Chapter 34
PUBLIC/PRIVATE REAL ESTATE VENTURES

Scope of the Chapter

Cities across America, unsatisfied with the trajectory of present development trends within their boundaries, have become pro-active in re-shaping their destinies. Local governments, utilizing authority under state law to undertake redevelopment or economic development, enter contracts with private developers to build politically desired projects at preferred locations. The first section of this chapter describes the varied planning and economic goals of these public-private ventures.

Urban renewal got its start with federal funding but depends mainly on local government finance these days.[1] Many cities finance their expeditions into real estate development by issuing redevelopment agency bonds to be repaid out of increased property tax receipts from the project itself, as new construction is added to the tax rolls. This method of public finance is called tax increment financing (TIF), described in the second section of this chapter.

A third section highlights the process by which a redevelopment agency selects its private redevelopment partner, and some of the main deal points in agency-developer agreements.[2]

A final section is about the use of eminent domain by redevelopment or economic development agencies to acquire land for their project sites, forcing out reluctant owners and tenants. First, we look at eminent domain compensation rules for owners and tenants and then at the way courts interpret the constitutional phrase 'public use' when private property is condemned for ultimate re-sale to private developers selected by the public agency to build and own the redeveloped property.

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[1] Federal funding of local urban renewal programs began with the Housing Act of 1949 and ended, formally, with the Housing and Community Development Act of 1974 although the Community Block Grant program provides communities a potential, though much reduced, source of continued federal funding for renewal. *See generally* William H. Brown, Jr., *Urban Redevelopment*, 29 B. U. L. REV. 318 (1949); Jon C. Teaford, *Urban Renewal and Its Aftermath*, 11 HOUSING POLICY DEBATE 443 (Fannie Mae Foundation, 2000).

[2] Interview with Larry Kosmont.

I. CITIES AS LAND DEVELOPERS

Through redevelopment, cities become *de facto* land developers. Like private land developers, city redevelopment agencies engage in these endeavors for the money–to enhance the local government tax base. But municipal actors have varied goals that often extend well beyond the 'bottom line.' Lawyers, whether representing cities or developers, need to be aware of these differing goals, and how best to achieve them, in order to negotiate sensible deals. Courts need to appreciate the sometimes subtle distinctions among types of redevelopment goals in deciding whether a particular redevelopment project constitutes a 'public use' for which private property could lawfully be condemned.

Here, we examine three types of efforts, categorized by the nuances of municipal objectives. Portland, Oregon, embarked upon redevelopment to improve downtown quality of life. Rogers, Minnesota, embraced redevelopment to attract major employers to a small suburban town. In this section, we show how Portland and Rogers achieved their goals and compare their efforts with those of redevelopment projects that are single-mindedly tax-driven.

A. REDEVELOPMENT TO ACHIEVE PLANNING GOALS AND IMPROVE THE QUALITY, UTILITY AND LIVABILITY OF URBAN SPACE

Portland, Oregon: A Redevelopment Success Story. Many cities use redevelopment funded by tax increment financing to achieve broad planning objectives. Perhaps the best example of this comes from Portland, Oregon, sometimes called the greenest city in America. Oregon's state wide planning goals aim to concentrate urban development within declared urban growth boundaries and to preserve farms, forests and other open spaces lying outside those boundaries.

The Pearl District. The crown jewel of Portland redevelopment is the River District Urban Renewal Area, 300 acres (aka The Pearl District). Before 1994 much of this former rail, manufacturing and warehouse hub had been abandoned and was in decay despite its prime location just north of downtown, near a freeway and the Willamette River.

As early as the 1970s, artists began moving into cheap industrial loft space. By the 1990s, a developer had bought the abandoned rail yards and struck a deal with the Portland Development Commission to remove an on ramp to the Broadway Bridge that blocked optimal redevelopment by bisecting the rail site. In exchange, the developer promised to convert the 34-acre rail site into a high quality mixed use neighborhood.

Today, the former rail yard has been transformed into a thriving, carefully designed, pleasant urban neighborhood reminiscent of Tribeca or Soho in New York City–at a much reduced scale, of course. In the Pearl District today, you will see mid-rise housing mixed with retail and restaurants sometimes in the same project, offices and employment centers, all located in close proximity on small blocks with intersecting street grids. This thriving district has drawn thousands of enthusiastic new residents and visitors, exactly as the Portland

Redevelopment Commission had hoped.[3] It has also quadrupled the property tax base, adding a billion dollars in assessed property values to the tax rolls in less than a decade.

At the outset of project planning, the two private housing redevelopers in the Pearl District would have preferred more office and retail space and less housing than public officials desired, and housing at moderate residential densities in the 20 to 30 unit per acre range, townhouse developments reminiscent of Washington, D.C.'s Georgetown. The Portland Redevelopment Commission wanted densities four or five times greater than that and negotiated contracts conferring sizable public subsidies upon developers willing to build at densities of 132 units per acre.[4] Al Burns, a Portland senior planner, calls this use of TIF "buying the urban form you want."[5]

Oregon state redevelopment law encourages high densities by identifying 'lack of proper utilization' as a defining characteristic of blight. So, for instance, a site could be deemed blighted that contained a perfectly serviceable one story building in an area where market demand and the city's zoning would support a six story structure.

To draw development to the Pearl District, the redevelopment agency paid for public works to achieve its broad civic betterment objectives: a 4.5 acre park, a Classical Chinese Garden, a modern public street car connecting the area to downtown, new roads and parking facilities, and 2,000-3,000 subsidized affordable housing units.

The South Waterfront District. Later, the Portland Development Commission transformed Portland's South Waterfront District. This area bordering the Willamette River had been "an underutilized largely vacant, under-performing industrial part of town hampered by a lack of infrastructure and a need for environmental clean up."[6] It was physically close to downtown, but disconnected and overlooked.

The 'anchor' for this project is the Oregon Health Sciences University (OHSU). The OHSU main campus has fully developed the steep hill on which it is perched far above the waterfront. With great imagination, the city ambitiously financed and built an Aerial Tram that links the OHSU main campus to the waterfront, making it feasible for the University to remain in Portland by expanding its facilities–a wellness center, new clinical space and a new bio-tech research center–in the South Waterfront rather than having to relocate to a suburban campus out of town.[7] Residents of the redeveloped project area can choose among new high rise towers, mid rise buildings and town houses. The

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[3] Will Macht, *Crossings, Corridors and Urban Networks*, Center for Real Estate and Urban Development Quarterly 3 (2d Quarter, 2008, PSU Center for Real Estate).

[4] http://www.pdc.us/ura/river.asp (last visited 05/17/08). See also, Portland Development Commission: Governance, Structure and Process, 86 City Club of Portland Bulletin 23 (01/21/05).http://www.pdxcityclub.org.

[5] Interview of Al Burns by author, RiverPlace Hotel, Portland, Oregon, May 6, 2008.

[6] http://www.pdc.us/ura/sowa_n-macadam.asp (last visited 05/17/08).

[7] Email to author from Al Burns, 05/15/08.

entire District showcases 'green' and sustainable building practices resourcefully integrated into the natural river front environment.

Measures of Accomplishment. Over the years, Portland has channeled tax increment dollars into public improvements that encourage walking, biking, bus and tram use, to minimize auto use and implement smart growth policies favoring mixed use and high residential densities.

As a result, the city boasts fewer vehicle miles traveled by private automobile than other cities of comparable size–Charlotte, Columbus, Orlando and San Antonio.[8]

Housing density in Portland is also higher than in otherwise comparable cities.[9] The average lot size for single family houses across the Portland metropolitan region has fallen from 13,000 square feet to less than 5,000 square feet over the last 25 years.[10]

While the downtown areas of comparable western cities– Seattle,Salt Lake City and Denver–grew at a pace only one-fourth to one-third as rapidly as their suburbs, in the last decade population growth in downtown Portland has matched that of its suburbs just about one for one.[11] Moreover, most suburban development in the Portland metropolitan area has taken place within already built up areas. Very little new housing has been sited on green field lands recently included for development within the regional urban growth boundary. One reason is that most of the permissible expansion area lies within separately incorporated cities where voters oppose bond issues for the infrastructure needed to support new development on previously unbuilt sites.[12]

Critiques of Portland Redevelopment. Though downtown Portland is a pleasantly compact walkable city, neighborhoods outside downtown don't look much different than neighborhoods in other western cities. The redevelopment commission has come to realize that outside the urban core the market won't support the high density development needed to generate significant TIF revenues. Also, of great significance to elected local officials, residents in the suburban neighborhoods of Portland are comfortable with their surroundings and vociferously resist proposals for higher density housing or intense commercial development.

Ironically, one of Portland's biggest political controversies derives from the financial success of redevelopment. Overseeing redevelopment, the Portland Development Commission is a quasi autonomous entity with a big staff

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[8] Data from "Highway Statistics," FHWA, 1990-2002, Urbanized Areas, Selected Characteristics, Table HM-72 except Portland data 1999-2002 which comes from Oregon DOT, Highway Performance Monitoring System Office.

[9] Arthur C. Nelson and Thomas W. Sanchez. *Lassoing Exurban Sprawl. In Post Suburbia: Examining the New Metropolitan Form.* Washington: Fannie Mae Foundation, pp. 43-102 (2002).

[10] Amanda Suutari, *Participatory Planning Makes Portland, Oregon a Sustainable City.* http://www.ecotippingpoints.org/ETP-Stories/indepth/usaportland.html.

[11] Michael Lewyn, *Debunking Cato, Why Portland Works Better Than the Analysis of Its Chief Neo-Libertarian Critic.*
http://www.cnu.org/node/1532.

[12] Interview by author with Robert Liberty, Metro councilor, May 6, 2008, Portland, Oregon.

compensated from the impressive TIF cash flows largely derived from the Pearl District. The PDC has far more discretionary revenue than the city itself. Oregon tax limitations don't give the city many easy ways to fund capital improvements except with TIF revenues. So the city commissioners voted in 2008 to expand the Pearl District by 42 acres, extend its completion deadline to 2021, and more than double its bonded indebtedness, instead of winding down Portland's redevelopment activities and relinquishing the property tax base back to the city and school districts.[13] (The PDC plans to reach fiscal accommodation with the school districts and Multnomah county by funding specific public projects of interest to those jurisdictions.)[14]

B. Redevelopment for Job Creation

Rising unemployment in the 1970s and early 1980s accelerated the move to economic development as elected officials felt compelled to try to do something to stimulate job growth.[15] 'Economic development' embraces many different types of projects.[16] By the early 1990s, nine out of ten cities were offering incentives for economic development, mostly property tax cuts or job training.[17] Economic development agencies were created to retain and lure private employers and were empowered to use eminent domain, tax increment financing, grants and loans.[18] Results from these efforts are mixed at best, though hard to calculate,

[13] In *Abeel v. City of Portland, Land Use Appeals Board, State of Oregon* (LUBA 2008-117) (PDC failed to demonstrate that Pearl District and the proposed expansion area were blighted as required by state law when the plan was amended in 2007-08.). http://www.oregon.gov/LUBA/docs/Opinions/2009/01-09/08117.pdf.

[14] *Friends of Urban Renewal v. City of Portland, Land Use Appeals Board, State of Oregon* (LUBA 2008-116) (PDC has no authority to spend TIF from Pearl District for a new school located ten miles from the redevelopment site. http://www.oregon.gov/LUBA/docs/Opinions/2009/01-09/08116.pdf.

[15] Joyce C. Man, *Determinants of the Municipal Decision to Adopt Tax Increment Financing,* TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT 87, 88 (Craig L. Johnson & Joyce Y. Man eds., 2001).

[16] The text excludes from the category of economic development projects that combine significant social welfare objectives with real estate improvements designed to assist the disadvantaged residents of troubled areas. In these projects, TIF cross subsidizes extensive welfare outreach programs within the project area. A good example would be City Heights, San Diego, where a private foundation has spent over $100,000,000 in constructing moderately priced housing, attractive shopping opportunities attuned to the present needs of area residents, a police station, and an office building that provides space for social service organizations of importance to an ethnically diverse neighborhood. The foundation and the city support an array of carefully orchestrated social service programs for area residents. TIF funds finance some public amenities, but most of the budget for improving City Heights comes from other sources. http://www.cityheightscdc.org/community.html. This is quite different from the redevelopment project that transformed South Miami Beach from a low income enclave to a high end international beach resort. South Beach redevelopment featured significant civic improvements along with wholesale gentrification. Many low income residents remain in South Beach and TIF funds are being used to subsidize housing and social programs for their benefit. Michelle S. Viegas, *Community Development and the South Beach Success Story*, 12 GEO. J. POVERTY L. & POL'Y 389 (2005).

[17] Survey, *91% of U.S. Communities Offer Development Incentives*, 33 SITE SELECTION 294 (1993).

[18] Most state home page links show specific tax and business development programs. Eric L. Krohel, *The Variety of State Incentives to Attract Business Continues to Grow*, 10-JUN J. MULTISTATE TAX'N 14, 2000 WL 1357903 (W.G.&.L.) (June,2000).

because few states track tax subsidies accurately and critically enough to evaluate the net cost/benefit impacts.[19]

Cities foster economic growth "to gain new investors, citizens and lenders. The overall aim is to improve the competitiveness and well-being of their jurisdictions by providing new or better public services and infrastructure, and by increasing their tax-base or debt leverage."[20] Here is a good example of this from Minnesota.

Subsidizing Job Generators for a More Livable Rogers, Minnesota.[21] Minnesota authorizes local governments to use TIF to attract development that would otherwise not occur in the locale.[22] TIF funds can be used to pay for infrastructure (streets, sewer, water, parking facilities), land acquisition and site clearance for private firms. In 2005, there were over 2,200 TIF districts in Minnesota.[23]

Before 1984, the town of Rogers was an isolated farming community of three square miles with a population of 650 on the outer fringe of the Twin Cities (Minneapolis and St. Paul). Today, Rogers houses 7,000 residents on seven square miles (through annexations.) Median household income and median house/condo values are 50% above the state average.[24] In 1984, the tax base was $40,000,000. Today, it is $1.1 billion. Now, as then, over half the town is dedicated to commercial and industrial uses.

This transformation began the year Gary Eitel became the city administrator and planner of Rogers, Minnesota.[25] He arrived at about the same time as Interstate 94 was being extended through town. He saw the potential because the interstate extension brought Rogers within an easy commuting distance of Minneapolis-St. Paul. He began energetically planning for the town's expansion with much needed sewer and water facility improvements, and a planning framework friendly to new commercial and industrial development. Gary Eitel explains: "By using tax increment programs to leverage public and private investments into infrastructure, the City could influence the location of new industry and retail where it was most efficiently served by utilities and

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[19] See, e.g., William H. Simon, THE COMMUNITY ECONOMIC DEVELOPMENT MOVEMENT 71 (2001).

[20] Christian Iaione, *Local Public Entrepreneurship and Judicial Intervention in a Euro-American and Global Perspective*, 7 WASH. U. GLOBAL STUD. L. REV. 215, 253 (2008).

[21] Mike Kaszuba, *Enough with the Subsidies, Rogers' New Officials Say*, Minneapolis -St. Paul, Minnesota, Star Tribune (Nov. 27, 2007).

[22] MINN. STAT. ANN. §§469.001, 469.028.

[23] Joel Michael, *Tax Increment Financing* (Minn. House of Rep. House Research, updated Jan. 2008), http://www.house.leg.state.mn.us/hrd/pubs/ss/sstif.pdf.

[24] Estimated median household income in Rogers, 2005, was $79,200. Statewide: $52,024. Median house/condo values were $319,500. Statewidemedian: $198,800. Rogers is 96.6% white, non-Hispanic.
http://www.city-data.com/city/Rogers-Minnesota.html.

[25] Bob Grawey, *Eitel's Legacy Measured in Concrete Block*, Star News, 02/06/07.
http://www.erstarnews.com/2007/February/6block.html.

transportation, and ensure compatible land use consistent with the City's existing and planned residential areas."[26]

The pace of commercial and industrial development quickened in the mid-1990s as the Minnesota Department of Trade and Economic Development embraced the notion of using tax increment financing to keep major industrial firms from departing across state lines after a well known manufacturer named Graco threatened to leave the state.[27]

"They (state officials) wanted us to develop an economic assistance program (along with other cities in the state)," Eitel explains. "They wanted us to be aggressive, so we came up with a policy that projects costing $10 million or more could get 25 percent of the available tax increment as an economic incentive."[28]

Roger's Eitel landed Graco's 300,000 square foot facility, visible from I-94, and other firms soon followed. The town negotiated deals with major firms: Graybar, Opus, Super Target, Kohl's and MBY. Today, Rogers boasts an industrial park of 3,000,000 square feet of built space.[29]

All these new businesses, through their utility bill payments, seeded downtown redevelopment, and helped amortize the town's sizable investment in updated sewer and water systems. In 1984, the town had a wastewater treatment facility capable of handling 100,000 gallons a day. Its present capacity is 1.6 million gallons a day. Before it launched its aggressive economic development program, the town had only one school–an elementary school. Today it boasts a high school adjoining a new 40 acre park, a junior high school located next to a 50 acre park, and two elementary schools. There are other new parks as well, a fire station, the Rogers Activity Center and Ice Arena, trails, and new streets. All these public improvements have been financed by TIF dollars. (Rogers keeps 75% of the tax increment).[30]

TIF is a tempting fiscal device, but used excessively can result in higher taxes for established firms and residents to compensate for the taxes rebated to lure new firms.[31] By 2006, Rogers' voters had tired of the tax give-aways. They finally balked at the town's subsidy to a retailer of outdoor sporting gear called Cabela.[32] Cabela got $5 million in a combination of TIF and tax abatements to build their new regional store. Though proud of the 'category killer' Cabela store,

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[26] Email from Gary Eitel to author, 01/23/09 (on file with author).

[27] Ibid.

[28] Ibid.

[29] Mike Kaszuba, *Enough with the Subsidies, Rogers' New Officials Say,* StarTribune.com. Minneapolis St.Paul, Minnesota.11/27/06. http://www.sayno2outdoorsretailsubsidies.com/pdfs/nov2706startribune.pdf.

[30] Gary Eitel, memo on Strategic Planning for Rogers, emailed to author 02-11-09.

[31] Daniel R. Mandelker, *Public Entrepreneurship: A Legal Primer,* 15 REAL EST. L.J. 3, 21 (1988).

[32] Listed on the NYSE as "CAB" since 2004, Cabela's describes itself as the world's leading outfitter of hunting, fishing and outdoor gear. http://www.cabelas.com/cabelas/en/templates/community/aboutus/history.jsp?auPage=history&cm_re=aboutus*left*ourhistory.

voters were "hopping mad" about the subsidy,[33] and chagrined that Rogers led all Minnesota cities in the percentage of its TIF surrendered to private firms–27%.[34] As for the convenience of a Cabela's being located there, many residents figured it highly likely that the retailer could have found a site somewhere in the same market area without a subsidy from Rogers. At the November, 2006 election, the voters turned out the old council and voted in a new 3-2 anti-TIF majority whose first official act was to fire Gary Eitel on the spot.[35]

Speaking in his own defense, Eitel insists that without the subsidy, Cabela's wouldn't have come to town, and Rogers was phasing out the use of TIF well before the election. No new TIF districts had been created in six years and three were about to expire, restoring all their TIF proceeds to city coffers by 2009-11.[36]

One result of Eitel's summary dismissal was that city employees voted overwhelmingly to unionize, "concerned over job security and job stability," and apprehensive that they were becoming "numbers," not people in the eyes of the growing city's governing council.[37] In the 2008 election, an Eitel admirer, Jason Grimm, was elected mayor, handily defeating the leader of the anti-Eitel faction.

C. Redevelopment to Augment the Local Government Tax Base

Shoring up the local tax base by increasing real property, sales, income, gross receipts and hotel occupancy taxes is one of the main purposes of redevelopment nationwide. Strapped for funds, especially since the taxpayer revolt against the property tax in the 1970s, local governments use their planning, eminent domain and TIF powers to attract businesses that will increase local tax revenues.

Competition among cities is fierce for 'tax enhancing' firms–especially for discount retailers like Costco, Target or Wal-Mart, shopping malls, and auto dealerships. This is especially true in states which allow local governments to claim a share of sales taxes generated within their boundaries. Shopping center developers and their major anchor tenants know they are enhancing the local tax base, and often strike deals with cities to recoup a share of the new tax dollars they expect to bring. Subsidies take the form of direct grants and tax rebates or indirectly, as cities promise to acquire a site for a retailer voluntarily or by eminent domain if necessary,[38] subsidize the price the developer pays for land,

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[33] Mike Kaszuba, *Enough with the Subsidies, Rogers' New Officials Say*, StarTribune.com. Minneapolis-St.Paul, Minnesota.11/27/06. http://www.sayno2outdoorsretailsubsidies.com/pdfs/nov2706startribune.pdf.

[34] Ibid.

[35] Jeffrey Spivak, *The TIF Backlash*, 66 Urban Land 171, 171-72 (September 2007).

[36] Mike Kaszuba, *Enough with the Subsidies, Rogers' New Officials Say*, StarTribune.com. Minneapolis-St.Paul, Minnesota.11/27/06. http://www.sayno2outdoorsretailsubsidies.com/pdfs/nov2706startribune.pdf.

[37] Bob Grawey, *Rogers City Employees Say 'Yes' to Union*, Star News, 10/23/07.

[38] See, e.g., *Wheat Ridge Urban Renewal Authority v. Cornerstone Group XXII, L.L.C.*,176 P.3d 737 (Colo.2007). After determining that it could condemn a certain prime corner as blighted, the Wheat Ridge Urban Renewal Authority initiated negotiations to sell the site to a commercial developer who builds stores for Walgreens. The agency and the developer entered a Development and Disposition Agreement (DDA). For its part, the renewal agency promised to acquire the site either voluntarily

and construct infrastructure such as parking and road improvements that the developer would otherwise have had to finance.[39]

Most tax driven retail projects look no different from what discount retailers build without municipal assistance. As long as the retailers' check out aisles are lined with shoppers, it fulfills its tax generating mission. To be sought after, cash cows don't need to look beautiful.

These retail projects may boost tax revenues in the particular city or town where they are placed, but seldom result in a net public benefit to the market area in which they are located. This is because virtually all such projects would probably have been built anyway somewhere within the same market area–though maybe not in the particular city whose redevelopment agency lured them there.[40]

As a California appellate judge noted over three decades ago, when a city tries to attract consumption-based businesses such as hotels and shopping centers, rather than seeking out firms engaged in production, the city is not increasing "the total wealth of a region as a whole" but "merely redistributes the existing supply by capturing business from rival communities....The success of such strategy assumes the absence of effective countermeasures by rival communities targeted for displacement."[41]

Planning consultant Larry Kosmont explains the practical appeal of tax driven projects by asking us to imagine we were elected to a local city council.[42] As budget season nears, we will receive from our staff a menu of municipal costs. A municipality is a service business that voters judge on the basis of performance. Just to maintain services at their present levels will require additional revenues to cover cost of living increases. The council has three choices: cut back on services, raise taxes and fees or find new revenue sources. Besides the fact that the council would need voter approval to increase the property tax, new taxes are famously unpopular. It is easy to see why TIF funded economic development greatly appeals to many a local elected council member.

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from the present owners or by the use of eminent domain, if necessary, and then to lease it to the private redeveloper. In turn, Walgreens promised to lease the site from the Authority for 25 years, and construct a drug store there. Of the five parcels needed for the project, the Authority was able to negotiate the purchase of only one and at some point changed its mind about going through with the deal. The developer sued, and was denied specific performance because the court balked at enforcing a contract provision requiring a public agency to exercise the sovereign prerogative of eminent domain. But the court granted the disappointed developer the right to contract damages.

[39] Allan Kotin & Richard Peiser, *Public-Private Joint Ventures for High Volume Retailers: Who Benefits?*, 34 URB. STUD. 1971, 1972 (1997).

[40] "Though there is some disagreement in the literature, the preponderance of evidence in recent studies concludes that TIF is more likely to shift investment from one area to another than to create new investment." Rose Nacarrato, *Tax Increment Financing Opportunities and Concerns* (Tennessee Advisory Commission on Intergovernmental Relations, March,2007). http://www.state.tn.us/tacir/PDF_FILES/Taxes/Tax%20Increment%20Financing.pdf .

[41] *Regus v. City of Baldwin Park*,70 Cal.App.3d 968, 983, 139 Cal.Rptr. 196 (1977).

[42] Interview by author with Larry Kosmont, 01/26/08 (notes on file with author). Larry Kosmont is the principal of Kosmont Companies, a development services firm offering a full range of real estate and economic advisory, brokerage, project finance, investment, and planning services for both the public and private sectors. http://www.kosmont.com/.

II. TAX INCREMENT FINANCING ('TIF')

A. HOW TAX INCREMENT IS DETERMINED

"TIF is one of the few locally controlled funding options for investment in infrastructure improvements necessary for economic growth."[43] Cities in fifty states and the District of Columbia[44] are empowered by state law to fund redevelopment through tax increment financing (TIF). TIF allows redevelopment agencies to receive and spend the property or sales taxes derived from increased assessed values or sales that accrue after formal adoption of a redevelopment project's boundaries. Redevelopment activity is supposed to be self-financed from the increased property or sales tax revenues it produces. "TIF is politically popular largely because of the widespread presumption that a TIF project will pay for itself."[45] No hike in local taxes is needed. Unlike tax abatement programs, TIF doesn't necessarily involve "giving away tax breaks to businesses or reducing the community's total tax revenue for future years."[46] Under TIF, any increase in property taxes collected in the redevelopment project area is reserved to pay redevelopment expenses.

Here is exactly how tax increment financing works. The increment is the difference between the tax yield in the base year, the year before the project boundary was set, and the tax yield in each year after that. The tax yield is the tax base multiplied by the tax rate.[47] The tax base is usually the fair market

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[43] J. Drew Klacik & Samuel Nunn, *A Primer on Tax Increment Financing*, TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT 15, 16 (Craig L. Johnson & Joyce Y. Man eds., 2001).

[44] ALA. CODE § 11-99-2 (1975); ALASKA STAT. § 29.47.460 (Michie 2004); ARIZ. REV. STAT. ANN. § 36-1471 (West 2005); ARK. CODE ANN. § 14-168-203 (Michie 2003); CAL. HEALTH & SAFETY CODE § 33670 (West 1999); COLO. REV. STAT. ANN. § 31-25-107 (West 2002); CONN. GEN. STAT. ANN. § 7-485 (West 2005); DEL. CODE ANN. TIT. 22 § 1706 (2005); D.C. CODE ANN. § 2-1219.21 (2005); FLA. STAT. ANN. § 163.335 (West 2000); GA. CODE ANN. § 36-44-20 (Michie 2004); HAW. REV. STAT. ANN. § 46-103 (Michie 2004); IDAHO CODE § 50-2008 (Michie 2004); 65 ILL. COMP. STAT. ANN. § 5/11-74.4-2 (West 2005); IND. CODE ANN. § 36-7-26-25 (West 2005); IOWA CODE ANN. § 403.2 (West 1999); KAN. STAT. ANN. §12-1770 (1991); KY. REV. STAT. ANN. § 65.491 (Banks-Baldwin 2004); LA. REV. STAT. ANN. § 9032 (West 2002); ME. REV. STAT. ANN. tit. 30 § 5203 (West 2004); MD. ANN. CODE art. 41, § 14-206 (2005); MASS. GEN. LAWS ANN. chap. 23A, § 3E (West 2002); MICH. COMP. LAWS ANN. § 207.655 (West 2003); MINN. STAT. ANN. § 469.012 (West 2001); MISS. CODE ANN. § 21-45-11 (2005); MO. ANN. STAT. § 99.810 (West 1998); MONT. CODE ANN. §7-15-4301 (West 2003); NEB. REV. STAT. § 18-2147 (2004); NEV. REV. STAT. ANN. § 279.676 (2004); N.H. REV. STAT. ANN. § 162-K:8 (2004); N.J. STAT. § 52:27D-461 (West 2005); N.C. GEN STAT. § 160A-512 (2005); N.M. STAT. ANN. § 3-46-35 (Michie 2005); N.Y. GEN. MUN. LAW § 970-O (McKinney 2005); N.D. CENT. CODE § 40-58-20 (2003); OHIO REV. CODE ANN. § 725.07 (West 2005); 62 OKLA. STAT. ANN. § 861 (West 1997); OR. REV. STAT. § 457.420 (2003); PA. STAT. ANN. tit. 53 § 6930.2(A)(3) (West 1997); R.I. GEN. LAWS § 45-33.2-3(7) (2004); S.C. CODE ANN. § 6-33-20(A)(1) (Law. Co-op. 2004); S.D. CODIFIED LAWS § 11-9-2(3) (2004); TENN. CODE ANN. § 13-20-205(A) (2005); TEX. LOC. GOV'T. CODE ANN. § 374.032 (Vernon 1999); UTAH CODE ANN. § 17A-2-1247 (2005); VT. STAT. ANN. tit. 24, § 1893 (2004); VA. CODE ANN. § 58.1-3245.2 (Michie 2005); WASH. REV. CODE § 39.89.030 (West 2005); W. VA. CODE § 7-11B-4 (Michie 2005); WIS. STAT. ANN. § 66.46(3) (West 2003); WYO. STAT. § 15-9-207 (Michie 2004).

[45] Joyce C. Man, *Introduction*, TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT 1, 4 (Craig L. Johnson & Joyce Y. Man eds., 2001).

[46] *Id.*

[47] There is nothing special about the formula TAX BASE X TAX RATE = TAX PAYMENT OBLIGATION. In the federal scheme, adjusted gross income is the tax base. Multiply that by the statutorily prescribed rate for the tax due.

value of the property to be taxed. The rate is usually set each fiscal year by the taxing authorities, absent constitutional rate limitations.[48]

Suppose in the base year, the tax assessed value had been $100,000. In the following year, the first year of redevelopment, the area is re-assessed at $500,000, presumably due to the newly built project. The increment is the current tax rate multiplied by $400,000–the difference between the tax base before and after the establishment of redevelopment project boundaries.

B. BONDING THE INCREMENT

Redevelopment agencies obtain the capital necessary to acquire land and meet their commitments for site improvements by borrowing against future tax increments. To raise large sums of capital quickly enough to cover the costs of redevelopment project infrastructure,[49] the redevelopment agency sells bonds.

Municipal bonds carry lower interest rates than private mortgage loans because municipal bondholders are entitled to deduct from gross income the interest they earn on municipal bonds, while most private sector lenders pay income tax on the interest payments they receive. The interest is not exempt on municipal bonds secured by privately owned property and paid by private firms.[50] These are called 'private activity bonds.' However, the tax code allows interest to be deducted on public facilities even if privately owned and operated such as airports, sewer and water facilities, and on '*qualified* private activity bonds.' These exemptions allow deductions of interest on bonds used to finance stadiums, redevelopment,[51] hospitals, and other statutorily privileged purposes.[52]

When governments promise their "full faith and credit" to repay bondholders, the bonds become general obligations and are issued at the lowest rates of interest. When governments don't make an unconditional promise of repayment and instead pledge revenues from a specified source (e.g., tolls from

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[48] Anderson & Assoc., REDEVELOPMENT AND TAX INCREMENT FINANCING (Sacramento, 1974). "A tax increment is computed by multiplying the total property taxes levied and collected by the municipality and all other taxing entities on the taxable real property in an urban renewal project area in a year by a fraction, the numerator of which is equal to that year's market value of all taxable real property in the area minus the tax increment base and the denominator of which is equal to that year's market value of all taxable real property in the area." TEX. LOCAL GOVT. CODE ANN. § 374.033(a) (Vernon 1999).

[49] In some states, "TIF bond proceeds are used for a variety of purposes, not just redevelopment (or development), including elementary and secondary education, roads, bridges, parking facilities, airports, water and wastewater facilities, recreational facilities, and electrical power plants." Craig L. Johnson, *The Use of Debt in Tax Increment Financing*, TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT 71, 72 (Craig L. Johnson & Joyce Y. Man eds., 2001).

[50] Daniel Knepper, *Eliminating the Federal Subsidy in Kelo: Restricting the Availability of Tax-Exempt Financing for Redevelopment Projects*, 94 GEO. L.J. 1635 (2006).

[51] To obtain tax exempt status, the bond must satisfy the requirements of I.R.C. § 141 *et.seq*. One reason that renewal may have persisted long after direct federal subsidies ceased is that the value of the tax savings to redevelopment bondholders far exceeds the sums ever granted directly for renewal. One scholar, Lynn Sagalyn, estimated the indirect interest subsidy at $12 billion in 1984, whereas the total sum of direct federal renewal grants, 1949-74, was about $500 million. *See* Bernard J. Frieden & Lynne B. Sagalyn, *Downtown, Inc.: How America Rebuilds Cities* 26 (1989).

[52] See IRS Publication 4078, Tax-Exempt Private Activity Bonds, http://www.irs.gov/pub/irs-pdf/p4078.pdf .

a roadway), bondholders are only as secure as the revenue source. Tax increment bonds are secured solely or primarily by the anticipated cash flow from a defined tax cash flow, typically real property or sales taxes.[53]

Suppose a developer agrees to construct $200,000,000 worth of new offices, shops, and condos on a vacant site which the redevelopment agency will acquire and sell to the developer. Relying on that agreement, the city places the site in a redevelopment area. At a property tax rate of 1%, the developer's improvements would yield a tax increment of $2,000,000 in annual property tax revenues above the pre-developed tax yield [base ($200,000,000) multiplied by the tax rate (1%) = tax yield ($2,000,000)]. Thus, the city could borrow as much money as $2,000,000 a year would repay, taking into account the costs of issuance and interest reserves which can easily consume 20-30% of the par amount of the bonds.

Before the developer completes the promised redevelopment project, there will be no tax increment with which to repay the bond investors. To comfort potential bond investors until then, redevelopment agencies sometimes insist upon private redevelopers guaranteeing repayment of the bond. The guarantee is not for the full value of the project, just enough to pay the bondholders, typically 1-3% annually of the project's fair market value, depending on the local property tax rate. Besides the redeveloper, other potential guarantors could be a government agency, a major insurance company, a bank, or a 'blue chip' corporation. Once the project is completed, and the tax increment starts flowing, the guarantor is released from having to make any further payments "in lieu of taxes."

C. THE IDEAL PROJECT FOR PRODUCING TIF DOLLARS

TIF financed projects do best in places experiencing dramatic growth in effective demand for space, rising property values and robust tax revenues. In areas lacking these characteristics, property tax revenues aren't going to increase quickly and broadly enough to finance the costs of land acquisition and redevelopment. Densely built, rundown areas filled with marginal businesses and low income residents are only good candidates for TIF-funded redevelopment if located where there is strong potential demand for "higher and better" uses–areas that are ripe for gentrification. Gentrification means displacing the present area residents and small businesses, a harsh and contentious operation. Clearing heavily populated, long established residential areas is emotionally wrenching for the displaced and those who must implement the removal policy, expensive, takes time, and absorbs political capital. It is not surprising, then, that commercial and industrial projects outnumber residential by about two-to-one, or that new construction in redevelopment project areas outpaces rehabilitation by a margin of about eight-to-one.[54]

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[53] These are sometimes called tax allocation bonds. CAL. HEALTH & SAFETY CODE § 33670 (West 1999).

[54] State of CA Controller, Annual Report of the Community Redevelopment Agencies for Fiscal Year 1998-99 at xxi, xxii (2000), available at http://www.sco.ca.gov/ard/local/locrep/redevelop/98-99/ [hereinafter Annual Report].

An optimal TIF project is one upon which private redevelopers are ready to build immediately, that can be built quickly, at the highest conceivable density, at the greatest fair market value, garnering huge retail sales. Vacant sites are preferred because demolition of an existing building lowers the property tax by the value of the building removed and the tax base only recovers when new structures of equal or greater value replace those that were removed. Every dollar of new construction adds a dollar to the tax base.

D. A TIF CASE STUDY

To see precisely how TIF works, consider this example: The City of Menomonie, Wisconsin (pop. 15,000)[55] was motivated to form a tax increment district because its downtown area was stagnant and further threatened by a new shopping mall that had been built on the north end of town near an interstate highway. Without city intervention, more downtown deterioration was expected. The town sought to condemn land to make room for a new grocery store as an anchor for rejuvenating the area.

The project site consisted of a city block, one-half of an adjoining block, and the intersecting street which the city vacated. At the time the project was conceived, the site contained several stores (some vacant, built at the turn of the century, now in poor condition), a fraternity house, a few older houses that had been converted into student rentals, and, at the end of the block, the house of the chancellor of the University of Wisconsin-Stout. That house was also vacant because the then chancellor chose not to reside in it. The fraternity challenged the city's attempted condemnation, alleged constitutional and statutory infirmities, eventually lost the constitutional arguments, but prevailed on its statutory claims.[56]

The Fraternity's Goal in Initiating Litigation. The fraternity's claimed motivation for filing suit was to preserve a 'hallowed tradition.' Just a smoke screen, according to counsel for the city, convinced the fraternity never wanted anything but a higher price than the city initially had been willing to pay.

If Sigma Tau Gamma had lost its lawsuit, the city could have acquired the frat house by condemnation. The purchase price would have been set through a court-ordered valuation process. Even after the Wisconsin Supreme Court held that the city could not condemn the property under the Tax Increment Law, the city could have started condemnation proceedings from ground zero under the Blighted Area Law. The city decided not to take the 'proof of blight' route. "A financial decision was made that the delay in beginning the project was, in the end, going to cost more than the additional amount paid by the negotiated price. In other words, the increase in construction costs while awaiting the redevelopment law condemnation procedure, as well as the lost increase in

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[55] *At* http://www.city-data.com/city/Menomonie-Wisconsin.html (last visited 04/10/05).

[56] *Sigma Tau Gamma Fraternity House Corp. v. City of Menomonie*, 288 N.W.2d 85 (Wis. 1980). See generally, David N. Farwell, *A Modest Proposal: Eliminating Blight, Abolishing But-for, and Putting New Purpose in Wisconsin's Tax Increment Financing Law* ,89 MARQ. L. REV. 407 (2005).

revenue because of the more efficient store and the better location, outweighed the benefit to be obtained by completing the condemnation."[57]

The fraternity negotiated a price to its liking and built a new house elsewhere in the city.

The On-Site Outcome. By prior agreement, the city sold the entire redevelopment site, including the fraternity house, to Donald Williams, the grocery store owner. Don's SuperValu of Menomonie is independently owned, but part of a voluntary marketing group called SuperValu Stores. Mr. Williams was always the 'real' purchaser. He approved in advance and paid the increased price the city negotiated with the fraternity.

Here was the city's financial analysis, according to the Wisconsin appellate court opinion, written before the city settled with the fraternity: Following completion of the project, the property tax yield from the redevelopment site was expected to increase from $3,481 in 1976 to $24,282 per year thereafter because of the improvements. Project costs and income were estimated as follows:

Costs:		**Income:**	
Property Acquisition	$278,000	Sale of Land	$154,000
Appraisal Costs	$ 2,000	Sale of Bonds	$220,000
Relocation Costs	$ 50,000		$374,000
Land Clearance	$ 40,000		
Utility Relocation	$ 4,000		
	$374,000		

Bond financing enabled the city to cover the difference between what it cost to assemble, clear and prepare the land for development ($374,000) and the $154,000 land purchase price paid by Don Williams. The bonds were to be retired with the tax increment income generated by the improvement.

Let's assume the city's property tax rate had been approximately 2%. If the site was worth $175,000, the tax yield before redevelopment would have been $3,500. (The fact that it cost $374,000 to acquire and clear the site doesn't mean the cleared site was worth that much.) At then prevailing municipal bond rates, it would take an annual tax increment of $15-20,000 to cover debt service on a bond of $220,000. To generate that much increment, Don Williams had to construct a grocery store worth over $1,000,000, which he did.

The grocery store is a commercial success. The bondholders are being repaid. The city has continued to use tax increment financing for other projects. Most citizens of Menomonie approve of the project. It has not resulted in a downtown boom, but it has kept the downtown area alive and well. Although some historic buildings were lost to the grocery store, Menomonie's Main Street has since been designated a national Downtown Historic District, with a restoration and revitalization program currently under way,[58] and the city and county (Dunn)

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[57] Letter to author from Phillip M. Steans, Bakke Norman, S.C., the attorney who represented the city in the lawsuit and subsequent purchase negotiations (Jan. 4, 1993).

[58] Interview by author with Phillip M. Steans, Bakke Norman, S.C. (Nov. 6, 1992).

promote a vibrant and growing local tourism industry on the strength of the 19th century buildings still to be found there.[59]

E. THE IMPACT OF REDEVELOPMENT ON OTHER TAXING ENTITIES

Until the redevelopment agency fulfills its contract obligations to the redeveloper and has fully repaid bondholders and other redevelopment creditors, tax increases that would have been shared by the city with other taxing entities–school districts, counties, and special districts–are siphoned into repayment of redevelopment agency obligations.[60]

The other taxing entities continue receiving a share of property tax revenues from the redevelopment project area based on pre-redevelopment assessed valuations. But they forfeit revenues from the enhanced tax base until the redevelopment bonds are paid, usually 20 to 40 years. These taxing entities may elect to cover their expenses by increasing tax rates, where allowed. If they did, tax increment financing would have indirectly contributed to higher local property taxes.

Basically, cities with active redevelopment agencies are the main TIF winners. Counties, school districts and other taxing entities are the primary TIF losers[61] if the project built in the redevelopment zone would have been built somewhere else anyway but within the boundaries of the county or school district. There is evidence that this is exactly what happens with retail or commercial projects, though probably not as much with industrial projects.[62]

Most studies of TIF funded redevelopment conclude that other taxing entities surrender approximately twice as much real property tax revenue as they eventually gain when the project is complete, the bonds have been retired,

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[59] *Available at* http://64.176.26.183/tourism_frame.html (last visited 05/29/05). *At* http://discover-net.net/~mlana/menomonie.html (last visited 05/29/05).

[60] In California, redevelopment agencies can retain tax increments only for repayment of obligations. CAL. HEALTH & SAFETY CODE § 33670(b) (West 1999). Obligations include loans and advances from the city or county, tax allocation bonds, lease-purchase agreements, reimbursement agreements with the city or county, disposition and development agreements with the city, county or outside developers, owner participation agreements, bank loans and any contracts that could result in damages or other liabilities for breach. *Marek v. Napa Cmty. Redev. Agency*, 761 P.2d 701, 46 Cal. 3d 1070, 251 Cal. Rptr. 778 (1988) (redevelopment agency's executory financial obligation under DDA counted as 'indebtedness' under Community Redevelopment Law, entitling agency to honor contract by using tax increment funds for it).

[61] In Kentucky and Washington, state constitutional provisions restrict the use of school financing for any other purpose. Courts in those states have interpreted these provisions to bar TIF projects draining away property tax revenues from schools. Amy F. Ciercello, *The Use of PILOT Financing to Develop Manhattan's Far West Side*, 42 FORD. URB. L. J. 795, 806 (2005).

[62] Richard F. Dye and David S. Merriman, *Tax Increment Financing: A Tool for Local Economic Development*, 5/1/06 J. HOUSING COMMUNITY DEV. 22 (2006): "Our evidence shows that commercial TIF districts reduce commercial property value growth in the non-TIF part of the same municipality. This is not terribly surprising, given that much of commercial property is retailing and most retail trade needs to be located close to its customer base. That is, if you subsidize a store in one location there will be less demand to have a store in a nearby location. Industrial land use, in theory, is different. Industrial goods are mostly exported and sold outside the local area, so a local offset would not be expected. Our evidence is generally consistent with this prediction of no offset in industrial property growth in non-TIF areas of the same municipality."

and all the TIF reverts back to the original taxing entities.[63] This is not surprising, considering the perverse incentive of the sponsoring city to raid TIF revenues from other taxing entities.

Suppose that property values are increasing in an area targeted for TIF funded redevelopment by 5% a year. Imagine that the city, the school district, the county and other taxing entities each share 25% of the property tax revenue. As long as the new project increases property tax revenues by more than 1.25%, the city will be ahead even though the project is economically inefficient–evidenced by the fact that it results in a diminished rate of growth in the tax yield. In this scenario, three-fourths of the public contribution to the project is financed by entities other than the host city. Imagine that the project produces an increment of 1.5%. The city is ahead by .25%. The other taxing entities cover their share of the cost and realize no increased tax revenues until after the project debt has been amortized.

Methods of Safeguarding the Interests of Adversely Affected Taxing Entities. States have come up with various ways to safeguard schools from becoming net losers as a result of TIF funded economic development. The same menu of options could be offered counties and other taxing entities.

(1) Many states authorize municipalities to negotiate payments in lieu of taxes (PILOT) from subsidized firms or developers. PILOTs never fully replace revenues lost to TIF. (2) Some states make up all or most of the local school district revenue loss due to TIF. (3) In some states, the schools receive notice of proposed TIF funded projects that would divert revenues from schools, and the opportunity to comment. (4) In other states, school districts take a seat on a TIF advisory committee. (5) Some states impose an absolute ban on the use of the school district's share of future property tax receipts. (6) A handful of states allow school districts to exercise a veto over any redevelopment plan that diverts tax increments from schools. In these states, without school district approval, redevelopment is permissible but may not be funded with property taxes that would previously have been reserved for schools.

The National Education Association (NEA) endorses the idea of giving school boards a veto over any TIF funded economic redevelopment that contemplates including the school district's share of property taxes. They see this as the "first line of defense," enabling school districts to "effectively protect education."[64] As an NEA-sponsored study observed: "Too often, these poorly monitored subsidies have gone to low-density industrial parks; tourist, convention, and shopping destinations; and other enterprises that may not really need specific public support, do not create long-term jobs with decent wages, and contribute little to community infrastructures as a whole."[65] School districts using the leverage of their veto power could negotiate suitable agreements with redevelopment agencies on potentially beneficial projects and opt out of pure tax giveaways.

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[63] Richard F. Dye and David F. Merriman, TIF Districts Hinder Growth, 13 Policy Forum #4 (University of Illinois, 2000).
http://www.igpa.uiuc.edu/lib/data/pdf/PF13-4_tiff.pdf.

[64] NEA, *Protecting Public Education from Tax Giveaways to Corporations* 3(January, 2003).

[65] NEA, Protecting Public Education from Tax Giveaways to Corporations 7(January, 2003).

Don't expect redevelopment officials to greet a school district pocket veto with wild enthusiasm. School districts are sometimes big, slow moving bureaucracies, self-absorbed, and unskilled in real estate development. Through indifference, incompetence and intransigence, they could delay to death otherwise viable redevelopment efforts.

III. PUBLIC AGENCY DEALINGS WITH THE DEVELOPER

A. Why Redevelopment Agencies Don't Become Project Owner/Builders

Local redevelopment agencies are empowered to acquire and clear land, construct public facilities, and install utilities, landscaping and other infrastructure intended to make the area more attractive to private investment. They are not meant to become shopping center, office building or apartment house developers, competing at taxpayer expense directly with the private sector. Instead, under state law, redevelopment agencies must find private entrepreneurs willing to construct and operate the projects called for in the redevelopment plan. The agency promulgates a plan for each area scheduled for redevelopment, acquires the land necessary for the projects contemplated, and makes some provision for the requisite infrastructure. Then, unless the land is needed for a government use, the agency is obligated to sell or ground lease the acquired sites to private firms.

B. The Agency-Developer Tango

Early Consultation. Sophisticated redevelopment agencies won't initiate the redevelopment process without good reason to believe the site is of interest to private developers. The more cautious agencies won't acquire property until inking a contract with a solvent private developer to purchase the site. Otherwise, the agency risks getting stuck with an impractical plan, an unmarketable site, and unrecoverable acquisition costs.

Politically connected developers confer informally with public officials about the possibility of their striking a redevelopment deal long before the formal redevelopment process begins.[66] An experienced Florida-based land use attorney, Charles Siemon, observes that developers and local officials often reach tentative agreements before the beginning of the official public review process. The negotiated deal is presented and approved at a public meeting pretty much as presented.[67] State open meeting laws require elected officials to conduct their business in sessions that are open to the public, but these laws don't bar

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[66] Patience A. Crowder, *'Ain't No Sunshine: Examining Informality and State Open Meetings Acts as the Anti-Public Norm in Inner-City Redevelopment Deal Making*, 74 TENN. L. REV. 623 (2007).

[67] Charles L. Siemon, *Public/Private Partnerships and Fundamental Fairness, in City Deal Making* in Terry Jill Lassar, INTRODUCTION TO CITY DEAL MAKING 81(1990).