

City of Kansas City, Missouri
Sustainable Economic Development.
Executive Summary

INTRODUCTION

Kansas City is on the move. Over the past decade, the City of Kansas City and its partners have invested hundreds of millions of dollars in all areas of the community, bringing significant residential growth north of the river, signature developments to downtown and a renaissance of smaller-scale developments throughout the community. Kansas City has regained its luster and its attractiveness is reflected in the influx of new urban dwellers, businesses, offices, restaurants and other amenities.

With growth and revitalization come increased expectations and new costs. As Kansas City has become more aggressive in providing incentives for new development, there are greater expectations that those incentives will continue and be provided to more and more projects in the future. At the same time, as Kansas City has added new infrastructure, new population centers and new attractions to visitors, its operating and maintenance costs have grown to support these additions.

The challenge for the City in coming years is to design an approach that promotes sustainable economic development. Sustainability enables the City to continue to invest in growth and development without sacrificing the investments already made or services provided to existing communities.

Addressing this challenge is extremely important to the City's future. Two key themes are clear from the many discussions the consulting team had with members of Council, City and agency staffs, developers and those involved in the development process:

- When the City invests in a project, it needs to provide a positive financial return to the City.
- Economic development is essential to the City's future and the City needs to be able to continue investing in new projects by receiving such positive financial returns.

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SUSTAINABILITY IN ACTION

Building a sustainable economic development program is challenging. The City will likely need to continue to invest in projects that might not

otherwise occur if left to market decisions alone, especially in economically distressed neighborhoods. The City may also choose to invest in high priority and "once in a lifetime" economic development efforts, for example developments around Kansas City International Airport, intermodal commerce at Richards-Gebauer and investments in its economically disadvantaged neighborhoods. At the same time, the City lives with the constant presence of the Hancock Amendment's limitation on revenue growth, the challenge of serving the entirety of its 300plus square mile land area and the needs of its vibrant, diverse population.

In order to ensure that future economic development will be sustainable, the City's Finance Department engaged a team comprised of three financial advisory, financial modeling and consulting firms to analyze, comment on and make recommendations regarding the City's economic development process and program from the perspective of sustainable development. The purpose of the firms' study is multifold:

- 1) To evaluate Kansas City's approach to making economic development investments for new projects;
- 2) To compare and contrast Kansas City's approach to best-practices from around the country;
- 3) To create a detailed fiscal impact model to help the City evaluate incentive policies and assess the consequences of new economic development proposals;
- 4) To help the City create an economic development policy framework and investment criteria to prioritize requests for financial assistance and public investment in proposed new economic development projects; and
- 5) To develop a set of "sustainable investment criteria," which will allow the City to continue to invest in projects which will generate economic development returns, but will also protect the City's General Fund and overall financial condition. In this way the City can sustain its ability to deliver quality municipal services to the entire community.
- 6) To recommend approaches that: protect the City financially; maintain the City's ability to encourage economic development; to provide quality services city-wide; and to avoid creating additional burdens on existing taxpayers.

APPROACH TO THE ANALYSIS

The Consultant Team approached the City's economic development process and program from a variety of perspectives, including: reviewing projects already completed, underway, just beginning and on the drawing board; touring the community to understand the types of investments being made; interviewing dozens of participants in the process (City staff, City elected officials, economic development agencies, bankers, development lawyers, and a host of others); reviewing City financial documents, project pro formas and prior bond transactions; analyzing particular statutory constraints; and drawing upon the firms' work with other communities in Missouri, the Kansas City metropolitan area and around the country.

Over the course of the study, the Team produced several work products to assist the City in moving forward toward a sustainable economic development strategy: a comprehensive set of findings and recommendations, presented in this Executive Summary; a new fiscal impact model, allowing the analysis of sustainability at both micro (project) and macro (citywide) levels; and, a series of briefings for the Mayor and City Council. Completing this effort is a set of public investment criteria or guiding principles to help the City sustain economic development while maintaining financial health.

The written analysis of the firms is presented in seven briefs plus the investment criteria, which follow this Executive Summary:

- Investment Sustainability
- Breadth and Depth of Public Investment Targeting Incentives
- Financial Guarantees by the City
- Streamlining the Economic Development Process
- Linking Planning and Financing Approvals
- Technical Brief. Findings from the Fiscal Model
- Policy Framework: Investment Criteria

FINDINGS

While Kansas City is doing many things right, there are a number of recommended policy refinements which can improve overall sustainability. Many of our findings reflect the consequences for the City of the investments it has already made, the impacts those investments have had, the changes in the City's development market, and the choices the City now has for the future. The findings of the firms' analysis are summarized below:

Fiscal Condition and Impact

- Importance of Commercially-Driven Revenues. The City's budget relies heavily on tax revenues generated by commercial development. Approximately \$340 million, or 70 percent, of the City's annual tax revenues are sales taxes and earnings taxes paid by commercial land uses. These revenues are in addition to property taxes, utility taxes and other fees and charges paid by both commercial and residential development. Revenues from commercial development are essential to the General Fund which pays for the costs of general City services for its residents and to the Capital Improvements Fund which supports and maintains the miles of City infrastructure.

Revenues generated and captured by future commercial development are essential for maintaining and improving services to businesses and to City residents. Assuming a mix of 1,300 new residential units and approximately 700,000 square feet of new commercial space—a level of development representing the average growth rate based on regional forecasts—new development produces a benefit of \$1.5 million (before accounting for tax abatement or redirection).

Expenditures for new residential services each year exceed residential tax revenues by approximately \$500,000.

Conversely, new commercial development produces positive annual fiscal benefits totaling more than \$2.0 million, partially due to expenditures by residents at retail establishments. The net impact of new development would be \$900,000 after funding services, but before tax abatement or redirection.

Fiscal Impacts of Development Vary Significantly. Fiscal impacts are dependent on the specific type, location and other characteristics of residential and commercial land uses. Residential development significantly increases demands for services and generates relatively little revenue. These impacts will vary depending on sales prices and assessed values, demographics of the household, and service and infrastructure capacity and needs in the development area. Commercial development generates property taxes, sales taxes, earning taxes, franchise fees and other important revenues. As a result, commercial development is an essential component to the fiscal health of a community, as part of a balanced mix that includes residential development to provide a necessary labor force and customer base.

Not All Development Produces Net New Revenues for the City. If a new business competes directly with existing businesses, or if growth in demand from new residential (or visitor-serving) development is insufficient, sales recorded at the new business may simply represent a shift of sales from existing businesses. Likewise, a commercial project may move jobs and

revenues from one part of the city to another, without producing a net increase in either.

City Investments are Not Free. The redirection or abatement of incremental taxes to facilitate new development reduces the fiscal benefits of new commercial development, and worsens residential-related fiscal impacts. The redirection or abatement of taxes to new residential and commercial development could result in annual shortfalls of \$700,000, assuming historical average uses of these tools by the City', rather than an annual benefit of \$900,000 using the assumption of the fiscal model created as part of this study. The cumulative shortfalls would grow to over \$3.5 million after five years of continued new development.

- Range of Incentives. Through Missouri law and its own ordinances and practices, the City makes available a large array of economic development incentive programs. Individual projects often seek multiple incentives, creating a layering effect that dramatically reduces the fiscal benefit of the project to the City.

Strategy

- No Comprehensive Economic Development Strategy. If it was mentioned at all, most participants in the economic development process acknowledged that the FOCUS plan no longer carried any weight in the City or with its partners. Without FOCUS or a similar plan, there is no coherent, comprehensive strategy to promote economic development in the community. The City has reacted to proposals from outside, but has not provided clear and consistent guidance on what types of development it seeks, where in the community it wants that development to occur and to what level it is willing to invest to make that development happen.

- Incentives are Provided to a Wide Range of Projects. Because of the size and diversity of the community, the City and its partner agencies have awarded incentives to a wide array of project types: urban core redevelopment; suburban residential development; urban destination development; suburban retail and commercial; downtown condominiums; and, core neighborhood housing development. The impacts and fiscal benefits of this array of project types vary dramatically. The City's use of incentives for non-residential projects, however, does not appear to make any distinction among these land use types.

- Not All Development is Created Equal. The City's existing economic development practices essentially treat all projects as being equal. The fiscal

impact of these projects varies dramatically among types and locations in the community.

- Not All Development is Good for the City. The City benefits significantly from projects that generate significant earnings tax revenues and sales tax revenues for the City. Projects that require the capture of all of these potential new revenues likely create a net negative fiscal benefit to the City. Except in unique instances, these deals might be better left for another community to make.

- . Competing ...Against Itself. Kansas City allows for a level of incentives inconsistent with other communities in the metropolitan area and with comparable communities around the country. Development occurs in Lee's Summit and Overland Park and other areas of the metro with much smaller, less costly and more targeted incentives. And while the City does clearly compete with Kansas for business, the tools and incentives it has available to it exceed those available on the west side of the state line and may, therefore, exceed what is necessary to attract the project.

Process

Fragmented Decision Making. There are a dozen or more "portals" by which a project can enter the economic development incentive system in Kansas City. Different council committees review different components of economic development projects carrying incentives. Each portal has a different process, a different standard of review and a different approach to economic development. Fragmentation creates a situation where the City cannot comprehensively review all financial aspects of a project and allows a project's sponsors to diminish the role of the public decisionmaking process.

Incentive-Creep. As the result of a fragmented system and the expectations of the development community surrounding economic development, the incentives initially requested for a project are often expanded and extended incrementally over the course of financing. Oftentimes, this expansion of incentive does not subject the project to a completely new review of its cost-benefit viability, importance and community benefit.

Inadequate Council Review. Many city councilmembers expressed a level of frustration about the quality and timeliness of information they are provided about economic development projects and acknowledged that, by the time the project gets on the agenda for action by the full city council, they feel they have no power to slow it down, ask critical questions, modify it or stop it.

Lack of Consistent Message from City Staff. Although ties between the departments have improved considerably in recent years, projects seeking incentives may proceed to the council for its action even though one or more City departments disagrees with or would like substantial changes to the development and financing package.

Sustainability

- **Victim of its Own Success.** In many ways the City's success in retaining and attracting new businesses, constructing large-scale projects and growing its population base (especially in the Northland) has created an environment where every developer has an expectation that its project will receive public incentives. Rather than being viewed as a mechanism to correct a market failure, incentives are seen as an entitlement that should be granted in each and every case.

- **Jury is Still Out.** Much of the City's significant investment in economic development in recent years has not yet begun to provide returns. Many projects are just completed or are in the midst of multi-year construction phases. It will be at least another five to seven years before the City is able to assess the rate of return on some of these investments, especially in the signature projects begun this decade.

- **Uncompensated Risk.** In addition to granting or redirecting captured incremental tax revenues generated back to the developer or the project, the City has pledged its General Fund guarantee to a number of economic development projects. Three-fifths of the outstanding debt liability associated with these transactions accrues interest on a variable basis, without any hedging of interest rate risk. Additionally, many of the projects financed with City-backed economic development bonds have marginal or no debt service coverage, meaning the margin for error is quite small or non-existent. Without net benefit generated by incremental taxes, the risk the City assumes by attaching its credit to the bonds is significant and uncompensated.

RECOMMENDATIONS

Based upon the findings of its analysis activities, the firms recommend a number of steps for the City to consider in maintaining a path toward sustainability.

Strategy

- Develop a clear, specific Economic Development Plan and policy framework outlining priorities for where and what types of economic development will be encouraged through City incentives
 - As a component of this strategy, establish a policy that provides more significant incentives for the first development in an area, lower incentives for later projects and no incentives at all after the development area reaches "market investment conditions"

- . Develop a more rigorous "but-for" standard so that incentives are only provided to development that would otherwise not occur and only those incentives necessary to make it occur

Tailor available economic development incentives by land use classification based on the priorities of the Economic Development Plan, and market and financial analysis of required amounts by land use

Alter the funding of EDC and other partner agencies to assure that their interests are aligned with those of the City by funding them directly, rather than through a fee paid on completed economic development transactions. (Fees would be paid, instead, directly to the City.)

Process

All projects requesting any type of incentive (TIF, abatement, City-backed bonds, improvement districts) should be subject to a fiscal impact analysis conducted by the City's Finance Department.

All assistance that might ever be granted to the project should be considered in the fiscal modeling process.

If the project suffers any sort of material change during the application process or after approval (but before completion)-including changes in land uses, changes in incentives requested, changes in expected fiscal benefit-the entire revised project should be re-evaluated using the fiscal model including the impacts of the changes

For projects involving City issued bonds, the City should charge an annual issuer fee against the project to account for the administrative burden of administering that transaction in the future. The City should look to state-level issuing agencies (the Missouri Development Finance Board, as an example) to guide its fee schedule.

Modify the PIEA ordinance to require council approval both of the creation of the PIEA district (as it does now) and the approval of any subsequent request for abatement within that district. Abatement requests should be subject to fiscal review by the City's Finance Department.

Link land use approvals for an economic development project with the financial approvals for that same project. The City might consider the use of a development agreement format to accomplish this. In many communities, the development agreement is the master document establishing the land use rights, the amounts of incentives, and the developer's responsibilities (scope of project, timing, etc.) that results from the various planning, financial and administrative approval processes. The City's current developer agreements focus only on the financial aspects of the transaction.

Appoint a city employee in the City Manager's office, with formal responsibility to coordinate City evaluation of and staff work for all economic incentive requests.

City staff involvement should begin whenever an application is submitted to any economic development agency, including PIEA, TIF Commission, LCRA, Port Authority and EDC. Every Agency incentive grant should require City Council approval.

Require passage of one ordinance containing all economic development incentives granted to a project

Sustainability

All investments should produce a net positive return on the City's investment, according to the fiscal model, of at least 33% to the City's General Fund. The City may choose to make discrete modifications to this policy, such as the development of low-income housing. Establishing a standard that a project must yield at least a 33% percent fiscal benefit to the City's General Fund, after accounting for incremental services costs and any tax re-direction, would provide a measure that each project can be tested against (unless other clearly defined economic development measures are met). If all projects meet this standard, a sustainable fiscal balance is projected to be achieved by the fiscal model.

The City should generally provide only the level of incentive required to make the project viable while ensuring that no more than 70% of the projected incremental revenues are captured by/granted to the project. The City should generally seek to negotiate incentives at less than the legal limits of those incentive programs.

The City should generally grant a level dollar amount of incentives, equal to the amount of incentive needed for the first year of stabilized occupancy to make the project feasible. Incremental revenues generated in excess of this level which would otherwise be collected by the General Fund should be

captured and used to fund an Economic Development Reserve Fund to protect against the risks and consequences of such investments on the City as a whole (via developerpaid PILOT)

The City should significantly limit incentives for residential projects which do not provide significant net fiscal benefits.

The City should apply the resources in its Economic Development Reserve Fund sparingly. The City may choose to undertake a project that is very important economically, and will have positive spin-off effects in the surrounding area but which itself does not have a positive impact; this may be especially true for example in distressed neighborhoods where the development market is the weakest. The City needs the flexibility to invest in such exceptional projects without creating adverse financial consequences and major financial risks to the City in future years. This reserve fund will also reduce the risks on the City's past investments and financial guarantees.

Such an annual appropriation requires the City to determine that these particular projects are important enough to the City to be worth spending General Fund monies directly (and not assuming they have no cost to the City).

The City should apply a single set of standards for review by all economic development agencies.

The City should require the same detailed, fiscal impact analysis for all aspects of economic development including tax abatement, TIF, Super TIF, MODESA, providing benchmarking against standard sustainability and financial criteria.

The City should restrict the use of Super TIF to those projects leveraging state funds through State TIF or MoDESA.

The City should reduce its exposure to variable interest rates by converting a portion of the bonds to fixed rates.

The City should seek opportunities to convert bonds it guarantees to self-supporting tax increment bonds without guarantees and otherwise reduce the General Fund's current credit exposure to economic development bonds.

The City should not provide future financial guarantees of bonds issued for economic development projects.

The City should not extend abatements or convert abatements to TIF or subsequently expand incentives.

SUMMARY

Kansas City has experienced many economic development successes. Downtown housing appears to be the rule now, rather than the exception.

Marquee businesses have continued to choose the City as their home. The City's Northland is growing rapidly as the result of competitively-priced housing and the growth of amenities. The success of recent projects in future years may allow the City to reinvest in its central core.

Much remains at stake. If the City gives away its future tax base, and has to increase its level of service to accommodate new development, existing services levels to its citizens will suffer. If the existing community suffers, growth may suffer, it will be more difficult to support additional economic development incentive programs, making it more challenging for the City to grow its tax base. A balance must be struck, ensuring that the community grows without sacrificing the investments it has already made or burdening its existing residents with new costs.

By approaching economic development from a comprehensive, coherent, strategic perspective, the City will be able to manage its destiny with much more certainty. The authors hope our efforts will assist Kansas City in bringing about an even brighter future.