, the mayor, the city council?

These questions about the allocation of public resources go to the heart of public development where the initial rationale for intervention flows from the nature of the public's long-term policy objectives. The fact that the city could turn to, and the state could deliver, emergency funds from Battery Park City of a magnitude sufficient to close a sizable portion of the city's budget gap underscores the long-term value of holding public real property assets, as a component of government's fiscal structure.<sup>34</sup> Indeed, maintaining whatever control it could over the site's potential revenue stream—through a lease arrangement with the to-be-created authority—was the city's driving motivation in its settlement with the state over negotiations for take-over of the fiscally troubled project in 1979 (New York State Committee on Housing 1979; Hayes 1986). Not only would outright sale to the state have been unthinkable, politically, but most likely, that sale price would have been substantially undervalued for the state to have had a viable project, financially (Hayes 1991).

The sale of the BPC 1991 Budget Bonds sends up a red flag. From a real estate perspective, the use of one-shots is akin to taking out a second mortgage, a means of redeploying built-up equity in an asset. While this may be "correct" from an private asset-investment standard, the timing is often "wrong," from a fiscal-policy perspective.

The long-term benefits from stable contractual revenue streams such as the BPC leases are especially dear during economic recessions when other, tax-sensitive revenues become more volatile. Similarly, selling or otherwise disposing of real estate for one-shot purposes during recessions when land values decline could be poorly timed in terms of the real estate cycle. Ironically, however, the very success of public-development ventures such as BPC makes them targets for takeover and privatization.<sup>35</sup> In this case, the public's prime real estate asset became most vulnerable, politically, when it was most needed, financially. Bleeding those future resources by accelerating their payment to pay today's operating expenses may, as a result, cut into the public's flexibility to bring resources to bear on tomorrow's economic, social, and fiscal problems.

## A Political Fit

Leasing proved to be the preferred strategic option in the 1980s for the disposition of significant publicly owned sites because it packaged financial returns in ways that met city officials' political needs for tighter control over land development; new, long-term revenue streams which would escalate over time with rising property values; and developer-provided public amenities.<sup>36</sup> That discretionary off-budget control flowed from these revenue streams which also could be used to accelerate future revenues by issuing bonds for capital improvements made leasing all the more attractive as a policy choice.

Leasing's financial returns stretch out over time, making them less visible than large one-time lump sums. Yet more to the point, the complexity of their pricing—linked to a public-benefits package—generally obscures a simple, easy comparison to other land transactions. Besides, public-private leases often are one-of-a-kind transactions with few close comparables. This combination of attributes affords public officials protection from the potential charge that they sold "too low." If the full underlying price of the public-private transaction is difficult to discern, it is harder to be "wrong," whether evaluated in light of current alternatives or in hindsight on the basis of subsequent transactions.

The many ways in which the city's multi-faceted objectives could be woven into the lease agreement meant that, ultimately, these agreements also would be highly complex formal documents, even as they relied heavily upon an series of interim (and often informal) understandings between public- and private-sector parties. As a practical matter, the time, expense, and expertise required of the public sector to negotiate and implement long-term leasing transactions precluded their widespread or uniform use.

"Leasing is not always, not even often, the best approach for cities," commented Susan Shick, Executive Director of Community Development for the City of Long Beach, a city with a long history of land leasing (Shick 1992):

It's a very expensive process because of the high legal costs. If you factored in the full "real" costs, leasing is not likely to show a profit. And a city can't really do what a developer can—maximize profits. It must balance interests (which it is good at). Leasing's only use is when you expect a *real* upside, when you can't get the full expected value today at a sale.

The political leadership and support necessary for these entrepreneurial ventures reinforces the need for selectivity. Leasing has been, and is likely to remain, a "prime-sites-only" strategy. By virtue of their location and physical size, sites such as Battery Park City, Yerba Buena Gardens, and California Plaza become "significant" from any number of perspectives—fiscal, planning, economic development. In contrast, for the larger inventory of "surplus" sites—functionally obsolete school buildings and fire stations, small and odd-sized pieces of land in out-of-the-way places, and abandoned utility easements—disposition typically proceeds by sale.<sup>37</sup>

Under certain circumstances sale dispositions might promise bigger dollars for the public treasury than lease transactions.<sup>38</sup> But as an input to the decision-making process, the financial trade-off between a sale or leasing rarely gets quantified, in no small part because so many "ifs" and "buts" about the development opportunity being sold preclude a solid estimate—that is, if such a comparison is sought. Hard, empirical evidence is not necessary to convince public entrepreneurs of leasing's strategic advantage, as an instrument of institutional power: Degrees of freedom in the way land might be used as a capital resource would be lost once one-time revenues flowed into the general treasury.

The adoption of leasing very much reflected the chance influence of maverick personalities who saw opportunity for public gain and professional influence. Astutely aware of leasing's malleable character, certain public entrepreneurs acting with uncommon sophistication and savvy, aimed to capture the benefits of rising land values by creating different "currencies of value"—in addition to, or in place of, cash returns. Bargaining with these new currencies in negotiations with private developers, they sought to link development of publicly owned sites to affirmative obligations for housing, public works, or targeted job hiring. If they were successful, the record would serve them well also.

Such leverage revealed a new form of "public finance," a novel way to get new civic amenities, housing, or subway improvements, but tangible public investment nonetheless. Because the strategy remained dependent upon market-driven private investment, which limits the pace and character of what the public sector can achieve, policy choices often became evident only when trade-offs among competing public objectives forced officials to be explicit.

The off-budget character of these returns remains a troublesome issue. When disposition deals are reviewed by the city council, that process accords with accountability for the decision to take benefits in-kind. It does not, however, meet the fair critique that these deal-specific returns do not get evaluated in the context of competing city priorities, and that they typically throw off few benefits for those poorer urban areas most in need. In theory, the latter imbalance could be redressed through compensating capital-budget allocations, though informed skeptics might see it otherwise. Development is not the best way to determine capital investment priorities, but given the constant fiscal pressures faced by city officials, the temptation to take what they can get, where they can get, when they can get it, is likely to remain irresistible.

The turn to leasing was a product of the times, an economic opportunity in sync with big-city fiscal pressures and political needs. Whether the process of selling, converting, and trading the development values of the public's proprietary interests—a style of making policy “through the numbers”—changes the nature of the public interests at stake, and if so, how, remains to be explored. The answers will not be easy nor simple. The early lesson of the experiment is that with patience, skill, and the right amount of luck with market timing, leasing publicly owned land can yield “returns” when worked by entrepreneurial officials who keep one eye on the bottom-line of profits and the other on the political payback.



## Notes

1. The federal bias against leasing urban-renewal parcels was both ideological and practical. From an administrative perspective, government bureaucrats sought to "close out" projects as soon as practically possible. Leasing inhibited extrication from projects because, with funds trickling in over time (rather than in one lump sum), the books would have to remain open until such time, years hence, the precise residual value and "net project cost" would be known (Hack 1992).

2. Few cities leased their urban-renewal parcels, but the six that did found that they were better able to control redevelopment because lessees were not as reluctant to agree to lease conditions as purchasers were to encumber a fee interest. Further, cities could more easily enforce the limitations since termination of the lease with city re-entry is a more effective sanction than forfeiture under sale covenants (*Yale Law Review* 1958). Also see Brownfield and Rosen (1961).

3. The singular exception to this tenet of political economy has been public ownership and management of urban waterfronts and submerged tidal lands. Under the public trust doctrine, the state, through its legislature, holds these lands "in trust for its citizens in perpetuity and retains control over their development even after they are granted or sold to private parties." When developed, these lands must be used and maintained for a "public purpose," the principle of irreplaceable resources being paramount, with commerce, navigation, and fisheries being the original public purposes. The public trust doctrine applies only in certain states, generally those of the original colonies. Some state constitutions prohibit fee disposition of waterfront lands, New York for example.

As a result, in most coastal urban areas, long-term leasing has been the only means of disposition when such lands have been targeted for private commercial development. Because no major development was likely to take place without long-term institutional financing, potential large-scale violations of this implicit policy mandate were effectively monitored by the self-interests of third-party lenders. The issues involved in securing long-term financing and the broad scope of uses considered "public purpose," have, however, made the public trust doctrine something of a battleground for the urban waterfront developers and citizens. See Carlson (1983), Kiefer (1987).

4. During the 1960s and 1970s, when investment conditions in downtown markets were weak, little economic rationale existed for cities to take aggressive leasing positions in land development. There was, however, an intellectual legacy to leasing. During the debate over the federal urban-renewal legislation in the 1940s, planners advocated leasing as a means of exercising greater public-sector powers over future land use (Weiss 1985). In the 1960s and 1970s, other planners pushed for large-scale municipal land acquisition to guide develop-

ment in rapidly expanding areas at the urban fringe (Reps 1973). In the mid-1970s, in particular, in the wake of New York's fiscal crisis, a leading urbanist suggested that the city take charge of its real property assets: "If, in urban renewal, we had leased land instead of selling it to private developers, most cities, including New York, would be better off." Reflecting the unpopularity of this approach, Robert Wood had prefaced his remarks with the acknowledgement that the idea was probably more "theoretical and egghead" than another round of massive infusions of federal aid for cities similar in scale to what they had received in the 1960s (Robert Wood as cited in Hartog 1983).

5. Once again, a federal program, this time, Urban Development Action Grants (UDAG), had a major impact on the decision to lease or sell city-owned land. According to Meg Sowell, a former UDAG official, if the city owned the land, UDAG took the position that they would not "act to make the city whole." The city would have to lease land or offer a purchase-money mortgage as part of a sale disposition. Conversation with the author, October 31, 1990.

6. A "doodle diagram" Peter Kamnitzer, an architect involved in the project, called the RFP sketch. Rather than finished design proposals, the city was looking for an economic proposal—a real estate deal (Kamnitzer 1989).

7. Under an economic scenario with office rents rising at a lower rate (6 percent versus 8 percent), the CRA's projected lease payments for 1982–2011 would total \$426.7 million, as follows: holding rent, \$1,500,000; base rent, \$89,800,000; escalation rent, \$49,500,000; participation rent, \$285,900,000. City of Los Angeles (1981b, 7–1).

8. See above, note 2.

9. Buying a market presence was especially desirable for out-of-town developers who accounted for a highly visible proportion of RFQ/RFP submissions on major public development projects in cities across the nation. These included many subsequently chosen as developers: Olympia and York (Battery Park City and Yerba Buena Gardens), Cadillac Fairview/Metropolitan Structures (California Plaza), Forest City Enterprises (MetroTech). On the situations in New York, see *Exploring the Metropolis* (1988, 44).

10. By 1990, this national vertically integrated real-estate company had among its 1.9-billion real estate portfolio the following mega-mixed-use projects (recently completed or under development): the \$400-million Tower City Center (Cleveland), \$1-billion MetroTech complex (Brooklyn), \$250-million University Park at MIT (Cambridge), \$1.75-billion Robinson Town Center (Pittsburgh), and \$3-billion Central Station (Chicago). Forest City Enterprises, Inc., *Annual Report 1990*. In February 1991, the firm added another major project to its roster when it became a joint-development partner of the long-stalled \$530-million Atlantic Center mixed-use project in Brooklyn; the deal bolstered the company's "already imposing presence in Brooklyn," where it then had a hand in almost every major downtown project. See Breznick (1991).

11. In the case of Olympia and York's Yerba Buena Gardens, the deal (as renegotiated by 1990) gave the developers a concentrated locational presence in San Francisco's severely constrained office market. The 1.55-million square feet of potential new space represented 4.8 percent of the total Class A space inventory in the city as of 1990. More significantly, due to

the city's limit on development (from passage of Proposition M in 1986), the three office buildings amounted to 26 percent of the pipeline of potential new office space in the core office area until the year 2000. See Recht, Hausrath & Associates (1990, 7) as cited in Benson and Flaster (1991, 93).

12. The Boston study concluded that the bid process might be most efficient in cases when the property has a relatively low value and its uses are limited, but that negotiated development was an especially important strategy when markets are strong and the value of the property can be used to subsidize the development; also, in cases where a change in the use of property would have a great impact on the surrounding community. In both Boston and New York, the evaluations led to new disposition policies which eliminated the highest-bidder standard and substituted a negotiated-sales procedure; criteria for the latter permitted the city to maximize the noncash public benefits from development or link site usage to other city-planning objectives. See Brown and Herbert (1989), Flynn and Goldman (1980).

13. For a discussion of similar problems encountered under the urban renewal program with its singular reliance on price consideration for disposition policy, see Scheuer, Goldston, and Sogg (1962). For city agencies to replace a competitive-bid procedure with a negotiated disposition process, they often need legislative authority, or an institutional substitute with special enabling statutory powers such as New York's Urban Development Corporation. Cities may also acquire the flexibility to operate in this manner through interagency transfers as was the case in Boston between the Metropolitan Bay Transportation Authority and the Boston Redevelopment Authority for the redevelopment of the South Station Transportation Center.

14. When the public sector brings property as close to "development readiness" as possible, in effect, it is following the developer's strategy of "creating value," though few city officials would conceptualize it in those terms. For a private venture, this is the difference between what it costs to construct a project (everything from the "hard" costs for bricks and mortar to the "soft" costs for associated services such as architecture, engineering, legal, and construction finance) and what the market considers its worth to be when completed and occupied.

15. For example, strict adherence to redevelopment plans, design approval, conformance with applicable zoning ordinances; completion of construction before reconveyance of the leasehold interest; posting of insurance bonds guaranteeing completion of improvements; minimal progress on construction during specified time periods; and payment of realty taxes as if the land were held in fee.

16. After a change in the composition of the development entity in 1983, the developer was a partnership of Metropolitan Structures of Chicago (a large national developer in which Metropolitan Life Insurance Company of New York had a 50% interest) and California Plaza Associates (a partnership of Cadillac Fairview and two local developers, Shapell and Goldrich and Kest).

17. See City of Los Angeles, "Redevelopment Parcels RSTU&Y-1 Bunker Hill: Evaluation of Proposed Business Terms Between The Los Angeles Community Redevelopment Agency and Bunker Hill Associates," October 1981; and its follow-up "Redevelopment Parcels RSTU&Y-1 Bunker Hill: Evaluation of Proposed Business Terms Between The Los Angeles

Community Redevelopment Agency and Bunker Hill Associates, As Reflected in Proposed Amendments to The Disposition and Development Agreement," April 1983, both prepared by Keyser Marston Associates, Inc.

18. Termed "extraordinary developer obligations and development characteristics," the \$50.6-million figure cited had been adjusted (by \$3.5 million) for an allocation for plazas and open space that might typically have been required for development of a high-density project of 11 acres in an urban setting. As discussed further on in the text, this \$50.6-million figure would then be adjusted again to take into account the imputed economic benefits that would result from their inclusion in the project. See City of Los Angeles (1981a, 8-1 - 8-6).

19. Because of weakening market conditions, the timing and phasing schedule for the housing was altered under the First Amendment to the DDA. Though specific terms changed, the structural element of the deal in which the CRA tied development rights to its agenda held. Under the new agreement, for example, the developer could construct both the first and second commercial phases without constructing residential and could construct the third commercial phase without the second residential phase. "Under no circumstances," however, would the new agreement allow the developer to construct three commercial phases without building residential. See City of Los Angeles (1983, 4-4).

20. According to the City's economic consultant, they would reflect "positively in an economic sense in all of the following ways: (1) greater rapidity of lease-up of the office space, (2) higher lease rates for the office space, (3) greater rapidity of absorption of the condominium units, (4) higher sales prices of the condominiums, (5) higher hotel occupancy and room rates, and (6) higher lease rates for the retail space." Estimating the impact on the amenities on the developer's returns was, admittedly, "difficult to predict;" as a result, while some recoupment was considered necessary, the figure was, at best, an approximation. See City of Los Angeles (1983, 8-5).

21. After adjustment, the \$30.8-million public-benefit package represented a substantial portion of the estimated total value of the 11.35-acre site (\$89.1 million) if sold (fee ownership) that the city would take in the form of amenities. From the developer's perspective, it amounted to approximately 4 percent of an estimated total development cost of \$770 million (in 1981 dollars) (City of Los Angeles 1981a, 8-1 - 8-6).

22. Portions of Phase Two including a second office tower (Two California Plaza) and related performance plaza, hotel (Intercontinental Los Angeles), and residential condominium development (Museum Tower) were under construction by 1990, notwithstanding the softened market conditions by that time. Still to be developed were one more office tower, two residential components, retail frontage, cinemas, a Dance Gallery and Institute, Angel's Flight and Cultural Museum, and additional public open space (Community Redevelopment Agency of the City of Los Angeles 1990).

23. See Frieden and Sagalyn (1989, 140-144), Benson and Flaster (1991).

24. As they used the term, the ability to concentrate resources refers to the interaction among seven important variables: extent of formal independence, variety and intensity of constituency demands, control over the use of land, financial resources, political skill,

planning capabilities, and the extent of control over subordinate units. See Danielson and Doig (1982, 25–31, 256–285).

25. For example, the RFP for Rowes Wharf (one of the last remaining downtown waterfront sites) specified the following firm financial parameters: a land lease agreement, with no subordination of the BRA's fee interest and annual base rent; minimum base rents, not less than \$600,000 for residential portion, \$700,000 for commercial portion; rent escalations on terms competitive with the private market; for commercial portion, additional percentage rent from refinancing or sales transactions; an "as-is" disposition in which the city would incur no expenses in development of the parcel and give no tax abatements. (Boston Redevelopment Authority 1982, 9). Also, see Hayes (1991).

26. Starting in 1981, the dollar volume of development, on an inflation-adjusted basis, soared at an average annual rate of 33 percent; office development accounted the 36.4 percent of this investment. Source: City of Boston (1990, 20).

27. The BRA found additional ways to tap the fiscal power of property by using mortgages as collateral for short-term loans from developers to cover the costs of acquisition for certain parcels in the Charlestown Navy Yard. See "Charlestown Navy Yard, Boston, Massachusetts," case study in Wrenn (1983).

28. Contrasting Boston with nine other major office markets, the BRA in its report, *Downtown Projects: Opportunities for Boston*, recommended a slowdown in the rate at which new space was created and implied that the design review process would be used to regulate the growth of office space, thereby maintaining price stability. For a discussion of this policy in the context of a particular project (500 Boylston Street), see "The New England Life" (1989). On the political significance of this issue, I thank David Luberoff for his comments on an earlier draft.

29. Whereas the first \$17.5 million would go to capital projects (or to repay bonds), additional revenue above that amount could be used for current expenditures. A minimum of \$5 million, however, would be put aside into Boston's Housing Development Trust, a fund for neighborhood projects. At the end Fiscal Year 1991, of the \$65.3 million received to date (of the \$84.7 million due), 34 percent had been applied to the capital projects fund and 66 percent to the City's general fund. City of Boston Budget Office, data prepared by the Boston Municipal Research Bureau for the author, April 1992.

30. These excess revenues would be over and above those needed by BPCA to pay its own obligations for debt service and operating expenses. For a detailed discussion of these agreements see, Oppenheim (1990).

31. The remaining monies were applied toward reserve funds, capitalized interest payments, and issuance costs.

32. The series of agreements pursuant to the 1990 Bond transaction between the Battery Park City Authority and the City of New York: "Amendment and Agreement and Consent Pursuant to Settlement Agreement," May 18, 1990; "Second Amendment to Option to Purchase;" "Amendment to First Dedication Instrument;" Amendment of Letter Agreement;" "Amendment to Agreement as to Certain Excess Revenues of the Battery Park City Authority."

33. The policy issues surrounding the use of one-shots are not real estate specific; they are generic, as the practice occurs at the state and federal levels as well, particularly in times of fiscal stress. Confronting its own massive budget deficit in 1990, New York State balanced its budget with almost \$2 billion in nonrecurring revenues, one of which was a controversial asset transfer, the sale of Attica State Prison for \$200 million, to the State's Urban Development Corporation from the State. For FY91-92, among the asset transfers the Governor proposed selling was the Aqueduct Race Track in Queens to the Port Authority of New York and New Jersey (Kolbert 1991a, 1991b; New York Times 1991; King 1991; Verhovek 1991).

34. In fact, the BPCA Budget Bond issue came under fire from housing activists, who believed that the funds should be dedicated solely to the provision of low- and moderate-income housing. Their position reflects a commitment to the original plan for BPC as a residential community of affordable housing. The 1986 decision to use surplus revenues for housing (in other parts of the City) was a compensatory act to make up for the 1979 change in development focus which aimed to capture the site's enormous economic potential for commercial uses and luxury housing. See Oppenheim (1990).

35. During 1991 as the city faced future budget deficits, the BPCA explored the economic benefits of selling the remaining development rights on unbuilt parcels.

36. When leasing threatened to increase the risk of marketability of the project as in the case on the residential condominiums on the California Plaza site, the CRA switched to a sale disposition, reluctantly and only on the advice of its economic consultant. A sale promised more revenue because compensating financial terms required under a lease arrangement for condominiums reduced the value to be realized by the agency, thereby imposing "a very large penalty in return for retaining long-term control of the land" (Economic Research Associates 1981). The same situation arose in Boston's Rowes Wharf project where too, because of marketability concerns, the authority reluctantly switched to a sale disposition for the residential component of the mixed-use project.

37. Surplus properties may be subject to detailed procedures limiting their use and disposition. For example, other public agencies may have to be given first options on their future use; other entities like not-for-profit community groups are at times also given preference over the public-at-large. See Brett (1982), DePalma (1987).

38. See above, note 37.

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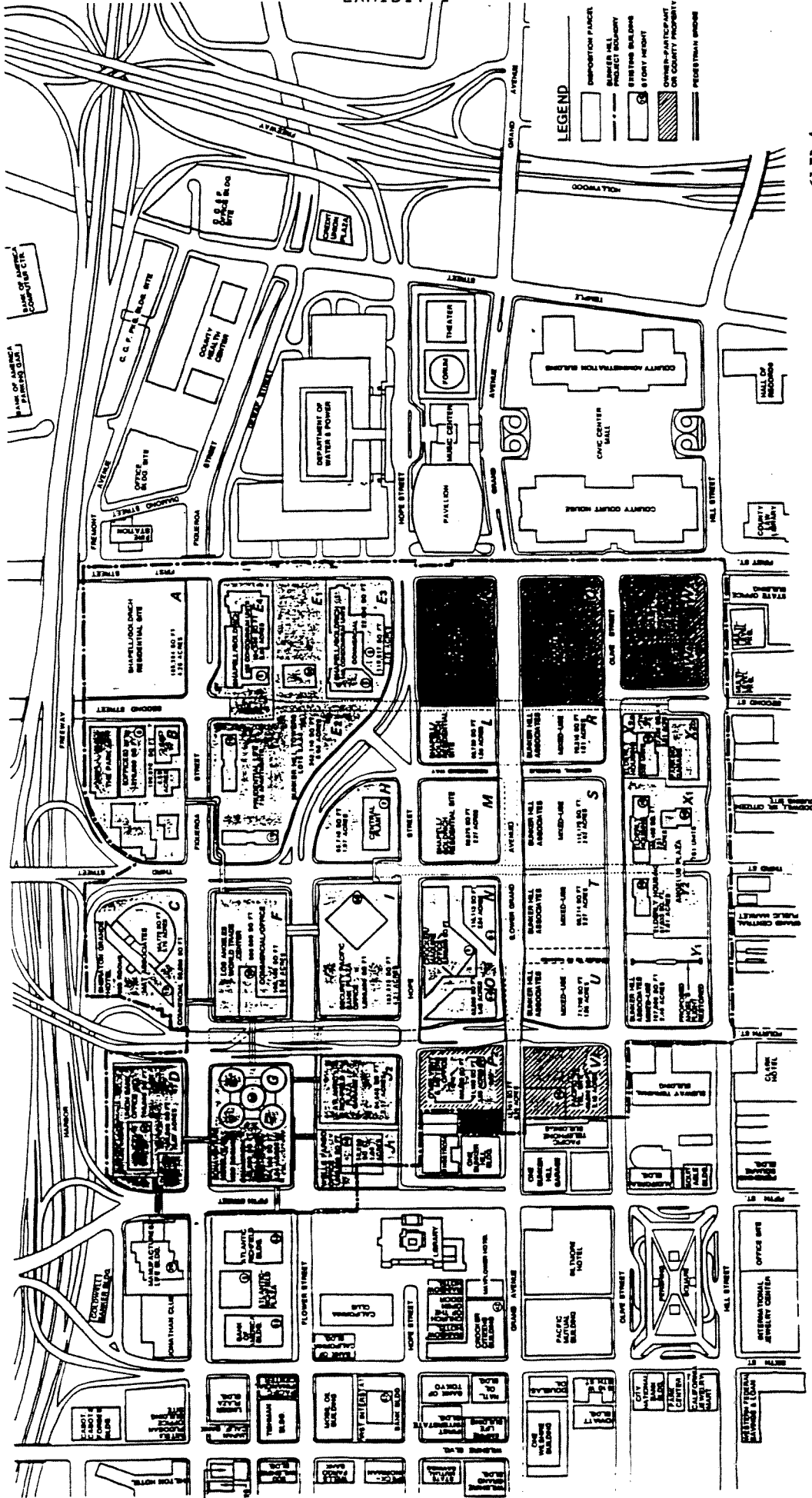
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**CRA**  
**LA**  
 Community Reinvestment Agency  
 of the City of Los Angeles  
 APRIL 1981  
 FEBRUARY 1982  
 MARCH 1982  
 Revised:  
 MAY 1983

□	LAND DEVELOPED OR UNDER CONSTRUCTION	97.3 ACRES
□	LAND UNDER CONTRACT	18.7 ACRES
■	LAND OWNED BY PARTICIPANTS	10.9 ACRES
TOTAL		86.9 ACRES

**DISPOSITION MAP**

**BUNKER HILL REDEVELOPMENT PROJECT**

EXHIBIT 2

CALIFORNIA PLAZA: PROJECTION OF LAND LEASE PAYMENTS 1982-2001  
(000s)

Type of Payment	1982-1991	1992-2001	2002-2011	Total
Holding Rent	\$1,500	0	0	\$1,000
Base Rent	9,800	40,000	40,000	89,800
Escalation Rent	0	6,900	61,300	68,200
Participation Rent	0	53,500	414,200	467,700
Total	\$11,300	\$100,400	\$515,500	\$627,200

Definitions:

*Holding Rent* = Payment by the developer to the CRA for a 42-month period, commencing on a specified date, for each of the three phases of the project, at \$500,000 per phase. At termination of the Holding Rent Period, the developer commences payment of Base Rent.

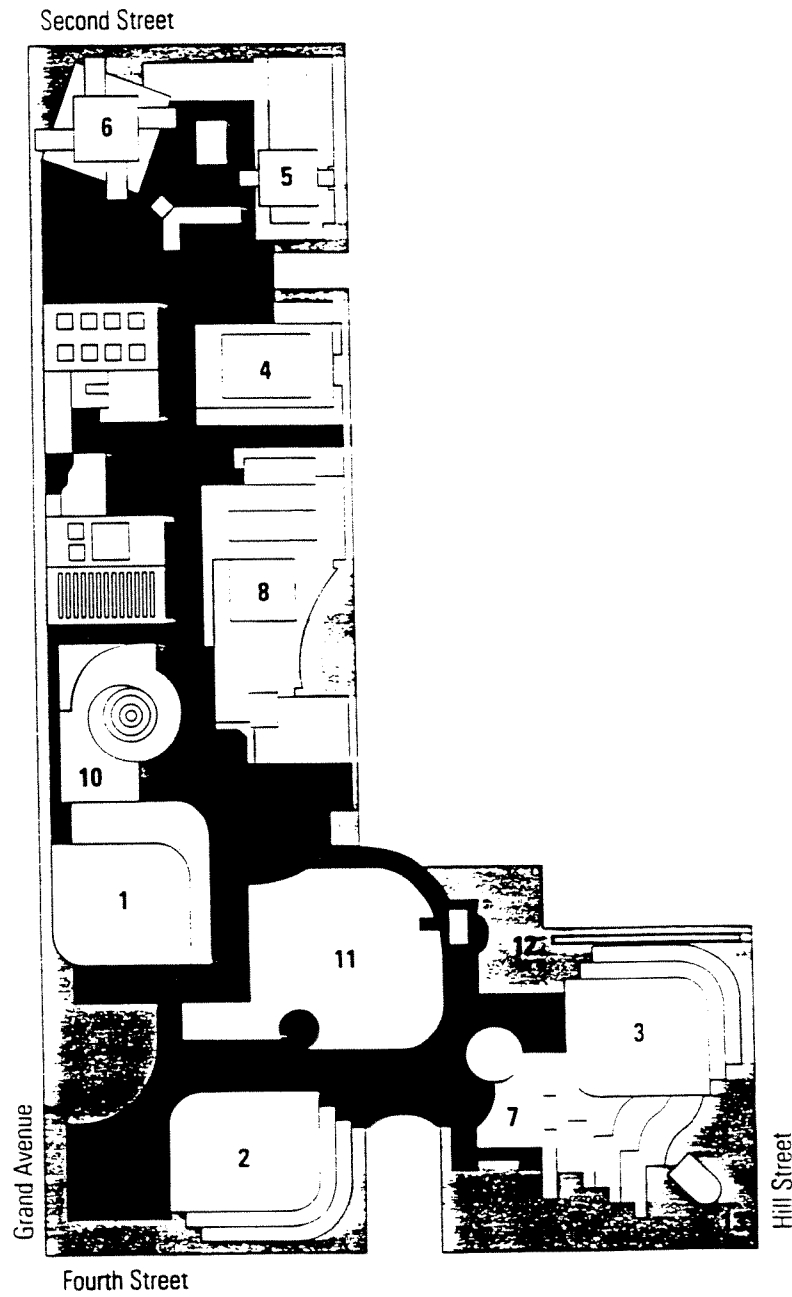
*Base Rent* = Payment by the developer to the CRA, at the expiration of the Holding Rent Period for each phase, of a fixed annual amount: Phase I, \$600,000 per annum; Phase II, \$1,500,000 per annum; Phase III, \$1,500,000 per annum; Hotel Parcel, \$400,000 per annum to begin 66 months after commencement of construction of the hotel.

*Escalation Rent* = Payment by developer to the CRA of a land rent that is adjusted to reflect the operating results of the project, as measured by the change in "Escalation Net Cash Flow" (ERNCF). ERNCF is defined as the net income after debt service: cash received from operations less all amounts paid for operating expenses (including subsidy to MOCA), debt service, and existing Base and Escalation Rent. The first escalation will occur the earlier of the 8th full fiscal year after commencement of construction of Phase I. Subsequent escalations will occur every tenth year after the first escalation. The total of Base Rent plus Escalation Rent in any one fiscal year shall not exceed 5 percent of Net Operating Income (before debt service).

*Participation Rent* = Rent to the CRA in addition to the Holding, Base, and Escalation Rents. Until the First Adjustment Year, 10 percent of the Participation Rent Net Cash Flow (PRNCF), after which 15 percent of PRNCF. The elements for calculating PRNCF are identical as for ERNCF with three exceptions: (1) deductions for capital and other expenses such as leasing; (2) deductions for any equity-interest type bonus required by a private lender as specified in detail in the DDA; and (3) a 20 percent preferred return on equity for the developer.

Source: City of Los Angeles, "Redevelopment Parcels RSTU&Y-1 Bunker Hill: Evaluation of Proposed Business Terms Between the Los Angeles Community Redevelopment Agency and Bunker Hill Associates," Prepared by Keyser Marston Associates, Inc., October 1981, Section 3.

EXHIBIT 3  
California Plaza Master Plan



- |                         |                        |                                     |                           |
|-------------------------|------------------------|-------------------------------------|---------------------------|
| 1 Office Tower Phase 1A | 4 Residential Phase 1B | 7 Dance Gallery Phase 1C            | 10 Spiral Court           |
| 2 Office Tower Phase 2A | 5 Residential Phase 2B | 8 Hotel Phase 2C                    | 11 Watercourt             |
| 3 Office Tower Phase 3A | 6 Residential Phase 3B | 9 Museum of Contemporary Art (MOCA) | 12 Angel's Flight         |
|                         |                        |                                     | 13 Metro Red Line Station |

EXHIBIT 4

CALIFORNIA PLAZA: PHASING SUMMARY

Use	Phase I <sup>1</sup>	Phase II <sup>2</sup>	Phase III <sup>3</sup>	Total
Office	880,000 SF	1,400,000 SF	950,000 SF	3,230,000 SF
Residential	250 DU	250 DU	250 DU	750 DU
Retail, Other Commercial <sup>4</sup>	137,000 SF	68,000 SF	41,500 SF	246,500 SF
Hotel	--	450 Rooms	--	450 Rooms
Multiplex Cinema	40,000 SF	--	--	40,000 SF
MOCA (Museum of Contemporary Art)	X	--	--	X
Entertainment Center	--	X	--	X
Urban Park/ Public Open Space	X	X	X	X
Angel's Flight	X	--	--	X
Angel's Flight Cultural Museum	--	--	X	X
Bella Lewitzky Dance Co.	--	X	--	X
Parking	1,500 spaces	2,050 spaces	1,100 spaces	4,650 spaces <sup>5</sup>

Notes:

1. Scheduled to begin construction in 1982.
2. Scheduled to begin construction in 1985.
3. Scheduled to begin construction in 1987.
4. Amounts to include a total of 100,000 square feet made available by relocation MOCA from the original development plan.
5. Plus possible off-site parking in structure.

Source: City of Los Angeles, "Redevelopment Parcels RSTU&Y-1 Bunker Hill: Reuse Appraisal," Prepared by Keyser Marston Associates, Inc., October 1981, Table 3-2.

EXHIBIT 5

CALIFORNIA PLAZA:  
SUMMARY OF "EXTRAORDINARY" DEVELOPER COST/OBLIGATIONS  
(000s, 1981)

Obligation	Phase I	Phase II	Phase III	Total
<b>Museum of Contemporary Art (MOCA)</b>				
Unadjusted Cost Burden	\$22,500	--	--	\$22,500
Adjusted Cost Burden	11,300	--	--	11,300
<b>Other Open Space/Cultural Uses<sup>1</sup></b>				
Unadjusted Cost Burden	5,600	7,700	4,000	17,300
Adjusted Cost Burden	2,800	3,900	2,000	8,700
<b>Minority and Women Business Enterprise (MWBE)<sup>2</sup></b>				
Unadjusted Cost Burden	2,000	2,700	2,100	6,800
Adjusted Cost Burden	2,000	2,700	2,100	6,800
<b>Timing and Transferability Requirements</b>				
Unadjusted Cost Burden	2,000	1,000	1,000	4,000
Adjusted Cost Burden	2,000	1,000	1,000	4,000
<b>Total: Unadjusted Cost Burden</b>	<b>\$32,100</b>	<b>\$11,400</b>	<b>\$7,100</b>	<b>\$50,600</b>
<b>Adjusted Cost Burden</b>	<b>\$18,100</b>	<b>\$ 7,600</b>	<b>\$5,100</b>	<b>\$30,800</b>

Notes:

1. Includes (a) an open space network, approximately 5.5 acres, of gardens, terraces, sculpture courts, plazas, mini-parks and water elements; (b) a central performance plaza featuring an outdoor stage and all-weather canopy; (c) Angel's Flight Park; (d) Angel's Flight Cultural Museum, approximately 5,000 square feet; (e) provision within the project for the Bella Lewitsky Dance Company, contingent upon the Company's ability to provide its own funding for construction of the facility; and (f) temporary preconstruction work on the Angel's Flight.

2. The developer is required to establish a MWBE Participation Plan. In addition to using "best efforts," funds are to be deposited in a "Special Trust Account," which can be drawn upon by the CRA, at its sole option, to fulfill the plan's goals if they are not achieved by the developer; if at the conclusion of the total development these goals have not been met, the monies in the account may be retained by the CRA. In the event the developer exceeds these goals, a credit will be given in the form of adjusted land lease payments.

Source: City of Los Angeles 1981a, "Redevelopment Parcels RSTU&Y-1 Bunker Hill: Reuse Appraisal," Prepared by Keyser Marston Associates, Inc., October 1981, Table 8-2.