THE FUTURE FINANCING AND DEVELOPMENT OF CITIES

A new report sheds insight on financing throughout California and cities in the Bay Area.

By Dr. Graham Squires

Squires researched and wrote a report for RICS on "The Future Financing of Real Estate Development in Cities," using the San Francisco Bay Area as a case study. This report was completed while Squires was visiting the University of California at Berkeley on a Fulbright-RICS (Royal Institution of Chartered Surveyors) Scholarship.

The research, which utilized an institutional approach where a range of stakeholders were interviewed, critically analyzed how the financing of cities was connected with real estate development. The research particularly focused on how the financial mechanisms in place were incentivizing certain organizations to produce development 'good practice' and lesson-learning outcomes for other global cities.

The Bay Area was selected as a region that has been successful in integrating cross-sector institutional support using innovative mechanisms. This area has also managed to bring an innovative approach to financing affordable housing, particularly where city administrations competitively and collaboratively dealt with both high demand and a stagnant property market.

Cities in the San Francisco Bay Area face a number of future financing challenges, particularly those that demonstrate rather complex real estate financing across different institutional financial structures that are often not mutually exclusive or uniform. In reality, financial structures occur in overlapping governance levels, and often are organized in partnerships that blend many interests. Multiple sectors and their respective stakeholders need flexible financial arrangements that consider different time aspects for completion and phasing at site scale. At the federal level, influence on city finance does much to determine the size of grants, but these often follow a specific federal program or have federally incentivized finance for real estate development. At the state level, there are new opportunities with state-driven real estate transaction fees, and a continuation of finance activity that engages with different functions (i.e. education, health, security and housing) for state-controlled districts. The state also encourages regional funds that involve institutions on environmental and transport concerns.

City administrations are beginning to have more financial and regulatory control over real estate projects, but ultimately depend on the resource base strength of the administrative boundary. Coordinated planning strength and master-planning capabilities are encouraging financial integration where institutions previously worked more in isolation. This multi-level financial base has some semblance of coordination via committees of interested stakeholders that have little formal powers but vast influence. Partnerships also generate a form of coordination as the formation of multiple-institutional vehicles can ensure that more interests are engaged - from financial institutions to communities that have an economic stake and voting right in the real estate projects that affect them.

Those involved in financing real estate development for Bay Area cities can learn from multiple sectors at four key overlapping tiers. At the first tier, public federal finance is provided and devolved to the city and sub-city scale via government programs like the Low Income Housing Tax Credit system (LIHTC or incentivized by commercial lending with the Community Reinvestment Act in the affordable housing sector.

At the second tier, we can learn from those elements that involve bonds and grants executed at the city level. Major instruments used in California include Infrastructure Financing Districts and Community Facilities Districts that operate as value-capture instruments — albeit less focused on blight than the now-disbanded Tax Increment Finance districts had previously been. At a regional level, cities can learn from mechanisms like the state-led regional priority development area grants that have been selected to encourage transit-oriented developments situated at key transportation hubs.

Lessons to learn at the third tier of financing involve city-level tax extractions and exactions. City financing from tax extraction occurs through instruments like special property taxes (i.e. Proposition 13), and with respect for affordable housing via inclusionary housing unit fees and levies, or inclusionary zones that encourage cross-subsidization within one or more sites. Exactions to learn from in this third tier include the use of impact fees on developers that contribute to external public costs that occur during the development stage, often in the form of Community Benefit Agreements that pay on the benefit principle. The fourth tier involves multi-institutional donations by both philanthropic and private syndicates. The REIT model can provide multi-institutional economies of scale for projects that no one individual organization could finance. Philanthropic contributions from several charitable trusts can also provide gap financing and seed-corn money to accomplish mission-based projects.

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There are many things cities in the Bay Area are doing right in this arena, but of course there is always room for improvement to overcome remaining challenges. The complexity and large scale of real estate development for cities in the Bay Area means finance partnership arrangements must be flexible. This is especially true if they are to withstand any cyclical changes and mitigate risk. Bonds over the longer term of, say, 20 years, are one way to provide some stability, as long as the project considers all aspects of the property market and failures in the market.

Public goods and services as a result of the development need to be paid for and, as such, the bonding approach needs to be progressive. This was the mission of the previous Bay Area redevelopment agencies. Financial consolidation and consortiums across the region that have formed to gain the benefits of financial economies of scale can now draw strength as the wider market improves. This flexibility in institutional approaches to finance can be harnessed by all real estate development sectors in all cities across the Bay Area — ideally using a cross-sector approach. Transportation hubs provide a platform for this cross-sector finance of real estate development, and are one approach that is gaining momentum by cities in the Bay Area as part of a multi-stakeholder industry that has been evolving financially over many decades.

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