Finding and Managing the Money for Public-Private Partnership Development

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Times are tough for redevelopment and the core business model on which redevelopment is predicated—the public-private partnership. As a result of the current economic crisis, redevelopment agencies—the public side of the equation—up and down the state are facing drastic budget reductions due to the State's "taking" of tax increment of $2.05 billion—a key funding source that would be otherwise directed to redevelopment.

The "take" is causing a ripple effect of uncertainty about the stability and availability of this critical funding source. On the private side, capital may not be readily available for complex projects in this economic downturn, which could necessitate greater equity at higher cost, making it more difficult for projects to "pencil out."

In today's economic climate, it will take creativity to align the public and private partner's interests to achieve the desired redevelopment and public benefits, while preserving the private partner's return. Savvy developers and agency personnel are finding ways to maximize value through not only exploring a variety of sources of capital, but also through structuring and managing traditional funding sources.

> The National Council for Public-Private Partnerships defines public-private partnerships as:
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> A contractual agreement between a public agency (federal, state, or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility.

Traditional funding sources for redevelopment public-private partnership projects have typically fallen into several categories. The backbone of redevelopment financing, at least until now, has been tax increment and bond financing. Tax increment funds can be used on a "pay-as-you-go" basis or to secure the repayment of bonds issued to raise a substantial amount of money up front. In addition, if the agency owns the property, it can contribute land value to the project and generate land sales proceeds as another source of revenue. The agency can either agree to sell the land outright or reinvest the land sale proceeds into backbone infrastructure as part of achieving project financial feasibility.

Federal programs such as federal grant funds and tax credits may also be used. For example, federal Community Development Block Grants can be used to fund brick and mortar development such as new infrastructure. Tax credit programs have been successful in funding specific activities such as affordable housing, historic preservation, and equity investment in low income neighborhoods and are most useful during good economic

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times when individual and institutional investors are making a profit and need a tax credit. Through tax credit programs, equity is raised from private investors who can then take a credit against federal income due over a specified period of time depending on the applicable tax credit program. In today's economic downturn, tax credit programs have not been useful; however, the recent federal stimulus package (American Recovery and Reinvestment Act of 2009) provided grant funding in lieu of certain tax credits to stimulate investment. As the economy improves, so will opportunities to use tax credit programs to fund development.

Assessment districts such as community facilities districts (CFDs), are often used as land-secured financing. CFDs are a mechanism to raise funds that are repaid by the future land owner as an assessment on the property. The initial funding does not originate from either the developer's pocket or the agency's, thereby rendering it an invaluable up-front funding source.

State and federal grants are often available to augment other revenue. Funding can be available through regional transportation agencies or councils of governments (COGs), particularly if the project qualifies as transit-oriented development. For example, the Association of Bay Area Governments (ABAG) recently instituted a program creating priority development areas (PDAs). Projects that are designated as PDAs are eligible for grant funding. Regional transportation agencies are the conduits for both federal and state transportation dollars that can be key funding sources for required off-site improvements.

The private developer side of the public-private partnership contributes private capital, which is typically comprised of a combination of debt and equity. Potential participants on the private side include commercial lenders, investment banks, pension funds, hedge funds, private investors and tax credit investors. The ultimate internal rate of return (IRR) received by the private developer is dependent in large part on the cost of capital provided by the various players. Typically, the greatest portion (70 to 80 percent) is comprised of private debt available at a relatively low interest rate and the balance of the capital is comprised of investor equity contributions, which require a much higher IRR (perhaps 3-4 times the cost of the debt), depending upon the risk.

The more complex and long term the project, the greater the risk. Due to the economic downturn, commercial lenders may not be willing to provide relatively high leverage, which compels developers to obtain a greater proportion of private equity, which in turn imposes challenges to obtaining financial feasibility with the IRR desired by the developer. (Currently, lenders may only be willing to provide up to 50 percent debt, and in some instances, especially for purchase of land, lenders are unwilling to provide any loans.) The use of public financing, such as the issuance of bonds, can lower the developer's cost of capital, but the risk of default associated with such financing shifts to the public agency side.

In structuring the project, there are additional factors to consider. Fiscal neutrality—the concept that new development should pay for itself over time and not burden a city's or a county's general fund—is a particularly important issue during difficult economic times when cities and counties face substantial cuts to their general funds. Long-term costs include maintenance of new backbone infrastructure, provision of police and fire services, and maintenance and operations of new parks and public facilities. Bargaining for fiscal neutrality should be addressed early in the negotiations as there are attendant costs to achieving fiscal neutrality. Aligning the timing of expenditures with revenue generation in the short term, as well as the long term, is critically important.

A CFD (or other special assessment district) is a commonly used fiscal neutrality tool, while some jurisdictions have required sinking funds or annuities to cover costs over the life of the project. Issues to resolve include the developer's obligation to pay the CFD fee until the land is transferred to others, a likely insistence by the developer to cap the assessment amount up front before the project is detailed enough to yield the true cost of on-going maintenance, and the need to balance a CFD against other land-secured financing so that the resulting property tax remains competitive and doesn't materially adversely affect pricing.

Leveraging redevelopment funds with outside grants raises other issues. Grants are primarily used for projects on a going-forward basis and cannot be used to reimburse past expenditures. The costs of securing the grant must be accounted for and grants typically have requirements about how and when to spend funds or risk forfeiting the money. Negotiations and legal agreements must contemplate grant timelines in conjunction with performance schedules if grant funds are an integral part of project financing.

In today's economy, creativity is more vital than ever in structuring the deal to maximize the project financing to facilitate redevelopment public-private partnership projects, while facing emerging issues such as bonding capacity and redevelopment stability, maintenance of tax base for revenue generation, and protection against budgetary "takes." Well-informed developers and agency personnel will find new sources of capital to augment traditional funding sources and structure and document the transaction to effectively apply those funding sources to achieve the respective redevelopment goals of the public and private parties involved.

Now Accepting Applications for William A. Carlson Fellowship Program

The California Redevelopment Association is now accepting applications for the 2010 William A. Carlson Fellowship Program. This fellowship program awards up to three stipends annually to California graduate school students to attend, at no cost, our annual conference, March 10-12, or one of our Redevelopment Institutes held in May and July (includes registration, hotel, travel, and meal expenses).

This is the seventy year of the award. The award was created to recognize former Executive Director Bill Carlson for his dedication and contributions to CRA and to the field of redevelopment. 2009 recipients of the fellowships were David Feinberg, Michael Reynolds, and Blake Hopkins.

For further information on the program, go to the CRA's website at www.calredevelop.org and click on William A. Carlson Fellowship, or contact Randi Dixon by email at rdixon@calredevelop.org or by telephone at (916) 448-8760.

The deadline for submitting an application is December 11, 2009. Award winners will be announced in January 2010.