# B 8. COMMUNITY DEVELOPMENT: ROSEVILLE EXAMPLE

Over the years most people in this country became congregated in big metropolitan areas and numerous smaller cities & towns with fewer living on farms. These urban areas typically grew with too little rational urban planning. Now there is often more thought about their future development. I am not an expert on urban development, but as a long time resident and taxpayer in a suburban community I became interested in a local development issue and became involved in arguments about it. This essay is offered to give an example of the sort of issues sometimes faced in local community development and some of the things that should require caution on the part of local authorities.

The city, Roseville Minnesota, is a suburb almost bordering both Minneapolis and St. Paul on the North. Its population is about 35,000, it is largely residential with a very large retail business. One section includes two small lakes and an area with some trucking terminals & some housing though some of the area is undeveloped. There has been general agreement for about 20 years that that section should be redeveloped sometime.

Recently developers who owned part of the section somehow persuaded the city council to give them the exclusive right for a year to negotiate with the city on a plan they wanted to work out to develop an area somewhat bigger than that they now own. That was obviously not the way for the city to start. Their interest in developing the area should have been publicly announced in a way that any developers interested could have sought more information and be given an equal opportunity to be considered.

One issue now is whether Roseville should continue to work with these developers with the expectation that if they can present a possible development plan, the city will then go along even though no other developers had an opportunity to provide a different plan. The council shows no interest in opening it up to other developers even after one developer submits a contract for consideration.

At this stage the sole developer group says it will develop a balanced community in which people can live, work and enjoy good recreational facilities. It remains to be seen how much of that is guaranteed to be finished in a reasonable time in the final contract with them. Another issue is how much the city should aid (subsidize) the developers financially if at all, and what further risk, if any, the city should take at present.

The developers had worked out some initial & tentative plans and presented them to the city council, which discussed them. It then called a public hearing to get comments. The plans included a “big box” retailer (Costco) as a major part of the plan, which the developers said was necessary for the rest to work. There was objection to any “big box” retailer and to adding retailers when the city already had a far higher retail to population ratio than normal. Its own long range development plans indicate that additional retail space is not needed, & a commission that had studied city needs recently had recommended against adding any retail space. It was assumed that either the plans fit present zoning for the area , or that zoning will be changed to accommodate the proposal. Any rezoning should not be so broad as to make it possible for anyone to put in anything they wanted to later that the council would not have intended to be part of further development. Most testimony opposed the development as presently proposed. But many vital questions remain unanswered at this time.

Evidently the Roseville city council felt that it had obtained enough go-ahead when an appointed “Stakeholder Group” recommended further negotiations with the developers. The Group was supposedly composed of people who would be directly affected by the development. Having a stakeholder group deliberate carefully about the pros and cons of the projected Twin Lakes project would have been a good idea <u>if</u> the group has been composed one third each of people who would benefit, those who thought they would lose, & a neutral third, and <u>if</u> their meetings had not been dominated by developer spokesmen. I gather that was not the case. It was not the balanced group, and it did not deliberate after hearing the pro and con argued. It was “sold” on the proposal by the developers. So I now wonder how we will know whether Roseville citizens would really approve of giving away how many millions of dollars (maybe as much as $50 million) to a developer to add big box & more retail competition to our already big retail complex & wonder how many understand all the risks the city would take in addition. A few hearings like one I attended are a formal requirement permitting a few inquiries & protests, but I expect widespread dismay at the results over time if the council approves much of this developer’s wish list.

Only a few people had time to testify in the hearing, and it is doubtful if everyone who has an interest in the development even knew about the hearing. To be sure, the city planning commission still has to give preliminary approval to the development planning going on, but that is thought by the council to be a mere formality. Perhaps it should be much more than that. Public input should be sought at various points in the negotiations between the council & the developers, it seems to me, and no final contract should be signed by the council without the citizenry being fully informed about all that is involved and having an opportunity to induce some changes on which there seems to be a consensus. Before any contract is signed that could involve many millions of dollars of subsidy by the city, citizens should be given an opportunity to vote on the deal, with enough information to know what they are doing.

The initial plans made it clear that the developers expected the city to provide substantial amount of financial and other aid to developers, but no dollar amounts were public knowledge. It is of course normal for a city to bear the cost of putting in sewers and streets & providing for their maintenance and for fire & police protection out of their taxes, though like most governmental units in the country just now, they are hard pressed to maintain normal services without extending streets etc. into undeveloped areas as would be necessary even for construction of any sort to be carried out. That raises the question as to whether this is a good time to develop, at possible the sacrifice of some other services.

It may be necessary in order to complete the project to use the power of eminent domain to acquire some privately owned property as it is, and there is a question as to whether courts would permit that power to be used to promote a private profit making developer's project. Since cases differ somewhat, as do courts, it is not clear whether it would be possible or not in this situation. What will the contract say if courts later forbad the use of eminent domain in this case?

It is also not entirely clear as yet as to whether the project as suggested now will meet all the requirements of state law, so that requires a ruling before proceeding. Whether this project as now projected would be consistent with city planning policies laid down earlier and with which all subsequent planning must be consistent has not been settled, and if it is determined that the project is not consistent, the question will be whether those earlier policy directives should be modified or not.

The area to be developed and much of the adjacent area is thought to be badly polluted, though few tests have yet been conducted to see how badly polluted and by what, and whether it is spreading etc. Much more testing would have to be done to learn the amounts of each pollutant and what would be needed to clean up each enough to meet government standards applicable to the uses to be made of each part of the land to be developed. Estimates of the pollution cleanup costs made before that are almost certainly worthless underestimates, yet our negotiations are proceeding with such estimates since they are all that are available now. Who can be forced to bear unknown cleanup costs? or the costs of tests etc. to learn most likely cleanup costs? Present owners, if they sell their land, could clean it up first, or if they don't, would have to sell it for less if development is likely to proceed. It was not clear at the time of the hearing whether the developer would bear any of the cleanup costs or would have to be reimbursed for them later, or whether the city would have to complete the cleanup at its own expense before developers would proceed. All that has to be agreed upon, and the public should be informed of the agreement before any contract should be signed.

It seems that the city council has apparently agreed, at least informally, to bear costs for some other things (dollar amounts as yet undetermined), & if they are initially met by developers will reimburse them.

Residents pointed out that the development would create very serious traffic congestion on streets leading to Costco, the big retailer, and that existing streets could not be widened without ripping out many blocks of housing. The developers pooh poohed the fear of congestion, which is to say they simply wanted to ignore what could be a practically insoluble problem.

These issues aside, the biggest financing question has not been settled at this point. There is still much misunderstanding about one major part of the developers proposal. They expect the city to provide some undetermined amount of the financing through issuing what are called TIF Bonds (Tax Increment Financing Bonds).

Developers say that the money the city provides to developers by issuing such bonds will be recaptured by the higher taxes the developed land will pay the city. That makes it sound to some people as though the city is only temporarily lending the developers some money which they will get back. That is wrong.

What is actually involved is that, after meeting some requirements as to what expenses TIF Bonds can be issued to cover, and after the developer has incurred those expenses, the city pays the developer the amount agreed to, getting that money by selling in the market TIF bonds for that total amount if it can. That is, the city borrows the money it gives to developers to reimburse them for certain expenditures they incurred. The city goes into debt to make a free gift of that money to developers so that developers don't have to incur some of the costs of the development from which they expect to make money when they sell the developed properties, or over time if they retain ownership even after they are developed. The city essentially puts up part of the total amount of money invested by the developers, but does not get to share in the profit the developer makes on the total sum invested. That is not a very attractive deal for the city in any case, & worse the higher the fraction of the total cost of the development project that the city bears. A private estimate is that the developers plan to invest about $150 million and want the city to provide about $50 million. That is one third, though other instances where developers do not take the entire risk themselves were found to be closer to one tenth by the city.

In the present Roseville situation. the developers never mention that TIF involves an outright gift to them. They make TIF sound like a good deal for the city. They say that the tax increments will likely pay of the bonds before the 25 years are up, and the city will have from then on the full tax increments to make possible lowering other taxes. They now project that their development will add about $220 million worth of additional taxable property from which the city will benefit. That means developers say they expect to be able to sell off the properties after they have developed them to other owners for that amount, but that dollar figure may be far higher than they really expect to be able to get or are at all likely to get. Developers are in a position that it pays them to put as good a face on the development project for the city as they can get away with.

There are three important things that not everyone (including those on the city council) may not understand fully but need to be very clear about. They are are (1) that whatever the expenses the city agrees to finance with TIF bonds constitute an outright subsidy to the developers by the city, not just money lent that will be returned to the city, so a city needs to avoid it unless no developer will develop as desired without a city subsidy, & the city needs to be sure that the subsidy required is not too large to get the community benefits of the development, & (2) that there are a number of risks the city undertakes in selling TIF Bonds (in addition to the gift involved). This essay will discuss them, & (3) that there is an alternative way of using TIF that avoids the risks of issuing TIF bonds.

(1) Selling TIF Bonds is a way that the city borrows money from the bond purchasers, to give it as a free gift or subsidy to the developers. The city is in effect putting in borrowed money as part of the money the developers invest in the development, but the city gets none of the profits from the sale of the developed land. Of course the more the developers can get the city to put in, the better for them. At least the city should not provide any subsidy to developers on the mistaken notion it will get any of that money back. (I said that above, but it may need to be repeated.)
If developers get no TIF gift they might or might not undertake the development. If they don't, it likely indicates that it is too risky unless the development is subsidized. They fear they would not get back all they project, or they fear development costs might exceed projections. The city should then probably not proceed immediately with development at the cost to it of putting in roads etc. to make new construction possible, let alone going into debt to make a monetary gift to the developers. The money the city gets from the development will be the extra taxes from the developed properties, and that will be needed, if TIF Bonds are used, to pay interest on the bonds for about 25 years and pay them off at their face value at maturity or before if possible. Only after that would the city be able to use some of the tax increments for various purposes other than continuing to maintain the public services for the development.

A community is expected to benefit from a good development, not from a poor one. The question is what costs, including subsidy, is worth it.

(2) There are risks for the city in TIF financing. The first risk comes in trying to sell the TIF Bonds. The inducement for those who buy the TIF Bonds is not the full faith and credit of the city but only the added taxes the city expects to get after development is completed which it has to use to pay interest on the TIF Bonds and pay off the bond buyers in full by the time the bonds mature in 25 years. TIF bond investors (likely institutional investors like pension funds) but possibly also some individuals will likely be cautious and prudent and investigate whether the projected developed properties will likely be good business investments or might fail, making the city's tax increments unable to redeem the bonds. It might not be possible to sell all the TIF bonds at prices that will provide the city the full amount they contract to pay the developers if "the market" is not convinced it is a quite good investment. That would be the first risk the city would take in even agreeing to finance any fixed amount for the developers through the use of TIF Bonds. No city should depend upon selling TIF Bonds to individuals not prudent enough to know the risk they might be taking.

There are other risks for the city. Assume all the bonds can be sold at satisfactory prices so enough money is obtained. But suppose the developers are unable to complete the development as planned, possibly becoming bankrupt and the city is unable to recover much and cannot even get enough tax increments from properties that were developed to pay interest on the bonds. The city is still obligated to pay that interest. Or suppose that the development was satisfactorily completed, the developers sold off the properties at the projected prices & made nice profits, but the buyers of some of those properties found out later that they could not make it, having paid too much for the developed properties. If some of those businesses failed or couldn't pay the taxes levied, so the city got the properties by default & could not sell them for much, the tax increments on developed properties would fall short. So tax increments on developed properties might not yield enough to enable the city to pay the interest on the bonds, or enough to do that and still accumulate enough in addition to pay off the bonds at maturity. Even if legally the bond holders bore those risks with ordinary TIF Bonds, it is doubtful that the city would default on interest or principal if it could possibly avoid doing so, because of what default would do to the city's credit rating. However the financial burden of the city in either of those cases, added to the gift made to the developers, might be beyond the city's means. This is a further risk for a city using TIF Bonds.

So TIF Bonds are risky debts the city incurs when it borrows money & makes free gifts of that borrowed money to developers, and even if it does manage both interest & bond redemption from tax increments, it may not get as much from tax increments after 25 years as it counted on.

Proponents of any TIF Bond deal can point out that such deals have been made before and have "been successful" in that the developments were profitable. Sometimes that success refers only to the profit to developers who sold and got out. It is better if success means cities also paid their obligations and even covered out of tax increments the extra long run costs for extending city services to the developed areas. But there were still free gifts from a city to the developers which were a cost to the city.

But whatever successes can be cited constitute no proof at all that any, let alone every, development project financed that way will be successful. Each one will depend upon economic conditions, upon the exact terms of the contract with the developers, and upon the successes of all the final owners of the developed properties. The city needs a very good contract lawyer to make sure that, beyond making a gift of money to developers, it takes minimal risks in the contract to be signed by the city.

(3) There is away to use TIF to make a gift to developers without incurring the risks (discussed above) incurred in selling TIF Bonds. (It does not involve the developers guaranteeing bond interest & bond repayment either. Why that is not safe will be explained later.) The other way of using TIF is called "pay as you go" TIF financing. It requires the city to turn over the tax increments for about 25 years to the developers until they reimburse developers for a specified amount of the qualified expenditures they had made. The worst outcome would be that the developers would not get back all they expected to get back if tax increments were insufficient. If developers will not take even that risk, when they are still getting as a gift whatever the tax increments amount to, that proves that the whole project is a bad economic gamble even for the developer, & a bad mistake for a city.

A city probably should not be involved unless a business is willing to take a chance when it bears all the investment costs. That is the way business is usually done. They put in all the money & expect to make a profit on the investment. A city certainly should not sign a development contract if the developer will take no risk of getting less subsidy than desired if TIF increments might be less than the subsidy needed.

For Roseville, the developers early provided figures that purport to show a number of the costs to be incurred early in the proposed project, some to be borne by the city, and where the money could be obtained.

All such figures should be viewed realistically, i.e. skeptically. <u>ALL FIGURES FOR FUTURE COSTS AND FUTURE REVENUES ARE ESTIMATES</u>, none are certain because the future is unknown, & <u>EACH ESTIMATE IS MADE TO SUIT SOMEONE'S PURPOSE.</u> One must consider what figures developers provide would likely be underestimates and what overestimates. Any city considering any development needs to have independent estimates made for it to rely upon more than upon developer estimates.

Both ways of using TIF financing are alternatives to the city doing the entire development itself with borrowed funds at at what it judges is an appropriate time (using all the development tax increments itself for each part when finished). A city can assume all the risks of development in the hope of making all the profits, if it is successful. Whether cities should assume the risks entailed in doing it themselves is questionable. Cities are not usually supposed to be risk takers. Most cities do not think they are usually in as good a position or as competent as business to undertake such efforts in any case. But a city may think it cannot avoid the development job if it decides at some time in the future that an undeveloped area might never be developed by any private developers.

City councils should also remember that although business is i a better position than a city to take risks that look good to it, businesses also frequently make misjudgments. Any one familiar with business cycles and with the high failure rate of small business in this country knows that business frequently over-invests in office space, in hotels, in retailing and various other things. I can't help but think that our developers are about to over-invest in retailing in Roseville & anyone who buys retaining space in the new development will fail, or drive out other small businesses in Roseville. Cities may need to "second-guess" their developers in some respects.

A note about the final contract to be signed for any development. I don't know what any proposed final contract between Roseville & the developer group might contain specifically, but completely independent contract lawyers should be consulted to make sure that any contract the city signs makes clear that it provides for full responsibilities of each member of the group for fulfillment of all the group's responsibilities under the contract. That, of course does not make it riskless for the city, even apart from the economic desirability of the contract. Because if a legal suit by the city was necessary to collect from any or all members of the development group in case of incomplete fulfillment of the group's responsibilities under the contract, it might not be possible to collect much or anything if only none of the businesses was healthy enough at the time to pay what might be required, or if any or all had gone out of business (& maybe set up business under another name). This consideration also suggests why even a developer guarantee of TIF bond interest and principal might be worthless. In any case, I hear that our group's reputation depends upon who one talks to but that is a different issue that I did not consider at all, but that any city council should look into thoroughly.