Explaining the Improbable
Local Redevelopment in the Wake of Federal Cutbacks

Lynne B. Sagalyn

Federal cutbacks in urban aid in the 1970s forced cities to finance redevelopment projects with their own resources. Freed from federal rules and regulations, cities responded with invention, devising new financial strategies that proved to be powerful alternatives to direct federal aid. The process that fostered the solutions—public-private dealmaking—transformed the nature of city development practice, raising with it troublesome issues of accountability. This article describes these financial strategies and the nature of public subsidies in the deals. Then it argues that the accountability problem poses a policy dilemma that makes it a hard target of reform.

In the mid-1970s, after providing more than 30 years of steady financial support for redevelopment from Washington, a shriveling federal pipeline threatened to cut off city initiatives across the country. City officials who had mapped out an agenda for rebuilding downtown saw tighter times ahead. These fiscal clouds prompted them to widen their intense search for new ways to pay for their projects. Saddled with big service bills and shrinking fiscal resources, municipal treasuries could not fund new ventures, and a spreading taxpayer revolt made going to the voters a chancy strategy. Surprisingly, however, cities coped well. In spite of all these problems, city officials succeeded in transforming the nation’s downtowns with new office buildings, hotels, shopping malls, and convention centers.

Cities tried many ways to get around the shortness of cash in order to finance their downtown projects. They sought new sources of money and used novel financial arrangements, the late 1970s to mid-1980s being a period of creative experimentation. The process itself transformed the nature of city development practice: after a long tenure as regulators and donors, cities became dealmakers and co-investors in private development projects (Frieden and Sagalyn 1986).

The change in roles was one of substance as well as style. In their agreements with private developers, city officials made commitments that went beyond traditional public works. They promised to build parking garages, skyways, parks, even department stores—as publicly owned elements of private real estate projects. Putting public money into private projects was nothing new. From the network of private canals in the nineteenth century to industrial plants and waste treatment facilities in the 1960s and 1970s, states and cities had used their borrowing power to promote business ventures that promised to improve local economies. But when cities financed downtown projects in the 1980s, they were acting as developers as well as lenders and investors.

This new role marked a change in expectations about the public sector’s separateness from the private sector. The federal rules of urban renewal had prohibited the physical integration of publicly funded improvements with privately owned structures (even when it led to costly duplication of facilities in separate free-standing structures) because such linkages threatened to breach the fiscal integrity of public support. Similarly, public subsidies were kept separate from and unencumbered by private ownership through disposition policies that favored land sale rather than leasing (Brownfield and Rosen 1961; Comment 1958). As federal programs were phased out, however, the sharp dichotomy between public and private activities gradually eroded; pragmatism, not prescribed rules, began to shape city development practice.

The emergence of public dealmaking in the 1980s reflects the fact that, in the aftermath of the federal aid cutbacks, cities did more than find substitute sources of funds; they redefined traditional notions of public-private responsibilities with their new strategies for redevelop-

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ement. These strategies placed a high premium on public entrepreneurship and private market feasibility. No longer relying on formula-based federal aid, cities custom-tailored financial assistance to fit local needs. Loans replaced grants as the way to deliver subsidies, with public dollars stretched farther through cost-sharing agreements with developers. And, increasingly, in bargaining with developers, cities negotiated direct financial stakes in a project in the form of profit-sharing arrangements, a practice very unlike the usual behavior of cities.

In this article I discuss these new financial strategies and show how they proved to be workable and powerful alternatives to direct federal aid for city redevelopment. The track record of completed projects is evidence of their effectiveness; at the same time, that success raises troublesome issues of financial accountability. These issues are easy enough to identify; they stem from low levels of scrutiny and hidden costs associated with off-budget financing. Yet they pose something of a policy dilemma: financial accountability is a hard target of reform because the very elements that make the strategies so successful preclude easy accountability. Moreover, city officials are unlikely to pay much attention to the types of rational decision-making tools most often proposed to make off-budget financing more visible, because the complexity that surrounds accountability serves a purpose. Since city dealmaking has proven to be such a productive way to manage city development, the task is to understand where it needs to be adjusted and what types of adjustments can make it more responsive to public review.

In the first two sections of the article I describe the strategies cities followed to cope with the federal aid cutbacks. Next I explain the nature of hidden subsidies in public-private deals, tracking not just the financial flows attached to direct public spending, but the very broad range of cities' financial activities. In the fourth and fifth sections I address the accountability issue and explain how the logic of complexity matches cities' existing resources to the problems of financing redevelopment. In the concluding section I discuss future directions in this area.

Local Sources, Federal Subsidies

Cities easily financed redevelopment under the federal urban renewal program. Continual appropriations ensured abundant money—more than $13 billion over the life of the program (Stull 1982)—and advance funding channeled dollars to cities when they needed it most, early in the planning process to pay for technical studies, land acquisition, relocation, and clearance activities. Raising funds was an administrative task—a set of procedures by which city officials got what they needed after filling out grant applications, meeting pre-set criteria, and complying with detailed regulations. Though full of bureaucratic delays, the process was clear, and if one did it right, the money would eventually be forthcoming. As a reliable money source, the federal urban renewal program cleared the way for cities to concentrate on implementation, allowing them to bypass a number of financing issues they had to confront later when this pipeline closed down in 1974.

Coming up with cash was one such issue. Although cities were required to pay one-third of total project costs, to make urban renewal easier for them, federal rules allowed cities to pay their share by building public works to serve a project area. Public works required city financing, but schools, parks, libraries, and street improvements fit easily within existing budgets for municipal improvements and allowed cities to cover their share without coming up with additional money. The opportunity was exploited aggressively. By 1959, the federal government was collecting only fourteen cents of every local matching dollar in cash; in 1968, the figure was down to twelve cents (Foard and Fefferman 1960; National Commission on Urban Problems 1969).

The federal program's abundant funds and liberal cost-sharing formula created a largess whereby cities were not pressed to be inventive financial problem-solvers. Their money role was that of a conduit. Layers of rules defined the formula for financial assistance and the procedures for land disposition in ways that tied cities' hands, making it hard (if not impossible) for them to do innovative deals. This old system prejudiced the outcome; still, cities had little need for the creative-financing techniques that became so necessary after the cutbacks.

In the post-cutback period cash came from many sources, which can be grouped into three categories: intergovernmental grants, city funds, and project revenues (Table 1). For redevelopment, states offered aid infrequently and only in minimal amounts (though in some parts of the country their assistance for economic development was substantial and growing); Washington still supplied most intergovernmental aid. Before the federal pipeline dried up, city officials successfully tapped the remains of categorical-aid programs for economic development, mass transit, and historic preservation. Though not as generous as during the halcyon days of
TABLE 1: Sources of public money for downtown retail projects

<table>
<thead>
<tr>
<th>Source of public money</th>
<th>Frequency of use (n = 38)</th>
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<tbody>
<tr>
<td></td>
<td>Number</td>
</tr>
<tr>
<td>Intergovernmental grants</td>
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<td>Federal aid</td>
<td>24</td>
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<td>Categorical program</td>
<td>11</td>
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<td>UDAG</td>
<td>23</td>
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<td>State aid</td>
<td>8</td>
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<tr>
<td>City funds</td>
<td>30</td>
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<tr>
<td>Tax-exempt borrowing</td>
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<tr>
<td>General obligation bonds</td>
<td>8</td>
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<tr>
<td>Industrial revenue bonds</td>
<td>5</td>
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<tr>
<td>Tax increment bonds</td>
<td>14</td>
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<tr>
<td>Budget allocations</td>
<td></td>
</tr>
<tr>
<td>CDBG funds</td>
<td>9</td>
</tr>
<tr>
<td>Other</td>
<td>6</td>
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<tr>
<td>Redevelopment agency equity</td>
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<tr>
<td>Private contributions</td>
<td>4</td>
</tr>
<tr>
<td>Project revenues</td>
<td>12</td>
</tr>
<tr>
<td>Paybacks</td>
<td>6</td>
</tr>
</tbody>
</table>

a. The sample consists of 38 downtown redevelopment projects opening between 1975 and 1985 that contain at least 50,000 square feet of retail space.
b. Percentages do not total 100 because of multiple sources of funds.

Even before federal funds dried up, local taxing power was the most important source of money for most cities. Cities always floated full-faith-and-credit general obligation bonds backed by their tax revenues, but for redevelopment they did so only when they could not use the more politically sheltered revenue bond backed by income from dedicated sources, such as parking garages and, therefore, issued without special voter approval. When the local dollars in the deal were big, more often than not cities issued tax-increment bonds. Tax-increment financing (TIF), a system for redeveloping blighted areas that dates back to 1952 in California, had spread to 23 states by 1979 (Huddleston 1982; Casella, Kim, Forrest, Przypysny 1984). Fiscal power accounts for TIF’s appeal. Under TIF state enabling legislation, the increase in property tax collections that normally results from new construction and rising assessments in a project area is channeled to redevelopment agencies instead of being split with counties, school districts, and other taxing entities. Using this revenue stream as collateral, redevelopment agencies issue tax-exempt bonds to finance their activities and operate with much greater autonomy than the federal renewal program ever allowed. Considered controversial as an instrument of public policy (see LeFevre 1978), TIF is an off-budget revenue-raiser that provides cities with an engine for powering redevelopment.

As federal funding allocations dwindled, city dealmakers also tapped municipal budgets, and they cut deals with other local agencies or public authorities to finance parts of a public-private project. Occasionally they found new pockets of money in the private sector, in contributions from downtown business interests and cash advances from developers. By themselves, none of these sources accounted for a large share of the public funding package, but layered one on top of another, they helped to close the funding gap. In our sample, more than half the projects relied on three or more financing sources and nearly a quarter relied on five or six.

San Diego’s Horton Plaza illustrates how a city managed without federal funds. For this retail-hotel-theater

Table 2: The role of public money in downtown retail projects

<table>
<thead>
<tr>
<th></th>
<th>Median</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Total public share* (%)</td>
</tr>
<tr>
<td>All 38 sample projects</td>
<td>30.8</td>
</tr>
<tr>
<td>22 projects with UDAGs</td>
<td>28.8</td>
</tr>
<tr>
<td>12 projects with loan paybacks</td>
<td>27.8</td>
</tr>
</tbody>
</table>

a. Public share measures the extent of the public sector’s direct financial involvement. It covers both grants and loans for land assembly, on-site and off-site improvements, parking facilities, structures, and other related project costs. Public dollars do not include very early expenditures for land acquisition and improvements if carried out as part of an urban renewal project, except in the case of Fanueil Hall Marketplace in Boston and Town Square in St. Paul.
project in downtown, the city raised $40.5 million, or 22.4 percent of the $180.5-million total cost. The largest portion of public money, 54.6 percent, came from tax-increment bonds. City taxpayers funded an additional 23.4 percent of the city’s contribution through a loan from the city’s capital improvement fund and other municipal sources. The rest of the money came from the project itself. Land sales to developers in the 15-block redevelopment area covered 8 percent of the city’s expenditures; the remainder, about 14 percent, came from temporary leasing of project land and interest earned on cash (from bond issues) set aside for later expenses.

As in the past, tax-exempt borrowing encumbered cities or their redevelopment agencies. But now part of the burden was shifted to private developers through lease agreements or loan paybacks. Originally a requirement of the UDAG program, loan paybacks leveraged public funds—politically as well as financially. By lending instead of donating public dollars, city officials might dramatically reduce their investment in a project with an eye toward banking those repayments for future assistance activities. This was the case with Cincinnati’s Hyatt-Saks, an $88.7-million hotel-retail project in downtown, which opened in 1985. In its deal with the developers, the city agreed to acquire land and construct site improvements, skyways, the hotel substructure, the retail service level, and a parking garage. To finance the $23.6-million expense, it tied up $7 million in intergovernmental grants, $11 million of general obligation bonds, and $5.6 million in city budget and Community Development Block Grant (CDBG) monies. Forty-three percent of the public share was an outright contribution, but the city sought repayment of the rest, $13.5 million, through a series of low interest loans that it finally secured from the developers of the project after lengthy and complex negotiations. Accounting for these paybacks more than halves the public share of total development cost, from 26.7 percent to 11.4 percent, a cut consistent with the data on 11 other projects with paybacks in the above-mentioned sample.

The new financial strategies worked exceedingly well because cities gained greater autonomy without loss of federal support. By relying on tax-exempt borrowing, cities were carrying the burden of financing redevelopment, but the federal government was still absorbing the subsidy. The turn to local tax-exempt financing merely changed the form of federal aid—from direct cash grants to indirect tax expenditures. Instead of depending on federal appropriations, cities were using income tax incentives to raise money from private investors who would not pay federal income tax on the interest from these bonds. Either way, federal taxpayers as well as local ones were contributing to these cities’ projects.

Tax-exempt bond subsidies channeled a vast amount of money into local redevelopment, probably more than what cities got from congressional budget appropriations for urban renewal. Rather than diminish the level of funding, the switch automatically exposed the federal treasury to big outlays because the new commitments were less controllable. Tax-exempt borrowing for all private-purpose projects had been escalating enormously throughout the 1970s, jumping from $8.9 billion in 1975 to $50.1 billion by 1983 (or 56 percent of total tax-exempt borrowing) as states and localities eagerly financed industrial pollution facilities, housing, convention centers, sports stadiums, and economic development activities (Leonard 1986; Petersen 1981).

Exactly how much tax-exempt borrowing went toward redevelopment is unknown. But to get a perspective on the question, suppose redevelopment bonds averaged 10 percent annually (a figure that approximates the proportion of private-purpose bonds issued between 1977 and 1983 for a range of activities, including airports, docks, and convention centers, but not parking garages, which are typically financed by small-issue industrial revenue bonds). In terms of an equivalent direct-subsidy outlay, one year’s borrowings (1984) would have been about $1.2 billion. In contrast, over the 25-year life of its urban renewal program, the federal government spent, on average, $520 million annually. Whatever fiscal stringency existed at the federal level in the 1980s, the treasury remained involuntarily committed to the tax-expenditure subsidies: as entitlements they were there for the taking. Though somewhat constrained in use, the total amount of private-purpose public debt was not capped until 1986.

Entitlement-based subsidies proved to be a powerful alternative to direct federal aid. They were easy to get, flexible to use, and not subject to delay, recall, or oversight by Washington bureaucrats. They afforded cities opportunities to act with greater initiative than before, without having to go to their state legislatures for the power to do so. And the tax-exempt bond market, highly efficient as a supplier of capital, readily accommodated the new public agenda for public-private redevelopment. Cities did have to be inventive and resourceful to aggregate enough money, but the new strategies gave them the financial resources to be partners at the negotiating table.

Privatizing the Process

Cities coped successfully with the cutbacks because the substitute sources of funds enlarged their scope of assistance. Tax-exempt financing was key; it eliminated an old set of constraints. Money raised directly in the national capital markets came without the detailed programmatic guidelines typical of Washington’s categorical aid; cities were free to use it in private development projects as they saw fit. In contrast to the old system, bonds could finance infrastructure, garages, open spaces, and buildings—whether publicly or privately owned. Cities were restricted only by IRS regulations and rulings affecting public-private projects, which placed an unconstitutional limit on the amount of space that could be devoted to the “exclusive” use of private parties. Though tax legislation in the early 1980s added other restrictions, most were not binding. Only in 1986 with the Tax Reform
Act of that year did tax-exempt financing for private purposes become severely constrained. This legislation did not end tax-exempt financing completely, but forced cities to issue more costly taxable bonds for many projects.

What is most significant about cities' turn to tax-exempt borrowing for redevelopment is that the nation's capital market became the new "rule maker." While states historically have limited municipal borrowing through legislation imposing debt ceilings, cities could bypass these if they used revenue bonds or tax-increment financing. Not all states permit cities to use these forms of off-budget financing: Washington, for one, prohibits the use of public debt for private purposes. Where state debt ceilings did not get in the way, however, cities enjoyed wide latitude in raising money under the federal government's regulations governing tax-exempt borrowing, and they got what they wanted for their redevelopment projects if the terms and conditions of their bond offerings were acceptable to investors. Making bonds attractive to investors meant designing issues that would carry minimum risk and rank high in financial security. Since marketability was paramount, Wall Street's technical standards for underwriting, guarantees, reserve funds, and disclosure—rather than public policy criteria—determined project acceptability (see Stegman 1981).

The returns cities sought from financing redevelopment also revealed new values. Under the old system, cities were betting on future property tax returns. By reversing the downward investment spiral, redevelopment promised higher revenues from the projects themselves (after a period of tax abatement) and, most important, from their spin-off impacts on neighboring property values. Spill-over benefits lost none of their importance when cities started to manage redevelopment through deal-making, but increasingly the new cash streams they targeted—lease revenues, loan paybacks, and profit-sharing payments—all specified the rate and timing of the return on public investment. No longer content to be one-time donors, cities offered aid with financial strings attached. By the early 1980s, profit sharing was a trend gathering momentum (Guenther 1982; Clarke and Rich 1985; Fisher 1987; Sagalyn 1989). In our sample of downtown projects, only three of the 16 projects opening between 1975 and 1980 contained agreements to share profits, in contrast to 13 of the 24 opening in the next five years.3

Cities readily embraced business-like criteria because they promised greater success in implementing risky redevelopment projects. The sharp separation between local renewal agencies and developers mandated by the federal urban renewal program had led to repeated failure. Excluding developers from early project planning meant that cities had to make decisions on the basis of their own feasibility studies and their best judgment. These judgments eventually left acres by the hundred unmarketable in Detroit, Newark, St. Paul, St. Louis, and numerous other cities across the country. Subsequently, when they turned to the new public-private strategy, cities put a high premium on market feasibility and involved developers early in the planning process.

While business-like practice fit the political and fiscal context cities faced after the cutbacks, this was uncharted terrain. Many cities made the transition from grantsmanship to dealmaking as fast as they did because the federal government through the UDAG program taught them to be dealmakers. UDAG staff went into the field instructing city officials in how to bargain, and national consultants followed up with technical assistance. Encouraging the use of paybacks and profit-sharing agreements was central to the program's notion of efficiency in grant allocation. And even if city officials were skittish of the consequences of bargaining for additional public benefits, the UDAG staff was ready to inject those terms into the agreement (Clarke 1984; Munkacy and Rappaport 1983; Negotiating UDAGs in St. Paul 1981). From a grants-allocation perspective, the pluses of this approach were obvious—higher probability of project success and greater productivity of public spending. On the other hand, one study found that this bias led public officials away from funding very risky projects (Gist and Hill 1984).

When cities turned to the private sector for redevelopment financing, the move recast the old intergovernmental equation for cost sharing in terms of public-private responsibilities. Instead of being set in advance by statute and formula, cost sharing was negotiated on a deal-by-deal basis, custom-tailored to meet local needs and to exploit opportunities for tax-exempt financing. Had the cutbacks not siphoned off funds, cities might not have changed course, though the study of downtown development that Bernard Frieden and I conducted leads us to conclude otherwise. The change in how cities managed and financed redevelopment was part of a broader trend toward using private resources to serve public interests (Schultz 1977). It was firmly rooted in the implementation problems cities experienced under the old system of urban renewal, then fueled by changing federal priorities.

Invisible Public Equity

How much money did cities actually contribute to their redevelopment projects? In Frieden's and my study of downtown retail projects, public direct spending for the projects in our sample ranged from as little as 3 percent to 83 percent of total development cost. In half the projects, the public share fell in the 20-to-50 percent range, with a median of 31 percent. This level of cost sharing added up to more public money in the deal than most local officials acknowledged. In personal interviews, when we asked mayors and top city administrators how much they had put into their new retail centers, typical answers were "nothing at all" or "very little." Further questioning revealed that most mayors and administrators did not consider federal aid to be money the cities spent, nor did they count off-budget outlays as actual spending, and when project appropriations were spread over several years, they lost track of what had been spent in the past. To figure what cities actually spent, we counted all their expenses for studies, plans, administration, land,
TABLE 3: The use of indirect subsidies for downtown retail projects

<table>
<thead>
<tr>
<th>Frequency of use</th>
<th>Number</th>
<th>Percent</th>
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<tr>
<td>(n = 30)*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Projects with indirect subsidies</td>
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<td></td>
</tr>
<tr>
<td>Present-value subsidies</td>
<td>14</td>
<td>46.7</td>
</tr>
<tr>
<td>Property-tax abatements</td>
<td>5</td>
<td>16.7</td>
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<tr>
<td>Below-market interest rates or deferred interest payment</td>
<td>6</td>
<td>20.0</td>
</tr>
<tr>
<td>Nominal lease payments</td>
<td>5</td>
<td>16.7</td>
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<tr>
<td>Value-creating trades</td>
<td>3</td>
<td>10.0</td>
</tr>
<tr>
<td>Projects with no indirect subsidies</td>
<td>16</td>
<td>53.3</td>
</tr>
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</table>

a. Information was unavailable for 8 of the 38 projects. In general, the information on indirect subsidies is scant and probably underestimates the frequency of use of indirect subsidies; thus, it is suggestive.

b. Individual forms of indirect subsidies will not total 46.7% because of multiple subsidies.

c. Generally in exchange for a share of the project’s gross revenues or cash flow.

Value-creating trade-offs are harder to quantify, though their impact on public-private cost-sharing is no less important. When fiscal conditions afford cities little freedom, their ability to control the building density of a site becomes an especially powerful financial resource, all the more so when that power is lodged within a quasi-independent redevelopment authority. To cope with the financial problems that continually threatened to unravel the deal for Horton Plaza, for example, San Diego’s Centre City Development Corporation kept renegotiating its original deal with the developer. The city for its part was desperately trying to keep its commitment to fund several thousand parking spaces for the retail center. Escalating construction costs and interest rates, however, eventually priced the project out of the city’s reach until the developer agreed to take full responsibility for the parking. As public and private responsibilities shifted, city officials kept readjusting the disposition price of the site; how much retail space the developer would be allowed to build was also negotiable. The city looked further for ways to bring office and hotel uses onto the site because the increased density would improve Horton Plaza’s balance sheet by adding new site payments and by generating future tax increments. Over time, the renegotiations produced a project dramatically different in scope and size from what the city and the developer first agreed upon (Table 4), but, by most accounts, one much better able to attract people downtown.

The use of value-creating density trades and hidden credit subsidies was hardly an innovation. These financing techniques all followed a time-honored practice of public finance: pay for projects with off-budget funds and indirect taxes (Meltzer 1971). Off-budget financing was one of the keys to the success of downtown revitalization. From the beginning it made the high cost of redevelopment a manageable issue in city politics by presenting the bill to someone other than the average taxpayer. After

Digging into local resources to finance redevelopment without federal aid. Horton Plaza, San Diego, California.
TABLE 4: Horton Plaza project characteristics

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<tr>
<td>Gross leasable area</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(sq. ft.)</td>
<td>563,000</td>
<td>650,000</td>
<td>700,000</td>
<td>780,000</td>
<td>850,000</td>
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<td>Number of department</td>
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<td>4</td>
<td>5</td>
<td>4</td>
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<tr>
<td>Parking ratio*</td>
<td>5:1,000</td>
<td>4.5:1,000</td>
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<td>3.4:1,000</td>
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<tr>
<td>Uses</td>
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<tr>
<td></td>
<td>Office</td>
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<tr>
<td>Size (city blocks)</td>
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<tr>
<td>Public investment</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(millions)</td>
<td>$28.5</td>
<td>$48.6</td>
<td>$53.9</td>
<td>$33.2</td>
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<td>Private investment</td>
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<tr>
<td>(millions)</td>
<td>$45.0</td>
<td>$85.0</td>
<td>$140.0</td>
<td>$180.0</td>
<td>$193.0</td>
</tr>
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a. Number of spaces per one thousand square feet of gross leasable area.

Washington cut renewal funds loose from specific projects in 1974 and encouraged each city to set its own community development priorities, mayors faced strong pressures to scatter their money across the city in order to do something for every district. Off-budget financing came to the rescue once more: it helped the mayors to continue pouring resources into expensive projects by diffusing their cost over time and removing them from the annual competition for community development funds (Frieden and Kaplan 1975). Making public commitments through off-budget processes raises issues of public policy, which are discussed below. In the late 1970s and early 1980s, however, few observers questioned the practice because dealmaking was too novel and unfamiliar to generate widespread criticism. Most important, the deals were pragmatic solutions in the face of the cutbacks and pressures to undertake popular projects.

Missing — Financial Accountability

The success cities scored with dealmaking poses troublesome issues of accountability. Hammering out development agreements that are complex even by real estate standards requires meeting behind closed doors. Eventually, when local government has to give formal approval, the city council will learn about the bargains that were struck; the public-at-large may have access to the agreement through summaries deposited at libraries or reported in the press. But alternatives dropped along the way seldom come to light, and the complexity of the business deal increases the likelihood that few people will understand it well enough to raise informed objections. The city, after all, is usually trading current costs against future returns that are necessarily uncertain. Besides, the deal that reaches the members of the city council is a fully negotiated agreement that they cannot take apart and amend piece by piece; so they have a choice of accepting it as is or becoming the spoiler of a project that has been years in the making.

The current system is not void of accountability—rather, the review is limited to a few select points in the dealmaking process. Redevelopment agencies are not fully autonomous, either politically or fiscally, as are their brethren transportation and port authorities (Walsh 1980). Since final development agreements and lease commitments must be approved by elected officials, in practice, city negotiators work to keep key members of the city council informed well in advance of the vote. When unanticipated crises or changes in development plans call for modification of these agreements, the deal again comes up for public review. And borrowing in the public bond markets requires disclosure of public commitments for specific projects and business terms with private parties bearing on the repayment of debt. In a way, when cities negotiate paybacks and profit-sharing agreements, the deals themselves contain an internal check on the productivity of public spending.

The information the public gets, however, represents a partial picture of costs. In accounting for their deals, cities tally the financial benefits on the revenue side of the ledger, recording future property taxes, paybacks, and profit-sharing returns. On the expense side, recorded costs typically include only current direct cash outlays and exclude the opportunity costs tied to below-market interest rates, deferred paybacks, tax abatements, and in-kind contributions—a practice that is in keeping with the standards and conventions of public accounting practice. Because credit subsidies and tax expenditures do not involve transactions in which the government actually receives and then disburses cash, they do not fall within the profession's narrowly defined focus of financial reporting (Leonard 1986). Even if city negotiators or redevelopment agencies prepare formal disclosure reports, council members and taxpayers may still mistakenly as-
Some parts of the deal are cost-free to the public or have no way to understand the benefits to the developer—because of the ways cities provide assistance. This is not all intentional. With many different agencies involved in negotiations and cost sharing, it is hard to track all the direct costs and indirect subsidies. Nevertheless, having incomplete data on the city’s financial commitments to a project not only precludes reasoned judgments, it intensifies the rubber-stamp problem faced by city council members.

If off-budget financing makes it difficult to track the full range of city expenditures for any one project, on a city-wide basis it can obscure the cumulative long-term commitments for redevelopment. For example, the Citizens League, a Minneapolis civic organization, recently studied Minnesota’s experience with TIF and found cities locking up startling amounts of future revenue from downtown tax-increment districts. State-wide, property taxes committed this way to pay for development assistance grew from $437,000 collected in 1974 to $56 million collected in 1984. In the Minneapolis-St. Paul area, many cities tied up 7 percent or more of their property tax base through TIF (Citizens League 1985). Since some publicly assisted projects produce more tax-increment dollars than needed to finance them, the Citizens League worried further that city governments could channel the extra money into other real estate projects rather than returning it to the taxpayers’ general fund. Ultimately, this finance loop is limited by Minnesota’s statutory 25-year life for TIF districts, but the potential for self-perpetuating bond refinancing compounds the problem of financial accountability.12

Since tax-increment income does not come out of a fixed budget, cities can commit it to one project after another without having to make trade-offs among competing expenditures for public safety, parks, sewers, or streets. In addition, by diverting taxes from counties, TIF allows cities, in effect, to commit revenues of other taxing jurisdictions to redevelopment.13 These end-runs around formal budget channels led the Citizens League to question whether, without some process for competitively allocating funds, city negotiators have sufficient incentives to bargain hard with developers and be selective about the projects they assist. “Because the direct financial burden on local taxpayers either is nonexistent or so diffuse as to defy identification,” the authors of the report said, “cities may be providing more assistance than is needed” (Citizens League 1985).

The numbers on the level of public assistance are suggestive on this point. The extreme differences among cities in the public share of total development costs—from 3 percent to 83 percent—probably mean that less sophisticated communities overpaid for what they got or agreed to projects with such poor earning prospects that they needed exceptional subsidies. Big up-front subsidies can carry risky projects through the first uncertain years, but, as is clear from the recent failure of several festival marketplaces (Guskind and Peirce 1988; Hunter 1988), they cannot turn weak projects into successes. City dealmakers have put together a project-producing system that works remarkably well—a little too well for comfort if it turns out to be a cover for making weak projects look good.

How can financial accountability be built into the process of public dealmaking? For a start, it would not be difficult to improve the quantity and quality of information on cities’ financial commitments. Requiring summaries of deals—written in clear, nontechnical terms and available to all interested groups—would remove the blinders from informed review. Requiring full, formal disclosure of both direct spending and indirect subsidies from all participating agencies—consolidated into a single statement for each project—would eliminate the fragmented search for complete information. Preparing independent policy-oriented audits of developer agreements—designed to take account of present-value subsidies and value-creating trades—would clarify the nature and extent of financial benefits to private parties. And cost-revenue analyses of the public investments in real estate projects would put all this information in a comprehensive fiscal framework, a first step for evaluating the full costs and benefits of public dealmaking.

There are, of course, impediments to implementing any one of these recommendations, but they are not insurmountable. For example, consider the pricing of a public-private deal. Determining whether financial incentives are needed and how the public benefits in the deal should be valued demands a level of financial skill commonly found only in the more sophisticated and diverse staffs of large cities. City planners lacking the technical skills in real estate finance are at a serious disadvantage if they are to negotiate with developers on equal footing. As a result, many cities may not be well-equipped to structure deals. Many cities have hired consultants with the desired skills and experience to check developers’ figures and to determine a level of help that would be fair but not excessive. This solution may not be realistic for struggling small cities, a problem that points to a general deficiency in the future training of city planners hoping to work in economic development and redevelopment.

The information approach to greater accountability for city dealmaking has limits. First, getting better representation of the numbers will not be simple or easy. The accounting profession is unlikely to take a wider responsibility for this, according to one expert, because doing so would require adopting a broader definition of its public-stewardship role (Leonard 1986). For reasons rooted in its historical focus and professional culture, the profession is not up to the task of instituting the kind of changes needed to track the indirect modes of public spending. Second, quantifying the full financial implications of a deal calls for different types of expertise. Costing-out present-value subsidies requires technical skills in financial projection and estimation, while figuring out the benefits linked to value-creating subsidies re-
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quires conceptual policy-based skills. These skill sets are not incompatible, but they are different. Even analysts with real estate expertise may find no easy solutions. Design amenities, subway improvements, and credit subsidies, for example, can be valued by referencing market equivalents, but other benefits, such as employment targets and environmental mitigation measures, have no obvious market prices. These differences will make it hard to standardize evaluation techniques and to define ways of measuring a deal's trade-offs. As a result, analysts venturing down this path should anticipate problems in reaching an agreement on many conceptual and analytical issues.14

Complexity with a Purpose

Even if the numerous analytical questions and conceptual ambiguities surrounding a comprehensive evaluation of dealmaking costs and benefits could be resolved, cities are likely to pay only minimal attention to such rational decision-making tools. First, the complexity that confounds accountability represents a successful match between city objectives and the resources at hand to achieve them. Second, off-budget financing is a political strategy that minimizes the direct costs paid by taxpayers; city officials have little incentive to change—to make costs more obvious—especially when fiscal resources are so tight. The dilemma is that the very success of the system stymies greater financial accountability: the complexity is functional.

To understand why complexity serves a purpose, we need to see how, in response to the financial problems they faced, cities' solutions enhanced the political feasibility of their redevelopment projects. When cities tapped a wide range of sources to cope with the cutbacks in federal aid, the process of aggregating funds made the deals complex because it involved (1) many players with different interests, (2) layering money (some of which had to be made to fit the needs of a project even if this involved a change in project design), and (3) dovetailing funds in ways that, ideally, put both public and private funds at risk simultaneously. By spreading the financial risk among many public agencies and private parties, the complex structure simultaneously created a coalition of vested interests that could help shepherd projects through potential political hurdles.

In response to the need for big subsidies, cities manipulated an extensive inventory of off-budget techniques. This made the deals complex not only because the subsidies were hard to track, but because the terms of the deals were linked in ways that made many of their trade-offs difficult to evaluate. How much was San Diego really giving away, for example, when, in exchange for the developer taking over responsibility for the parking at Horton Plaza, the city permitted the developer to build greater density on the site, when the market demand for space was less than that allowed under as-of-right zoning? Or, looking at it differently, how much was it giving away when the additional density amounted to a conscious gamble on the part of the city that a bigger project might better meet its objectives by drawing more people downtown?

Because cities end up making policy in these ways—through the numbers—public-private deals are complex. Cities are trying to meet multiple objectives within the framework of a deal that must be financially sound as well as politically feasible. They want to make public-purpose projects feasible for private developers while keeping public spending in low profile. They also want to capture public benefits (taxes, jobs, amenities) and financial returns without hobbling a project's chances for economic stability in the early, uncertain years of operation. Most cities do not set out to make public-private deals complex, to obscure costs, or to confound critics. Rather, the deals become complex as cities try to match their many policy goals against the constraints of public financing and the demands of private real estate investment.

The complexity of public-private deals is the main reason why financial accountability will be hard to achieve in the present system. It provides a justification for continued dealmaking, the reasoned claim by city officials being that custom-tailoring assistance is needed to meet the city's many objectives. There is much truth behind this argument. Given the special character of downtown development (or industrial-oriented jobs-based assistance), designing programs that have uniform applicability may well fail to reach targeted needs in the most efficient manner. In addition, the lack of comprehension of complex deals acts as a shield against close scrutiny; what is difficult to understand is more likely to be left alone. With such compelling forces at play, where are the incentives for change?

One source will be pressure from outside interests—good-government groups, such as the Minnesota Citizens League, and affected local governments—counties in the case of tax-increment financing (Report 1984). These groups are calling for more information on the full costs of public-private deals, broad-based analysis (regional and state-wide) of the fiscal impacts of tax-increment financing, and performance monitoring as ways to build in better accountability. In California, counties have used their political power and rights of review in the tax-increment process as levers to bargain for a share of tax increments that would otherwise go to redevelopment agencies. This type of third party intervention has helped make dealmaking more accountable by opening up the decision-making process. More action is needed. As cities increase their activities, dealmaking is becoming more controversial (Scardino 1986; Fox 1985; Sagalyn 1990). Though most deals now are cut behind closed doors, in the future city officials will have to find ways to open up the process and make public-private agreements fair and accountable if they want to preserve the strategic benefits of using negotiated development to shape city development.
Future Directions and the Conflict-of-Interest Question

Cities' responses to the federal aid cutbacks brought the initiative for redevelopment back to local government and, for reasons of preference, it is likely to stay there. Officials like the discretion and autonomy that comes with local dealmaking. When asked how they will fund redevelopment in the future, they recite this list: tax-increment financing, revenue bonds, and revolving UDAG loan funds. Though the Tax Reform Act of 1986 restricts the issuance of tax-exempt bonds for private purposes, many cities are finding ways around these restrictions and others seem confident that, as long as interest rates do not hit double-digit levels, they can continue to finance priority redevelopment projects by issuing taxable bonds. A bigger problem is the disappearance of UDAG appropriations and residual CDBG funds; city dealmakers acknowledge that in the future pulling together sufficient funds will present formidable challenges.

If the scarcity of federal funding pushed cities to be inventive and experiment with new financing strategies, the allure of potential revenue streams without new taxes is pulling some to think of land in a new way—as an enterprise to be managed strategically for public returns. With the growth of investment downtown, big cities, such as Boston, Los Angeles, San Francisco, and New York, which once had to buy developer participation in revitalization projects with deep subsidies now sell development rights on publicly owned parcels for public gain. Building on what they have learned from their earlier deals, these cities are negotiating with developers for a sophisticated package of benefits that includes inflation-protected lease payments, profit-sharing revenues, and public improvements, as well as commitments for job-training programs and minority hiring. Battery Park City in New York is one example of a project in which the financial benefits of land development under the aegis of a public authority are being transferred to the city at large. With several phases of the 92-acre land-fill project complete, the authority is using excess lease revenues from the commercial and residential projects to finance a $1-billion program to build and renovate low- and moderate-income housing.

When cities begin to use land in this way, they are coming full circle to a very early way of doing things. Using the public "estate" for public gain dates back to nineteenth-century New York when city-leased land for neighborhood produce markets was a source of revenue for the municipal treasury (Moehring 1981), and even earlier to pre-Revolutionary times, when disposition of city-owned waterfront lots was used as a means to control and manage development (Hartog 1983). The question then and the question now is, how does the public's financial interest affect land use decisions? Can the city serve as both a partner and a regulator at the same time? If it has a financial stake in a project and stands to earn a share of the profits, will it investigate the project's impact on traffic and neighborhoods with the same care it applies to proposals from other developers?

The potential conflict of interest is great, especially when real estate markets are very strong. So far, cities that have had co-investor relationships with developers seem to have escaped serious trouble, a record that suggests the conflict is more troubling in theory than in practice. Yet the absence of widespread abuse should not lull city officials into thinking that the potential does not exist nor that current arrangements are meeting high standards for accountability and fairness.

The conflict-of-interest question is linked to broad policy issues surrounding the productivity of city development practices. If cities begin to actively manage their publicly owned land as a resource, which agencies and officials will control the new revenues from sale dispositions and leasing arrangements? What processes will shape how decisions over the use of such "found" revenues are made? Will the benefits from managing public real estate assets be linked in some way to city-wide planning priorities? Market-driven financing strategies have been used most frequently for commercial projects because the capacity to generate revenue is far greater for them than for industrial projects or subsidized housing. As a result, downtown has benefited most from the types of projects that could be financed in these new ways. Though this outcome does not represent a zero-sum game, the future challenge for city officials and policy makers will be to consider how these strategies can be applied to housing and extended to neighborhood redevelopment.

AUTHOR'S NOTE

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NOTES

1. This was clearly understood by federal lawmakers. Several times in the late 1950s congressmen debated the issue, though subsequent amendments to urban renewal legislation further liberalized the program's rules, thereby giving cities additional opportunities to pay with in-kind cash contributions (Foard and Fefferman 1960).

2. The 38 projects are part of a larger sample of 75 downtown projects providing information on the role and form of government assistance.

3. TIF has been called the "public tax shelter" by one critic to emphasize that the majority of disputes over redevelopment are really intergovernmental distributional issues (Fulton 1988). The distributional issue is beyond the scope of this article, but it is a critical
one for future researchers. For one such analysis of TIF's use in Wisconsin, see Huddleston 1981, 1986.

4. At first it was not clear whether these loan payments would belong to cities or HUD, and the Reagan administration made continual efforts to recover the funds for the federal treasury. Notwithstanding this early ambiguity, cities quickly adopted the strategy. A study of 373 projects funded in the first four years (1978–81) of the UDAG program in cities with populations over 100,000 found that during the first two years cities used their funds as grants in 48 percent of the projects and required paybacks for 38 percent. In the second two years, grant contributions accounted for only 12 percent as cities' use of paybacks surged, compared to 78 percent for loan paybacks (Clarke and Rich 1985).

5. This estimate is based on Leonard 1986, Tables 6.1 and 6.2. My exclusion of small-issue revenue bonds (which finance a more extensive array of economic development projects beyond parking garages) makes this a conservative estimate.

6. Federal tax policy helped in other ways. In particular, tax incentives for historic preservation gave cities with aging building inventories a competitive edge over the suburbs, especially after tax legislation in 1981 increased the benefits making private rehabilitation projects very attractive investments. Private investors particularly liked commercial renovation projects through syndication offerings, and developers of these projects could easily raise equity money. By designing deals that took advantage of these syndicated tax credits, cities could leverage scarce public resources to attract certain types of projects they wanted for downtown. They might directly capitalize on the availability of these tax credits by arranging to sell and then lease back publicly owned historic buildings.

7. The 40 projects include the 38 referenced earlier in the text plus two projects with profit-sharing arrangements for which there was no direct public assistance.

8. When cities agree to lower the disposition price of land or lease payments in exchange for which the developer provides public parking or constructs public amenities, they are financing public facilities, indirectly. A case in point is Los Angeles' Museum of Contemporary Art, which was built as part of the public benefits package for the California Plaza redevelopment project.

9. Large cities used off-budget strategies most frequently and extensively, according to a national survey of 322 cities (Bowman 1987). While cities of all sizes relied heavily upon tax-exempt borrowing, the use of other off-budget techniques varied with population size. Those cities with populations over 200,000 were more likely to use tax abatement, land leasing, and loan guarantees than smaller cities.

10. In exchange for these terms, the city negotiated for profit-sharing revenues from the hotel, parking garage, and retail shops.

11. To estimate the opportunity cost of the interest subsidy, I assumed that the city's cost of capital was equivalent to the average interest rate on state and local government long-term bonds prevailing at the time the loans were negotiated (1982), 8.8 percent. I also assumed that the loans would be outstanding for their full term with no prepayment. If the developers refinance or sell their projects, thereby repaying the money sooner than the agreements anticipate, the subsidies would be smaller. My estimate is conservative because it assumes payment started at the time the loan was disbursed, whereas in some payback arrangements payments were deferred so as not to burden the project with heavy debt payments in the early start-up years.

12. The same issue surfaces in policy discussions about traditional public authorities that build, finance, and operate transit and other public services. See Walsh 1980.

13. The true cost of private-purpose tax-exempt borrowing is beyond the scope of this article, but a few comments are in order. A key issue is whether and to what extent such borrowing affects a city's credit rating (and thus interest expense) for general obligation bonds that finance traditional capital improvements. The city's implicit obligation to back the bonds is also an issue. Even though a city may not pledge its full-faith taxing power to service tax increment bonds, if a TIF-redevelopment project runs into problems, will the city run the risk of jeopardizing its own credit rating by letting those bonds go into default? Probably not. Yet how are city councillors and taxpayers to judge the nature of these nonbinding but potential liabilities? See Citizens League 1985 and Sabbatini 1978 for a presentation of arguments by proponents and opponents of TIF, and Peterson 1979 for an empirical economic analysis of the capital-market impacts of tax-exempt borrowing.

14. For an excellent prototype study covering one particular type of value-creating subsidy, incentive zoning bonuses, see Kayden 1978.

15. This issue demands a separate and careful analysis beyond the scope of this article. Instances like the disposition of the Coliseum site in which the city of New York structured the bidding and selection of the developer to get top-dollar for the land represent obvious examples of city policy run amok (see Frieden and Sagalyn 1989, 222–27, 252–57; Lasser 1990). Other situations are far less clear. Because cities' chief concerns in negotiating public-private projects are typically political rather than financial, city officials try to maximize the total package of public benefits—for instance, they strive to include design amenities, jobs for local residents, and affirmative action programs in addition to financial re-
turns. Financial interests like profit-sharing arrangements are just one of many bargaining chips.

REFERENCES


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*These references, though not cited directly in text, have important general relevance to the issues discussed.

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