



# Negotiating for Public Benefits: The Bargaining Calculus of Public-Private Development

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**Summary.** US cities capture public benefits from private developers under several bargaining frameworks: exactions, incentive zoning and public-private developments. These frameworks exist along a continuum of policy-intervention strategies, from passive regulation to active development, from a *quid pro quo* to incentive to investment policy posture. Each strategy defines a public position, structure and process for negotiation and parameters for the bargaining process. Though the means differ, the common element is that each strategy calls upon private development to support the costs of the public-benefit package. During the 1980s, American cities succeeded in tapping this wellspring of private development in an unparalleled way through active public development. To secure these benefits, the policy strategy demanded that cities take on significantly greater risk to achieve their planning objectives. With a strong real estate market in their favour, both San Francisco and Los Angeles negotiated aggressive business deals to fund their public-amenities agendas. A key difference in the approaches can be explained by their respective attitudes towards risk-taking and control, attitudes which reflected differences in political culture. Whether to build the public amenities directly (San Francisco) or require their provision by developers (Los Angeles) remains a matter of judgement, its relative desirability conditional on the priorities, politics and risk tolerance of individual cities and their development agencies. Experience varies and expertise matters.

During the 1980s, American cities succeeded in tapping a wellspring of private development to benefit the public realm in an unparalleled way. Along with the office towers, hotels, shopping centres and multi-purpose complexes that reshaped many a skyline came public sculpture, open space, gardens, streetscape amenities, transit improvements and, in places where there was a big vision (and the patience of persistence), major facilities for the cultural and performing arts. Cities extracted some of these public benefits as the price of development permission, while other benefits were the yield of zoning-

bonus incentives, either as-of-right or by special permit. When, however, the public sector initiated development of its owned lands, the process of securing benefits differed dramatically, in both scope and character, from regulatory-based approaches because the policy strategy demanded that cities take on significantly greater risk to achieve their planning ambitions. This was public development, in a new format.

Public development represented an aggressive policy stance. Frustrated by the passive nature of regulatory intervention, US city governments aimed to push the market

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to deliver what they wanted—long-term revenue streams, public works and housing—through a calculus of public–private deal-making. Acting upon their interests as landowners, they used land as a currency to secure those public benefits. By design, they staked their own financial and political resources actively to shape and control land development, then benefit directly from the venture. Because the benefits derived, in part, from the city's capacity to shape land values through regulatory powers, the coupling of actions gave special leverage to the policy initiative. For this reason alone, the deal-making was bound to be controversial, even if it yielded significant public returns.

This paper examines this bargaining calculus for what it can tell us about the political economy of public–private development. Negotiating for public benefits was central to the success of this policy strategy. Adopting the role of business partner in the development process meant that the public sector took a direct financial stake and an active role in implementation of a real estate project. This increased the political stakes of public involvement and intensified the negotiations with private developers. The ways in which the public sector aimed to manage these financial and political risks, and its skills for doing so, became as commanding an influence upon its ability to secure public benefits as were conditions in real estate markets.

The policy strategy raises many questions. If, for example, land value is the source of public benefits, how does private-market feasibility shape (or not) the character of public demands? Do cities make explicit the trade-offs they were willing to consider to achieve their benefit goals? When public benefits are to be provided directly by the private developer, what guarantees or safeguards are negotiated into the business deals to assure delivery? And, perhaps most importantly, how does the cyclic character of real estate development affect the success of the benefit strategy?

These questions are addressed through an analysis of two large-scale public–private

projects from which the public sought to achieve major cultural facilities and public amenities: California Plaza in Los Angeles and Yerba Buena Gardens in San Francisco. In each case, the city carried out its negotiations underpinned by a strong real estate market, thus providing a favourable context to study the limits as well as the capacity of what market-driven commercial development can contribute in the way of public benefits. In each case, to secure these benefits the city relied upon off-budget strategies which, though similar in intent, differed in terms of how the benefits would be realised, thus presenting an opportunity to compare how the negotiation agenda is shaped by local politics.

The first part of the paper lays out the logic of public–private development as a policy strategy and discusses how it differs from regulation as a mode for bargaining for benefits. The second section briefly describes the two California cases and explains how land functions as an off-budget mechanism for financing important project-specific public goods—open space, cultural amenities and infrastructure. The heart of the paper is in the next section, which lays out the dynamics of the negotiating process in public–private development projects. Based on this, it is argued that when profits of public development are used in these ways, an accountability problem arises, not merely because of a perceived *ad hoc* process for decision-making, but because the policy issues become confused when decision-making for revenue-raising is merged with that for spending priorities.

### **An Alternative Bargaining Framework**

As a means of policy intervention, public development differs in form and intent from regulation. First, through deal-making, custom-tailored agreements with private developers target planning and fiscal goals that cannot be achieved through uniform zoning ordinances or programmatic incentives. Secondly, policy objectives sought by the public sector are linked to business terms and condi-

tions rather than to regulatory rationales or legal principles. Thirdly, under the terms of most public-private development agreements, what the public is selling (and the developer buying) is not simply land *per se*, but rather a development opportunity—rights to build hedged with complex obligations to perform and responsibilities to produce, including a package of public benefits. Fourthly, unlike the initial carrots embedded in incentive-zoning ordinances, deals are based on mutual business interests designed to keep each side performing throughout the agreement period. These four differences define the opportunistic and aggressive character of public-private development.

The desire to control directly the development of prime, strategic sites and thus shape or direct the broader canvas of city growth was central to the strategy as played out in the 1980s in the US. To do so, cities needed: to act ahead of market demand, which they did by absorbing the front-end risks of market-shaping development; an institutional mechanism, deal-making, which provided for expanded governmental influence over the development process; and a means of fiscal independence from the annual budget appropriations process to empower long-term decision-making over development, which in practical terms meant a politically viable plan for self-sufficient project financing and revenue generation from privately owned commercial uses on the site.

In an era when most big cities operated with dwindling sources of federal aid and constant fiscal pressures to maintain existing levels of municipal services, public spending for large-scale development projects also demanded a form of government intervention that could capture enough of the appreciation in land values to finance the needed up-front public investment. Regulatory policies requiring subway improvements, public amenities or commitments for housing construction could generate public benefits—when developers initiated projects and, most successfully, in strong real estate markets. Yet the sums needed to redirect the pattern of development in the ways envisioned by cities

generally exceeded the financial capability of any single commercial project, even a large one. Further, when redistributive policies were incorporated into regulations, as in the case of compelling a cost-sharing of socially desirable uses, the outcome was unpredictable or uncertain because the policies themselves became subject to the limits of regulation (see Dalton, 1989).

During the 1980s building boom, land values in heated property markets provided almost an ideal lever for securing public benefits. Based on their proprietary interests as landowners, governments moved with the market pendulum—from giving financial assistance when real estate markets conditions were weak to capturing the benefits of rising land values when conditions were strong. The economic opportunity presented by commercial development on publicly owned land proved irresistible, coming as it did at a time when many big-city budgets were severely pressed by cutbacks in federal aid and a national recession (Sagalyn, 1992).

Because land values are shaped by the programme and density permitted on a site, US cities by virtue of their police power can create valuable development opportunities, especially under favourable market conditions, to support the public benefits they seek from private development.<sup>1</sup> It is the public sector's ownership position, however, which gives the public authority or redevelopment agency the bargaining power to shape the project throughout the development process—and to control the delivery of public benefits as a business partner in the process. In this context, public benefits become one of the 'returns' cities earn on their investments in public-private development projects. Moreover, when used in this way as a capital resource, land becomes a highly attractive means of financing public benefits because it can be manipulated outside conventional budget processes (Sagalyn, 1993).

Unlike negotiations rooted in regulatory approvals (exactions and incentive zoning) which define specific trade-offs, the scope of negotiations for public-private development is broad and relatively unconstrained, at least

at the start of the process. The broader field of discretion does not eliminate the task of defining a policy and programmatic focus. Quite the opposite: it adds complexity to the process. While the exchange calculus is simple—to get something of value (revenues and public benefits), the public must give something of value (development opportunity)—determining that value (which is typically undefined at the start of a public-private project) and coming to an agreement on that value and the currency of exchange<sup>2</sup> involves complex economic considerations about which both sides often hold differing opinions. The central negotiating task for the public sector is to translate its policy goals into fair and feasible business terms and conditions under which it will secure the public-benefit package.

### Using Land as Currency: Two Case Comparisons

#### *The Public Amenities Agenda in Los Angeles*

In the late 1970s, as part of the planning process for the last stage of the city's long-running Bunker Hill urban-renewal project, the LA Community Redevelopment Agency (CRA, the Agency), owner of the property, decided that cultural facilities and open space had to be a significant part of any proposed development scheme. A new downtown of office towers built since the mid 1960s had given the city a skyline, but as regional focal point for business growth, the downtown lacked an active 'heart'—a sought-after centre that could lure people out of their cubicles and cars with cultural activities after hours during the weekdays and at weekends. Downtown also lacked new housing, another element which the CRA believed would stimulate pedestrian and retail activity.

Urban-design considerations added extra merit to the emphasis on cultural activities. Though adjacent to other office development on Bunker Hill, the site, an 11.35-acre area eventually named California Plaza, remained isolated from the city's new central business core, which lay to the south. To city planners

and private developers alike, a cultural presence seemed to promise compensation for the area's relative isolation from the city's commercial core, and as the planning evolved, the site became targeted as home to a museum for contemporary art and a dance company, elements of a cultural landscape Los Angeles lacked and sorely needed (Snedcof, 1985). In addition, the demands of the site's history called for a reconstruction of Angel's Flight, a single-track funicular and tourist attraction that had carried locals and visitors up the eastern slope of Bunker of Hill from downtown since the 1890s.

The character of the desired public-benefits package is what set the Los Angeles project apart from others at the time. With the requirements for construction of and subsidy for arts facilities and programmes, it went beyond traditional public benefits (increased taxes, infrastructure, jobs, minority-business-enterprise participation, affirmation action). As described in the *Development Offering* (RFP) designed by the CRA to solicit proposals from prospective private developers, the city called for:

- (1) a commercial project of 3.5–4.4 million square feet with a substantial (30 per cent) allocation to housing uses;
- (2) major public amenities including a new, free-standing structure for the Los Angeles Museum of Modern Art (subsequently renamed Museum of Contemporary Art or MOCA) which was to form the focus of the multi-phase development; 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 (City of Los Angeles Community Redevelopment Agency, 1979, pp. 18–26).

At a minimum, the city required the developer to commit 1.5 per cent 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. After two moribund

decades, the market in downtown LA was hot, and the Agency—now in a position to dictate terms—was intent upon capturing what the market would allow. As the only big parcel of land left in downtown being offered at a time when development approvals were increasingly difficult to secure, a premium of some sort might be had since the site could be delivered to a developer with a mixed-use programme already approved.

California Plaza's size and anticipated cost, pegged at \$1.2 billion for office towers, residences and cultural facilities, gave it prestige as one of the largest redevelopment projects in the nation at the time. Agency officials planned to negotiate the financial terms of the lease with the developer later in the process, but from the start they made it clear that those terms would reflect prevailing market practices and include provisions for inflation-protected rents, escalations pegged to rising property values, and profit-sharing participations. Further, the Agency would take a no-risk position by not subordinating its land interest to the mortgage financing, and the developer would have to 'pay something' during the holding period of predevelopment and construction (Herbert Weiser, personal communication, 1989). These ground rules sent a clear message that CRA would use its position as a property owner to generate long-term fiscal returns and finance major public amenities, which would be provided and maintained by private development capital.

#### *The Public Amenities Agenda in San Francisco*

San Francisco's strategy for Yerba Buena Gardens (YBG), a \$2-billion mixed-use complex on three blocks in the downtown, illustrates an alternative path public officials followed to meet their planning objectives for what would turn out to be the largest downtown park since Union Square was presented to the city in 1850. In Los Angeles, the city leveraged the power of rising land values and a scarcity of developable sites to

secure from private developers a new museum, pedestrian spaces and an open-space performance centre for downtown. In contrast, under similar market conditions, San Francisco used the currency of publicly owned land to generate revenues (lease revenues and land-disposition dollars) which its redevelopment agency, acting as its own developer, used to build and maintain new cultural facilities and public gardens.

From its designation in the early 1960s as an urban-renewal project of large-scale clearance, redevelopment of the three central blocks of the Yerba Buena district was slated for some type of major recreation activity, even though the character of this activity had changed dramatically over time (Adams, 1995). Initial plans for a sports arena to complement a convention centre planned for the site were scrapped after nearly two decades of political controversy, law suits and ever-escalating construction costs. In its place, the city planned a large commercially oriented park and public open space. The new development programme, put forth in the city's Request for Qualifications (RFQ) in 1980, called for a "mix of commercial, entertainment, recreational, residential and cultural uses that will be a major attraction in San Francisco for residents and visitors alike". The objective was "to achieve an 'urban garden,' to create something uniquely San Francisco ... places for people to dine, relax and enjoy the City in a casual atmosphere in a garden setting" (San Francisco Redevelopment Agency, 1980, p. 18).

What the city wanted, according to its economic advisor, was a 1980s version of the world's best recreation and entertainment centres: Central Park and Lincoln Center in New York, Faneuil Hall Marketplace in Boston and Tivoli Gardens in Copenhagen (A. Jerry Keyser, personal communication 1989). Because the city wanted to be its owner developer for these facilities, it needed a financial plan capable of yielding enough revenues to cover the costs of constructing the public gardens, then estimated at \$104.5 million. Because the city also wanted to use the project to further its planning objective of

shifting new office growth to the area south of Market Street, a territory that historically had been avoided, incentives would be necessary to attract a private development team willing to take the risks inherent in meeting the city's large-scale development objectives, environmental-mitigation requirements, on-site infrastructure needs and public-amenity package. This was a tall order.

The city's financial strategy resulted from hardened experience, not abstract policy theorising. While the intense controversy surrounding the Yerba Buena project throughout the 1960s and 1970s symbolised widespread citizen opposition to the heavy-handed, command-and-control redevelopment strategies of that era (Hartman, 1974), it also reflected taxpayers' growing dissatisfaction with rising local property burdens. No minor discontent, the opposition successfully prevented the city from marketing bonds to finance its initial convention centre sports arena plan. Apprehensive that public investment in the convention centre sports arena complex would lead to tax increases (to cover operating deficits), citizen groups effectively blocked construction of the convention centre through numerous law suits, until the city devised a new plan for sole-source financing from a dedicated hotel tax approved by voters in a 1976 city referendum.

Consequently, when in late 1980 city officials sat down to negotiate with the private development team selected to develop the 23-acre commercial portion of YBG,<sup>3</sup> the political imperative for a self-financed project drove the terms of the business deal. Revenues from the sale of two office sites and a smaller residential site, plus other project-based income would cover 70 per cent of total projected costs for building the cultural facilities, gardens and public amenities, estimated at \$109 million by the end of negotiations in 1984. But the density on the three-block site was not enough to support developer payments for all of the capital expenses. The 30 per cent gap might be closed by selling additional land parcels outside the project area owned by the San Francisco Redevelopment Agency (SFRA), but as

a staff-prepared report on financial feasibility cautioned, the uncertainty of the timing of such sales made it an unreliable source of funding. To fund the residual share of these capital costs for the gardens, the SFRA would draw upon tax-increment revenues and bonding capability from the larger 87-acre redevelopment district. Once built, the private commercial uses—convention hotel; retail, recreation and entertainment complex; and parking—would have to carry the full costs of operation and maintenance, including security, for the cultural facilities and open spaces.<sup>4</sup>

For the strategy to work, the SFRA had to establish a scale of private development that would correspond to the anticipated economics of the desired public amenities. This it could do as owner of the land, and because the urban-renewal project lay outside the conventional land-use approval process.<sup>5</sup> The planning goals, translated into business terms, dictated phasing of the programme (1.6 million square feet of private development, plus parking and 340–540 residential units), in lock-step with the Agency's need for funds to construct, maintain and support the public facilities. These funds would be generated from deliberately timed land sales and long-term leases to the private profit-making businesses. The plan was termed the 'buckets structure', for the way in which the revenue streams generated from private development were to be channelled into a flow of funds for construction and maintenance of the public amenities (Benson and Flaster, 1991).

This was a risky and ambitious plan, even under strong market conditions. The SFRA's strategy sought to maximise the value of the real estate for itself and its private partners, then extract cash to both construct and maintain a world-class, public-amenity package. As in Los Angeles, the strategy was designed to build upon the momentum of a strong real estate market by leveraging the development value of the private commercial uses. The SFRA's second objective, however, was to control the development of the public improvements, and in this sense, their plan of

implementation contrasted sharply with that of Los Angeles's CRA. Given the legacy of controversy over YBG, it was terribly important that the SFRA, not a private developer, be viewed as managing the construction, operation and maintenance of the public amenities.

### **The Dynamics of the Negotiating Process**

Because of the ambitiousness of the plan for commercial development, the scope of the public-amenities package and the risks to both private and public players, negotiations with the private developers of both the Los Angeles and San Francisco projects promised to be hard and long. As initiator and co-developer of these projects, the public sector would be involved throughout the life of the development, way beyond land disposition, which is the conventional point of public leave-taking for an urban-renewal project. As a consequence, ironing out the interrelationship between the public and private roles and responsibilities during development and operation would take a front-and-centre position in these public-private negotiations. And, because the stakes are so high—politically and financially—for the public sector, negotiating safeguards to manage risks and assure performance, most critically, the delivery of the public-benefits package, becomes paramount for city officials.

For private developers, the stakes are no less, though they are different. They typically involve a loss of freedom in decision-making and control over the timetable for development. Public-private projects also involve increased public review and comment, specific contracting requirements and attention to political concerns, including greater disclosure than common to a private project. Moreover, the public sector is holding out incentives for the developer to take on substantial investment risks to meet the terms and conditions of the public agenda for a significant site (Frieden and Sagalyn, 1989).

For each side, then, the benefits created by the public-private venture involve an assumption of risk not normally associated

with either public or private development alone. Both sides recognise the opportunity to exploit differences in their objectives and values to create a public-private package more valuable than either party could achieve alone. The private partner's primary interest is to reduce predevelopment and financial risk, but still create a Class-A project generating the higher financial returns normally associated with higher risk. The public partner's dominant objective is to reduce political risk and secure its world-class, public-amenities package. To achieve these very different goals, the private developer necessarily takes on the political risks of its public partner, and the public agency subjects the public to the business risks of private development. Much of the negotiation dynamic, ultimately, is devoted to mediating the new and unfamiliar risks facing each side and assuring an adequate 'return' for those risks taken. The development-disposition agreement (DDA), which is the negotiated business contract binding both sides, acts as an anchor line, holding the partners in place, yet allowing enough movement to prevent the line from snapping (Flaster, 1992).

Three elements, then, come to shape the negotiating dynamic in projects such as California Plaza and Yerba Buena Gardens:

- (1) the strength or weakness of real estate market conditions as they determine the value of the land currency;
- (2) the complexity and investment risk of what the public sector wants and its financial strategy for securing the desired public-benefits package; and
- (3) the ways in which the public aims to manage the risk of the benefits capture and its skills for doing so.

### *Dimensioning the Benefits*

Since the leveraging of private development values is central to the success of both public and private agendas, determining value and dimensioning the benefits also becomes central to the negotiation process. The economics of the programme and densities to go on

a site underlie the business terms of a deal, as they are the drivers of development value. Consequently, the key negotiating issues for both California Plaza and Yerba Buena Gardens became:

- (1) the definition of what would be built—the programme;
- (2) the determination of what the site could economically justify—the valuation of the development opportunity;
- (3) the decision on disposition—whether to lease or sell the land; and
- (4) the schedule for implementation—how the parts of the project would hang together, specifically, the timing of the build-out of commercial development and assurances that the public-amenity spaces would get built.

The deal negotiated by the 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>6</sup> defined a structure of interlocking elements which remained firm, even as the deal's complex details changed over time. The deal covered: the scope of development (uses, scale, three-phase organisation and responsibilities between the CRA and the developer); scheduled phasing and timing of development; and the overall financial framework for compensating the CRA for its land. The latter, in turn comprised three elements: rent formulae for the leased commercial uses; disposition terms and payments for the sale of the residential parcels; and responsibilities for funding and construction of public amenities (City of Los Angeles, 1981a, 1983; see Figure 1).

The scheduled phasing and timing of development was critical 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 com-

plex set of financial penalties), as these were the control devices for delivery of the public-benefits package.

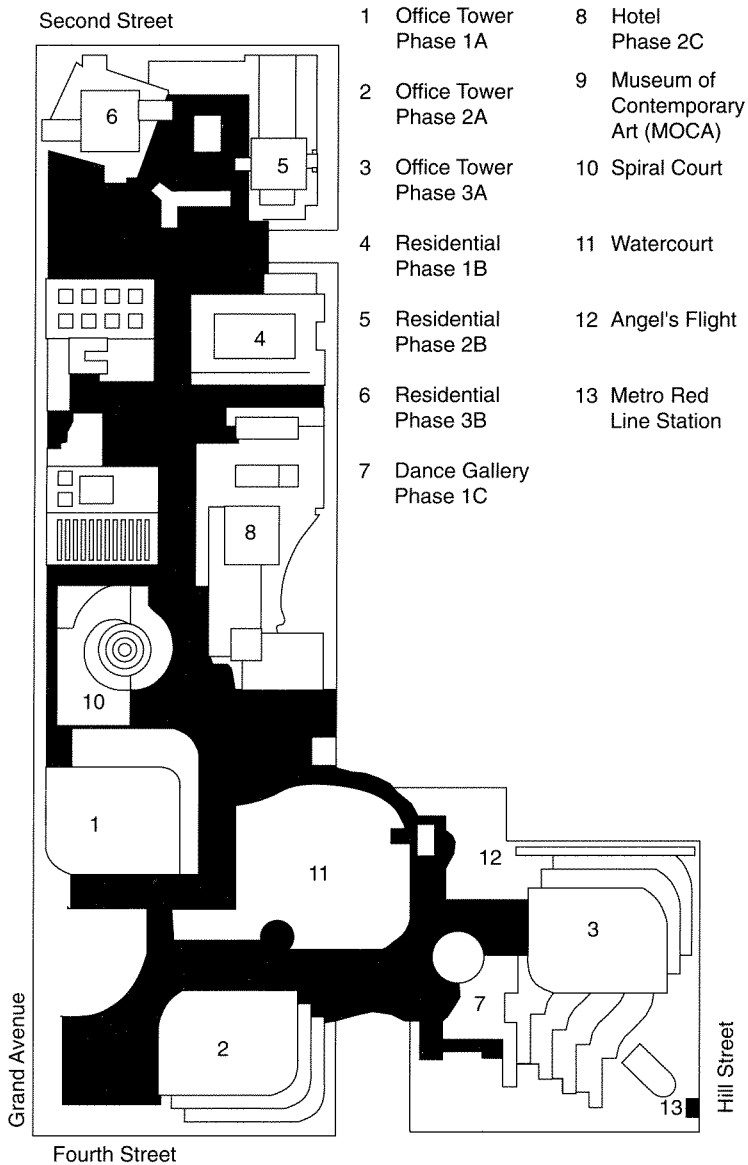
The developer-provided public-benefits package—estimated at \$50.6 million in 1981 dollars—consisted of:

- (1) a separate structure to house a 100 000-square-foot Museum of Contemporary Art (MOCA), including an annual operating subsidy;
- (2) an outdoor performance centre;
- (3) a hilltop park with an 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;
- (5) a location for the future development of the Bella Lewitzky Dance Gallery;
- (6) development of an Angel's Flight Cultural Museum; and
- (7) a financial commitment to a Minority and Women Business Enterprises Participation programme.

Termed 'extraordinary developer obligations and development characteristics', the \$50.6-million figure 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. This \$50.6-million figure would be adjusted again to take into account the imputed economic benefits that would result from their inclusion in the project (City of Los Angeles, 1981b, pp. 8.1–8.6).

The Agency's approach to negotiating this deal involved two types of trade-offs: public improvements in place of cash returns and a deferral of near-term sale proceeds—an estimated \$58 million over the decade—for less certain, but significantly larger, future returns from rising land values and strengthening project performance—\$627 million under projections for the first 30 years of the lease term (City of Los Angeles, 1981a, 1981b).<sup>7</sup> More specifically, some developer costs would be treated as in-lieu payments for land. Since most of the public-benefit costs occurred at the front-end of the multi-phase





**Figure 1.** California Plaza Master Plan. *Source:* City of Los Angeles Community Redevelopment Agency.

development, the agency would forego an up-front payment of land, in order to enhance the feasibility of the project to the private developer and lenders. Acknowledging its role as co-developer, the Agency would lease the land for the commercial portions of the site in a manner that would generate a relatively modest flow of dollars from base pay-

ments, but significant future returns to the agency from a profit-sharing formula.

Reporting on the transaction shortly before it was to go before the city council for review and final action, the *Los Angeles Times'* 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.

### *Assuring Delivery*

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 MOCA, 20 per cent of the open-space programme and the first residential phase. Until that construction conformed with the contractual agreement, the second or third commercial phase could not start.<sup>8</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 restrictions 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, MOCA, had to be built as part of the initial phase of development along with the first office tower. Secondly, 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 space and cultural amenities in the project.<sup>9</sup> Both became contentious issues in the negotiations because they imposed heavy up-front risks upon the developer (Herbert Weiser, personal communication, 1989). The first amounted to a disproportional burden laid on the initial phase of commercial development.<sup>10</sup> The second ultimately meant a 'recoupment' adjustment of \$19.8 million to

the pricing of the development opportunity.<sup>11</sup>

Though the developer 'balked', 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-storey 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. Phase 2, including a 52-storey second office tower (Two California Plaza) and its related outdoor performance plaza that can seat up to 2000 (The Watercourt), the hotel (17-storey Hotel Intercontinental) and a 20-storey residential tower (Museum Tower) went into construction in the 1990, notwithstanding the softened market conditions by that time, and opened in the first half of 1992.<sup>12</sup>

The contractual nature of these benefit arrangements might appear to be iron-clad, but details change over the life of a large-scale, phased, development project. Because the public benefits rode piggy-back upon the economic feasibility of the profit-producing elements of the commercial project or, in the case of housing, remained subject to uncertain market acceptance, some slippage and readjustment was inevitable. In terms of managing public development within these constraints, however, the interlocking elements of the deal created financial incentives for the 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 negotiated 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 jeopardise the future build-out of the project, its prized cultural amenity would be in place.

### *Managing Risks*

San Francisco's role in YBG, as embodied in the DDA and subsequent negotiations and amendments to the DDA, reflected a strategic decision made in the late 1970s to take on the risks of public development. Bolstered by a strong real estate market and hedged by a plan for self-sufficient financing, the city crafted a sophisticated and complex programme for its long-controversial downtown site which was economically sound and politically defensible. Yet real estate remains a cyclic business, and even the best-laid plans replete with risk-mitigating measures can go awry because real estate markets turn soft. The city would eventually be counting on \$97 million for the public improvements as well as funds for operation and maintenance (of the order of \$3–4 million annually) for the gardens, cultural facilities and other amenities coming from the project's market-driven commercial developments. Because of this financial dependency, the highly prized public-amenities package could not go forward without development of the office sites.

However much SFRA might exercise strong control, it could not shield the project from the risks of real estate development. In its negotiations with the developer, whatever other business terms might constitute a basis for bargaining, the agency took a strong non-negotiable position on the public agenda: the cultural and recreation uses as well as the public-amenity spaces were priorities that had to be built, and they needed assurances that this would happen. To achieve its goals, the business risk to which it was exposed by definition of the agency's plan would have to be managed, aggressively, by the agency.<sup>13</sup> It did this through the 'buckets structure', which was intended both to head-off political controversies and to ensure that the gardens and cultural facilities could get built and be well-maintained.

The buckets consisted of a series of priorities for funding the public amenities; funds in one bucket had to be filled before money could go to the next bucket. The public-amenity operations-and-maintenance funding was dependent not only upon the success of the private commercial components, but also on the cultural facilities becoming financially self-sufficient. Parcelling the 23-acre site in individual development parcels helped to facilitate the strategy. By breaking up the large site into several development parcels, clusters of parcels and related obligations could be linked together, all the while protecting the economic value of parcels in subsequent phases. This parcelling resulted in a series of three development phases with associated options to build-out specific amounts of commercial development. (Benson and Flaster, 1991, pp. 36–59).

The buckets structure became an imperative from the developer's point of view as well, for two fundamental reasons. First, it isolated YBG from the very real possibility of changing social policy about what to do with project revenues. The gardens and cultural facilities were viewed by the developer as essential elements necessary to make the project work and to make it a destination centre.<sup>14</sup> Since very few US municipalities can covenant to spend funds in the future, by setting up a segregated account through a redevelopment agency, the negotiators were able to come as close as possible to providing that assurance. Secondly, with the initial capital investment in the cultural elements of the project assured, both sides felt confident that the cultural community in San Francisco would successfully encourage the completion of it, even if dollars ran short for whatever reasons (MIT CRED, 1985).

Over the course of time, four fundamentals came to shape the agency's management of the risks of public development. First, a strong and carefully drafted DDA, defining the series of events and responsibilities of each party necessary for the public-private partnership to realise the successful completion of the YBG development. Secondly, the pricing of public land and timing of sales

to ensure available funds for the construction and maintenance of the public amenities, thus determining the quality of the public package that could be constructed. Thirdly, the creation of 'trusteed' operating and maintenance funds for the public gardens and cultural facilities, thereby assuring the private developer that the funds paid in would in fact be dedicated for these improvements and not moved into the city's general coffers where they might be used for other purposes. At the same time, these accounts assured the agency that its obligation for the capital contributions and operations and maintenance would be capped. Fourthly, the agency's strong political interest to see that the developer fulfilled its obligations threaded throughout the entire process.

'Arduous' is what one participant called the negotiations. By the time the developer and agency signed the DDA in 1984, three years had passed from their start. Once approved by the city council and signed by the mayor, a potential construction start for the hotel was in place for 1986, with the office building scheduled to begin construction in 1988. Delays began soon after, first from a voter-approved expansion of the convention centre which altered the development schedule, then from construction extensions granted in light of a softening real estate market. The question became, could the buckets framework hold the deal together and sustain the inevitable political, physical and economic changes?

In the autumn of 1993, the \$82-million 'Gardens' of Yerba Buena opened with a great civic celebration. Hailed as "San Francisco's newest neighborhood", "a dream come true", "the city's newest grand roof garden", "a downtown park for all seasons", after more than 40 years in the making, there was much rejoicing by citizens, city officials and the national and international press about the public achievement in place. In addition to the Center for the Arts (galleries, forum and theatre), the complex included a 5.5-acre Esplanade (outdoor performance stage surrounded by a grass meadow seating 3000, additional gardens, two cafés) and a 22-foot

high, 50-foot wide waterfall that leads to a Martin Luther King, Jr. Memorial, all sitting on top of the roof of the expanded Moscone Convention Center. Under construction and due to open in early 1995 was the San Francisco Museum of Modern Art (SFMOMA), financed independently of the project (see Figure 2). With world-class architects and designers for all of these facilities, the redevelopment agency and aligned cultural institutions had achieved their goal: a renowned arts-and-entertainment centre for the city.

All did not go according to plan, however. Depressed conditions in real estate markets and an economic recession undermined any type of timely commercial development after completion of the Marriott Hotel in late 1989. Consequently, the office component never went forward on schedule, and that torpedoed the likelihood of financing the public amenities 100 per cent from land-disposition revenues. The redevelopment agency cancelled Olympia & York's contract (and the developer forfeited its development rights), an action that left the agency holding \$27 million of up-front advances and option payments for the sites.

With heavy political pressure and civic expectations that the SFRA deliver on the public-amenity package, the agency reversed the public-private construction priorities of the original strategy and went ahead with the construction of the gardens and arts complex. It did so by drawing on O&Y's forfeited \$27 million, \$10 million from a renegotiated deal with the Marriott Hotel and a \$30-million tax-exempt bond issue. A \$48-million Children's Center, to be financed by additional borrowings, would also be developed in the late 1990s by the SFRA. Though the benefits package for YBG had been integrally linked to private commercial development, given the contentious history of this significant site, the SFRA could not take the political risk of failing to act to achieve its agenda and, fortunately, the original buckets strategy and a tightly drafted DDA provided sufficient funds to proceed, albeit by taking on more risk.

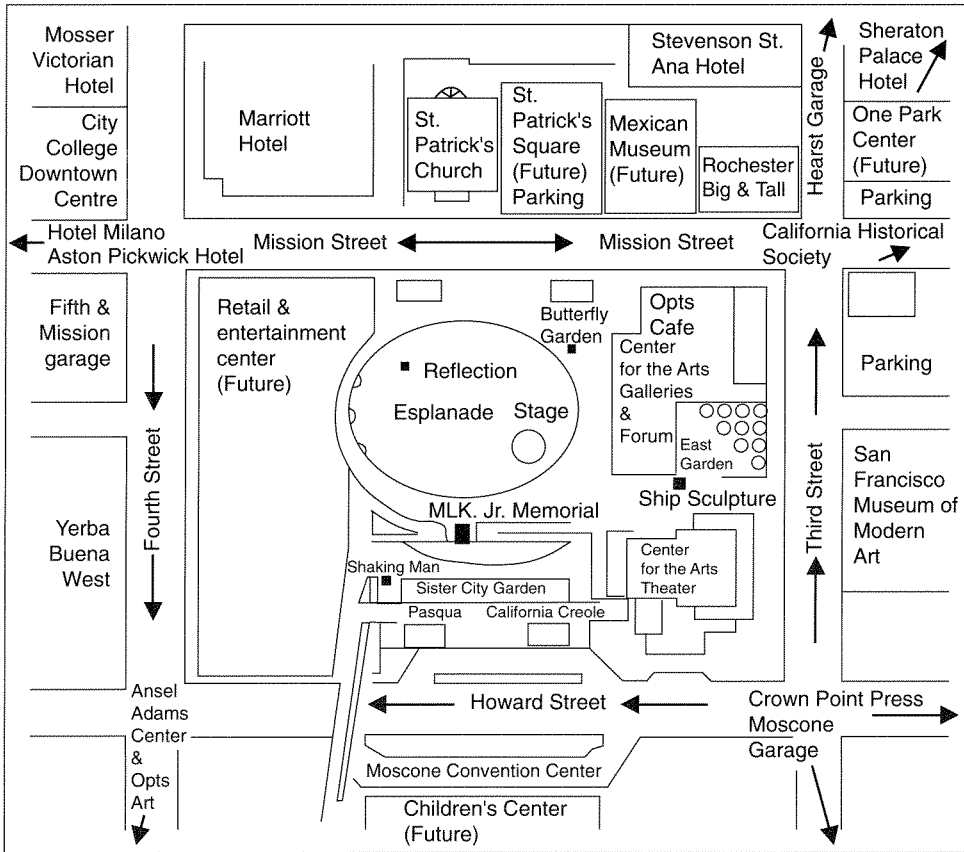


Figure 2. Yerba Buena Gardens and environs. Source: San Francisco Redevelopment Agency.

**Conclusions**

US cities capture public benefits from private developers under several bargaining frameworks: exactions, incentive zoning and public-private development. These frameworks exist along a continuum of policy-intervention strategies, from passive regulation to active development, from a *quid pro quo* to incentive to investment policy posture. Each strategy defines a public position, structure and process for negotiation and parameters for the bargaining process. Though the means differ, the common element is that each strategy calls upon private development to support the costs of the public-benefit package.

With a strong real estate market in their favour, both San Francisco and Los Angeles

negotiated aggressive business deals to fund their public-amenities agenda. A key difference in the approaches can only be explained by their respective attitudes toward risk-taking and control, attitudes which reflected differences in political culture. In Los Angeles, the CRA deferred part of its financial return by taking it over time, in exchange for heavy front-end investments in 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 did the SFRA. The decision in Los Angeles turned on risk, rather than control, and the agency's desire to avoid the problems and liabilities of bricks-and-mortar development.

The decision in San Francisco turned on control, and the agency's need to meet the political demands of the site's controversial history.

Whether to build the public amenities directly or to require their provision by developers remains a matter of judgment, the choice being conditional on the priorities, politics and risk-tolerance of individual cities and their development agencies. Experience varies. And expertise matters. In each case, negotiating public-private development agreements is a complex and complicated business which calls for skills and expertise in real estate finance and development. Few planning agencies or public authorities have the in-house skills to do the economic and feasibility analyses, so calling in consultants becomes the norm.

The 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, framed the issue in this way (Carl Weisbrod, personal communication, 24 April 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 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 local of accountability for these types of decision?

Using land as a currency in bargaining for public benefits revealed a new form of 'public finance'. It was a novel way to get new civic amenities, housing or subway improvements, but tangible public improvements nonetheless. As reflected in Weisbrod's comments, the off-budget character of these returns remains a troublesome policy 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 sceptics might see it otherwise. Private development is not the best way to determine public 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 it, when they can get it, is likely to remain irresistible.

## Notes

1. The special demands of large sites or significant publicly owned sites inevitably demand special-permit zoning or that a special planning system be created, one with flexibilities not afforded as-of-right zoning of small sites. In the case of sites owned by state authorities or quasi-independent redevelopment authorities, the land might not even be subject to local zoning unless a special understanding has been struck with local governments.
2. Even when trade-offs are defined explicitly, the exchange calculus is not as self-evident as policy analysts might expect. Based on his study of incentive zoning in New York City, Kayden (1978) concluded that the calibration of benefit to the city compared to the cost to the developer is difficult, if not impossible,

- under uniform regulations. Moreover, experience with individually negotiated agreements with private developers subsequently proved, through audit reports of selected projects in New York City, to be inefficient as well (Office of the State Comptroller, 1988).
3. In November 1980, the SFRA selected the team of Olympia & York/Marriott Corporation/Beverly Willis Associates for exclusive negotiation rights to the YBG Central Blocks and negotiations began the following month. They would be the 'master developer' along with the agency for the entire 23-acre site.
  4. The agency's financial models all indicated that lease revenues from the commercial uses would be 'insufficient' in the first few years of operations to cover all of the projected costs, thereby requiring other resources to meet the shortfall. The 6 years of projected operating deficits totalling \$4.5 million, or 4 per cent of the total capital budget, was, however, a relatively small sum which the agency believed could be easily covered by future land sales outside the three central blocks or expanded tax-increment authority (San Francisco Redevelopment Agency, 1984, pp. 1-2 of Attachment).
  5. Improvements planned for construction in the YBG area were not subject to the city's standard design review process; they could exceed the city's zoning height restrictions, and they were not generally subject to the Proposition-M growth restraint which limits annual office space construction to 475 000 square feet per year. While there is a citizen-review process for the make-up of the public-amenity package and programme, the SFRA retains control over the final decisions. Thus, the SFRA's business negotiations and policy would have a profound impact on both the physical and programmatic integrity of the downtown area.
  6. After a change in the composition of the development entity in 1983, the master 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 per cent interest) and California Plaza Associates (a partnership of Cadillac Fairview and two local developers, Shapell and Goldrich and Kest).
  7. The potential 'upside', of course, would have to be balanced against the possibility of slower than expected rises in property rents, 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.
  8. Because of weakening market conditions, the timing and phasing schedule for the housing was altered under the First Amendment to the DDA. Under the new agreement, the developer could construct both the first and second commercial phases without constructing the first residential phase 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 the residential component (City of Los Angeles, 1983, pp. 4.4).
  9. 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 of 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 (City of Los Angeles, 1983, p. 8.5).
  10. Phase 1-A commercial included nearly 30 per cent of the office development allowable in the three office towers of the project while it carried about 50 per cent of the extraordinary development costs.
  11. After adjustment, the \$30.8-million public-benefit package represented a substantial portion of the estimated total fee 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 per cent of an estimated total development cost of \$770 million (in 1981 dollars) (City of Los Angeles, 1981a, pp. 8.1, 8.6).
  12. Still to be developed are one more office tower, two residential components, retail frontage, cinemas, additional public open space and a Dance Gallery and Institute. Angel's Flight and Cultural Museum opened in the mid 1990s.
  13. Before the business terms could be negotiated, the issues of programme and design had to be settled because they were the drivers of the deal. Given the historic controversy over this site, the programme issues were debated and decided by a broad-based design committee, which included a consultant from New York City (see Snedcof, 1985, case study 7). This was a highly contentious process, played out in the public arena. It took nearly two years to resolve but led to the ARE—arts, recreation and entertainment—concept that became a dominant theme of the project.

14. That is why the developer initially proposed building and operating and maintaining the entire project (as with California Plaza in Los Angeles), with the costs of doing so reflected in the financial offer. But because of the inordinate public concern of being viewed as 'giving the land away' for a number of reasons—not all of which were without merit, remarked one negotiator—the agency rejected the initial offer.

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