

DOWNTOWN PRE-DEVELOPMENT ASSISTANCE PROPOSAL

July 23, 2020

Introduction

The DMC currently offers several financial incentives to catalyze Downtown property development. Although the details vary, each program offers property owners or tenants a financial benefit following the completion of permanent property improvements. In order to apply for these incentives, the applicant needs to already have a complete development plan, which might include an itemized budget, architectural plans, a development pro forma, or all of the above.

Although DMC staff frequently meets with property owners and developers who have yet to determine their development plans, staff assistance at this stage is usually limited to providing information about the downtown real estate market, and discussing incentives that could be available once a final concept is settled upon. A robust pre-development assistance strategy would change this dynamic, and give the DMC additional tools to spur projects forward. In addition to accelerating the path to development, pre-development tools could help grow the ecosystem of downtown developers, by providing financial support at an earlier stage in the development process than traditional development incentives.

Defining “Pre-Development”

For the purpose of this paper’s proposed assistance strategies, we can define “pre-development” as the period in which a property’s owner (either current or prospective) examines possible development options, with the goal of settling on a financially viable development plan. In the pre-development process, a prospective developer is looking to answer fundamental questions about the property they plan to develop:

- What is the potential demand for different real estate products in the immediate market?
- What uses can an existing building or site physically accommodate?
- How much will it cost to develop the property?
- What will the developed property’s rate of return be? Will it justify the cost?
- What are the risks associated with a development plan?
- What incentives or other tools are available to fill any gaps in financing?

Answering these questions can be difficult, and many prospective developers need professional assistance – from development consultants, architects, or engineers – to do so. This means that pre-development comes with a price tag, which can be intimidating for potential developers. Risk-averse property owners, for example, may be hesitant to spend time and money that may not result in an immediate return, and simply choose to put it off in favor of holding the property for sale or development at some point in the future. A pre-development assistance program would allow the DMC to take on some of this risk, in order to jump-start the development of key downtown properties.

Who Are We Helping?

Before outlining the kind of pre-development assistance the DMC might offer, it’s important to define who pre-development assistance is meant to help. One way to look at this question is to group prospective developers into two categories: **project-first** and **property-first**.

- **Project-First Developers**

A project-first developer already knows *what* they want to build – they just don't know *where* they want to build it. An example could be a developer who specializes in apartment construction who already has specific requirements for site size, existing utilities, and area demographics in mind, and is simply looking for a site that meets them. Other examples could include a grocery store chain, or a company looking to relocate its headquarters. In each case, project-first developers are trying to match a site or building to a known project type with relatively fixed attributes.

- **Property-First Developers**

In contrast to project-first developers, property-first developers have already acquired a specific property, or have plans to acquire one, but do not yet have a final concept for what the property would be used for. The developer may have purchased a historic property due to its valuable architectural character, or they may own a property that has belonged to their family for generations. In other cases, a property may have been purchased speculatively – possibly to develop, but perhaps to sell at a later date as market conditions change. Regardless of how the property ended up in the owner's hands, the essential problem for this group of owners is finding a development concept that fits a specific property, rather than the other way around.

This paper will focus on pre-development assistance for property-first developers – people who already have a specific property to bring to the table. This doesn't mean that the DMC can't help project-first developers select sites for development, or even provide assistance for property acquisition in special cases. However, the problem of site selection and acquisition should be thought of as a distinct issue, with its own unique challenges and benefits.

One of the biggest hurdles a formal assistance program for site selection and acquisition would face would be the difficulty of judging between potential owners to avoid placing more land in the hands of speculators. Although some current owners may not have the long-term best interests of Downtown in mind, at the bare minimum they are CBID assessment payers who have already made a tangible investment in Downtown. And unless the property is potentially subject to anti-blight litigation, the DMC has few options and should strive to collaborate with the existing owner in order to make progress on its development.

As with the other incentives in the DMC's toolkit, pre-development assistance should be prioritized for properties that lie within the DMC's geographic areas of focus. These areas should include the Downtown Core, the Retail Nodes identified in the recent Retail Action Plan, and the Signature Streets identified by the BuildDowntown Master Plan. Priority should also be given to historic properties, which are both a general priority of the DMC, and the properties where pre-development work is often the most challenging.

Potential Pre-Development Assistance Strategies

There are two overarching strategies that could be employed to deliver pre-development assistance to Downtown property owners:

1. **DMC-Developer Collaboration**

This strategy requires the greatest amount of staff involvement and expense, with the potential for greater rewards for key properties. DMC staff would directly partner with a property owner and hire any necessary outside consultants. The DMC would be the direct client of the consultants, shoulder a significant amount of the expense, and have a greater opportunity for input throughout the process. This approach is proactive and staff-driven – DMC staff would directly initiate the process, rather than waiting for a property owner to apply for an incentive.

2. Pre-Development Assistance Grant

This strategy is the most similar to a traditional incentive program. The DMC would offer a grant up to a defined maximum that an applicant could use to fund eligible predevelopment activities (outlined in the following section). The grant program would be initially funded at a set annual amount for two years, with the option to extend the program and adjust the annual funding amount if necessary.

Of these two strategies, the Pre-Development Assistance Grant option is the most suited to adoption as a formal program. A recommended pre-development grant program is outlined at the end of the paper. The DMC-Developer Collaboration strategy should be considered when progress on a strategically important property may not otherwise occur.

Eligible Pre-Development Activities

There are several distinct activities that could be eligible for funding by a pre-development assistance program. Every project's needs are unique, so the required pre-development activities will not always be the same. Some of these activities can be carried out by DMC staff, but many others will require the expenditure of funds on outside professionals. Below are some key pre-development activities that could be eligible for DMC funding:

- **Market Information**
Information about the local real estate market is the foundation of any development plan. This includes information on average rents and occupancy for different real estate products, other projects in the development pipeline, and local trends that could impact the viability of different development options. Most of this information can be readily produced by DMC staff, making it a low-cost addition to any pre-development assistance package.
- **Financial Modeling**
Real estate financial models are perhaps the single most important product of the pre-development process. Models can compare the financial feasibility of different development scenarios, allowing the property owner to discover a realistic path forward. In many cases, a development consultant or another professional with expertise in real estate finance will need to be hired to produce financial models, making this a primary area where pre-development assistance funds would be spent.
- **Design Assistance**
Design choices can be integral to the financial viability of a project. Historic buildings may require special treatment that could limit options for development or alter the cost. A challenging infill site may need an equally innovative design to make development possible. Although not every project will need the services of an architect in the pre-development stage, architectural design assistance will be key for many properties.
- **Structural and Site Assessment**
Some vacant properties can hide significant hidden costs, ranging from structural defects to issues with site drainage. In these cases, the services of an engineer may be needed in order to fully assess development options.

Funding

This paper suggests initially funding a formal pre-development assistance grant program at the following amount:

- \$5,000 per project
- Limit of \$50,000 annually (maximum of 10 projects per year)

- Program expires in two years, but the board will have the option to evaluate and renew (with or without changes in funding) after the initial period is over.

No fixed amount of funding is suggested for pre-development projects pursued under the more flexible DMC-Developer Collaboration option. Each project should be evaluated individually, with a funding cap decided early on in the process based on the availability of funds and the strategic importance of the property.

Benefits & Risks

The *best* outcome for a project that receives pre-development assistance is the completion of an actual development project – possibly with later assistance from a permanent development incentive. However, given the uncertainties involved in the development process, it is likely that some owners may receive pre-development assistance, and still choose not to develop their property. Unlike the DMC's other incentive programs, where money is only disbursed following the completion of a project, a pre-development incentive would carry a higher risk of money being spent without any visible result in the near term.

However, this risk is defrayed by several additional benefits that would result from the program:

Strengthening Relationships

The DMC operates based on an assessment paid by commercial property owners. Commercial property owners are the DMC's core constituency -- its continued effectiveness depends on commercial property owners perceiving the DMC as a valuable service provider, rather than an additional cost of doing business. Pre-development assistance would fill a role that no current incentive plays, and could allow the DMC to assist property owners who might otherwise not be able to apply for a traditional development incentive. The program would be a new positive point of contact between DMC staff and property owners, which could build trust, increase the flow of useful information between parties, and increase cooperation in the future.

Building a Base of Knowledge

The DMC stewards an area with fixed boundaries, and a relatively fixed number of properties. Many vacant properties are perennial issues, changing hands and development concepts many times before any real progress is made. And although not every piece of information resulting from pre-development assistance will be evergreen (inputs like rents and construction costs, for example, will become outdated), most of it could prove valuable in the future. DMC staff will better understand the challenges facing particular properties, and the gaps that may need to be filled to make development viable – even if this project is ultimately undertaken by a different owner.

More Realistic Property Valuation

There are many reasons why a property owner may sit on an undeveloped property, instead of choosing to actively market it for sale, or develop it. Often, these reasons are linked to a poor understanding of a property's true value. Some owners have an unrealistically low view of their property's value – they may think of it as having little commercial value at the present time, so they choose to simply pay the minimum amount of property tax until the market is ripe. Other owners have inflated expectations for their properties, demanding prices that outstrip any return that could be made on developing the property. Pre-development work would provide an owner with a much more realistic idea of a property's potential. Even if the immediate owner proves unwilling to develop, this information may help them set a more realistic sale price.

Why Now?

The last few years have seen an unprecedented uptick in Downtown property development, driven by a strong local and national economy, growing interest in Downtown, and proactive efforts on the part of DMC staff to fight

blight and market incentives. The DMC's existing incentive toolkit, which focuses on shovel-ready development projects, has been highly effective in this climate. Unfortunately, in recent months, economic uncertainty has upended previous expectations about continued growth.

A more challenging development environment means fewer eager property owners with shovel-ready projects, and an uphill battle for DMC staff attempting to encourage investment. Property owners may be more inclined to take a wait-and-see stance toward investing in their property, and even aggressive outreach regarding permanent development incentives could do little to change their mind. Pre-development assistance will not be a silver bullet, but in some cases, it may be the only tangible option available to build momentum around a property's development.

This doesn't mean that pre-development assistance will lose its usefulness if the market returns to full health. In a cold development climate, pre-development assistance may be the best option to make incremental progress on key properties. But in a hot market, pre-development assistance could be the extra nudge needed to "unstick" the few stubborn properties that hold neighborhoods back, and to assist the entry of emerging developers into the market. We may not know exactly what the future holds, but pre-development assistance is a flexible tool that can play a key role in moving Downtown development forward, regardless of how the market changes.