Public-Private Partnerships.

"Cities are organisms. They either evolve or they die. They cannot stand pat." *William H. Hudnut, Urban Land Institute.*

Ft. Norfolk's first new building is Harbor's Edge, a privately constructed building.

The vision for Ft. Norfolk (drawings above) will guide private development. Below a rendering of a proposed full service hotel, conference center and garage on main street.

Economic development is a tool used to enhance the economic stability of the community and thereby improve the service to and the quality of life for our citizens… That's the long version.

The short version? **a means to an end** … with the "end" being new business, more jobs or more job choices, and more money to use to meet other City needs.

While most people agree on the end, what is often disputed, be it a project in Norfolk, Virginia Beach or Detroit, is the means, particularly if it involves some form of incentive to a private developer or business.

In Norfolk, the City seeks to guide development through a series of long-range plans. For example, 30 years ago, a public/private partnership built Military Circle Mall, sparking development along Military Highway that continues to this day.

Sometimes, the City has waited for years for the right project to come along. Visitors to the City in the 1980s walked across blocks of surface parking lots where MacArthur Retail Center now stands. The parking lots held the space open as the City pursued developers, assembled land and rejected proposals that would have developed the site piece-meal. Finally City leaders interested an upscale retail developer.

But, to close the deal, the City agreed to construct two much needed parking garages (revenue bonds to be paid off by parkers), streetscaping and utilities, and secured a $33 million bank loan to construct and equip the Nordstrom anchor store (the loan is being paid off by rent and revenues).

The City total? Approximately $90 million. The private contribution? $200 million from the developer for construction of the mall. Today, not only does MacArthur Center draw 12 million shoppers a year, the construction spawned a development boom in new office buildings, retail, condos, restaurants and theaters.

Similar "placeholder" spots are identified in the City's long-range plans for sites throughout Norfolk – parking lots, outdated City buildings, cleared land, struggling neighborhoods – in key strategic places waiting for the right time or the right project to come along.

The result of City seed money (infrastructure or other funding) in each case brings new private investment and new jobs, new money for other City priorities and neighborhoods and new businesses and residential opportunities, even residential tax reduction -- just the "end" city leaders and residents had in mind. In 2005 development officials estimated more than $5 billion in private development in the past five years.

Ironically, as the City has seen increasing success attracting private investments, residents increasingly ask – "Why?" whenever the City finds it necessary to enter into a new partnership with a private developer.

Why give the money at all? If it's a good project, won't it be built anyway?

Many buildings are constructed with little or no City investment. But, developers in Norfolk face many challenges. First, is the reality of a 66 square mile City that cannot legally expand its borders. Most of its land has been developed, torn down (and in 1776 burned down) and redeveloped many times.

According to Development Director Rod Woolard, building in an already developed area is more expensive and more difficult than building on vacant land, particularly downtown.

For instance, small, odd sized lots mean a developer has to construct a concrete, multi-story building with the added code requirements (such as high-speed elevators) than a wood framed three-or-four story building the same size along a highway in the suburbs, said Woolard.

Add to that, the City's desire to implement its plans. In key areas, Norfolk officials have sought to find the highest and best use for a location. While developers are increasingly willing to spend their own money, it is the specificity of the City's expectations for a particular location that often drives the need, and its willingness, to enter into public-private partnership through something like a Performance-based Grant or other incentive.

What is a performance-based grant?

"It's called a grant, but we don't just hand over cash or a check," says Woolard. For one thing, in the case of a Performance-based Grant, the money isn't appropriated until up to 18 months after the City has realized new revenue from the specific project receiving the grant. "The grant is paid in arrears," says Woolard. Grant payment is appropriated in the budget year following realization of new revenue.

Performance-based grants, or other forms of City incentives to the private sector, most often raise questions from citizens, admits Woolard. But, in the cases in which the City enters into the relationship, it has determined the incentive is the only way to get what the City needs.

Norfolk has a lot of company across the country, and increasingly the world, when it comes to financial incentives. According to economists Alan Peters and Peter Fisher in a *Journal of the American Planning Association*, state and local governments offer some $50 billion a year in tax breaks and other economic incentives. And the incentives generate controversy because of the "fundamental yet unresolved question: Are they a cost-effective strategy for achieving economic growth?" write Peters and Fisher.

But, Norfolk was one of the first, and is still one of the few, cities that structures its Performance-based Grants in a way that protects the City from taking any risk at all, says Woolard.

The Performance-based Grant approach used by Norfolk "is more responsible" than many of those crafted by many other localities because the risk – should the project fail to materialize or under-perform – is carried by the developer and, ultimately, the lender. Not the City, according to Woolard.

"If you enter into an agreement with a developer or business and give them money up front (as is done in many cities), you can have all the provisions in the contract that if the developer or owner doesn't meet those standards, they have to pay us back," said Woolard.

But, the reality of the way most development is structured means that in the case of a company failing to perform or going bankrupt, the likelihood of a government recovering the money "is slim to none," he said.

continued on the next page

Performance based grants mean the project has to perform (increase City revenues) before developers get the money.

The Belmont at Freemason will have 241 luxury apartments and a 510 space garage. It is Norfolk's first transit-oriented development.

The City sold land to a private developer for construction of a much-needed Residence Inn. Although some questioned the land sale, Director Rod Woolard said the unusually restricted lot, and the cost of high rise construction — all privately funded — went into the City's decision.

Even if the project is completed, but falls short of expectations, any attempt to recover money given up front can be difficult.

In Norfolk, the grant is payable **after** new revenue from the project has been collected by the City. In addition, most grants have an annual cap and all have an overall cap – meaning that an underperforming project in the first few years will not be able to recoup the entire grant amount in the final year.

SAMPLE GRANT PAYOUT *

YEAR	NEW REVENUE	SHARING RATIO	GRANT
1	$150,000	25%	$37,500
2	$153,000	25%	$38,250
3	$156,060	25%	$39,015
4	$159,181	25%	$39,795

** The first four years of 10 year grant agreement for a hypothetical project with $10 million in private (non-city) investment and a grant amount equivalent to 25 percent of new revenue earned by City. The developer cannot receive more than $350,000 in this example. If new revenue is below expectations, the developer may receive much less.*

Who gets a grant?

A project must meet the following criteria (as determined by detailed analysis):

- Represents a significant capital investment by the owner/developer
- Be a significant job generator
- Be a catalyst for future development
- Cannot succeed in the beginning without assistance
- Must have long-term viability without continued City assistance

According to Woolard, when a developer finally understands that the grant payout is based on the incremental increase in value – and in most cases after the project has been completed – the projections and other performance calculations supplied by the developer tend to be much more realistic.

As part of the agreement, the developer agrees to give the City access to business records that would otherwise be private, so the City can track the project.

In 10 years, downtown real estate assessments grew 158% - to $1.3 billion dollars, thanks to companies such as Dominion Enterprises, which constructed a 20-story headquarters building on what was a surface parking lot.

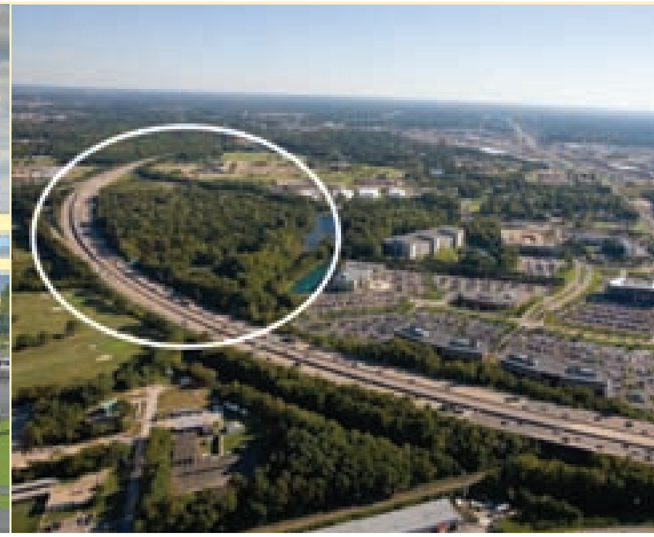
How is the grant calculated?

The City calculates how much the finished project will bring in new real estate valuation or business personal property. The City gets at least $2 in new revenue for every $1 in grant funding. Getting the formula right is a bit like walking a tightrope:

First, how much is needed? "We really try not to give them," says Woolard of the grants. If the grant is needed, what is the right incentive to make the maximum use of scarce land and fulfill a key objective. AND protects the City's interest if something goes wrong.

The City works either through Norfolk Redevelopment and Housing Authority or the Economic Development Authority (which are both authorized to issue revenue bonds and grants).

The rising cost of construction, economic conditions, or other factors can result in partnerships that are structured differently. But, the principles are the same: Do the minimum of what has to be done to get the development the City needs; and protect the City if the project isn't built. Two recent examples:



Adjacent to Norfolk International Airport, the Commander Corporate Center (above, left) will include the world headquarters of Blackhawk Products Group and much-needed "Class A" office space. Also, the City and Economic Development Authority are completing a master plan for Lake Wright East Office Park (circled area, right).

1. *Conference Center/first-class hotel/parking garage* – Several years ago, the City determined it was losing convention business to competing cities. It established a $1 per night tax on hotel rooms as a down payment on funding a new convention center. After studying the market, the City determined the market was saturated with full-sized convention centers. Norfolk could better pair a new conference center and first class hotel with the existing Marriott Hotel and Waterside Conference Center. The best location was determined to be across the street from the existing Conference Center, and the City began to assemble land. *This portion of the project would be funded and owned by the City.*

**Conference Center* – Research collected by the City showed that "convention or conference facilities do not generate operating revenues sufficient to cover their debt service," said Woolard. "The place where you make your money is from taxes generated from room nights" when the meeting attracts out-of-area attendees. The City wanted a developer who could build a first-class hotel, and operate and maintain the meeting facilities.

**Hotel* – The majority of funding for the hotel would be private, with the City providing $7.5 million. Because the money will be used for construction of the hotel (based on anticipated future revenues), the developer is required to obtain an irrevocable letter of credit from a bank for the City share of the project. If the hotel is not built, the City "goes to the bank and gets its money back," says Woolard.

**Parking Garage* – Unprecedented residential and business construction downtown (including the privately funded 20-story Dominion Enterprises Building) has added to parking demand. The City's parking system is a "stand alone" business and must pay its debts from the revenues it generates. 120 spaces in the garage will be made available for a charge to the hotel, the rest of the approximately 480 spaces "will allow us to meet the demand of this densely developed area of our downtown," said Woolard.

2. *High-rise condominium development downtown* – One of Norfolk's long-term goals, considered essential for the continued viability of downtown and economic health of the city, is for a solid residential base within the confines of the business district. With this residential base comes new services such as a supermarket, restaurants, entertainment and jobs that can be enjoyed by all residents. Because space is so limited downtown, most residential development is multi-storied.

When a planned high-rise condominium was delayed by the federal government wanting land for a courthouse annex (using this site was something the City strongly opposed), rising construction costs and a now slowing housing market threatened the project.

The City agreed to a $22 million grant to be used to pay off a portion of a privately obtained construction loan. Again, to protect the City, "the money will not be paid until the project is complete," says Woolard.