MEETING POLICY OBJECTIVES THROUGH PUBLIC/PRIVATE PARTNERSHIPS: THE REDEVELOPMENT OF PENNSYLVANIA AVENUE

by

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ABSTRACT

Public sector involvement in real estate development is not a new phenomena. Government participation in development of cities dates back to colonial times and the planning of Washington, D.C. and Philadelphia. In 1949 public development changed dramatically with the inception of the urban renewal program. Poor communication between public planners and developers, and a lack of market analysis led to the overestimation of development potential for sites. Consequently, land was cleared, residents and businesses displaced leaving land vacant for years.

Cities now recognize the need for collaborative efforts between public agencies and developers. With a reduction in federal assistance cities have turned to public/private partnerships to stimulate and induce private development activity. In public/private partnerships public agencies join with private developers for redevelopment projects in which cities provide assistance with land assembly and approvals, and financial inducements, while the developer builds a project that will create jobs, tax dollars and help revitalize a city. Through this type of relationship many cities have been able to set and implement policy objectives that would not ordinarily be achieved through traditional private development.

This thesis will focus on the Pennsylvania Avenue Development Corporation (PADC) and the redevelopment of Pennsylvania Avenue. It will identify the elements of public/private partnerships that have allowed the PADC to set and attain policy objectives. It looks at the capital structure and how the PADC utilizes multiple funding sources to finance its projects. It also looks at the lessons that the PADC has learned over 15 years and 25 projects, as well as the affect of the D.C. real estate market on its success. It illustrates how the PADC used these elements to achieve affirmative action goals, the historic preservation of Washington, D.C. landmarks, and the new development of a 1000 unit residential community. Part Four applies the techniques used by the PADC to a generic model for public/private partnerships.

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TABLE OF CONTENTS

FIGURES

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INTRODUCTION

Government investment in public development efforts is not a new phenomena. It is only recently, however, that joint development efforts between government and private developers have won the support of both the public and private sectors. Past failures in this area have lead many to believe that it was not possible for cities to stimulate redevelopment or to use private development interests to provide public benefits. Over the course of the last twenty years, to the surprise of most, the successful completion of major redevelopment projects implemented through the cooperative efforts of public development agencies and private developers has presented a new record of achievement.

This thesis will look at public/private partnerships, in particular the evolution of public sector planning and implementation of redevelopment projects. I will focus on the Pennsylvania Avenue Development Corporation (PADC), a public developer specially created by the U.S. Congress for the sole purpose of redeveloping the one-mile portion of Pennsylvania Avenue from the White House to the Capitol. I will identify key planning elements which have been instrumental to the PADC's overall success as a public developer and demonstrate how the agency's powers and resources have allowed it to set and implement policy objectives that could not have been achieved through traditional private development activities.

I have chosen to study the PADC because the agency has been very successful in the redevelopment of a significant national boulevard, as well as, in their ability to set and attain policy objectives whose benefits extend beyond the physical restoration of a distressed area. Also, the redevelopment of Pennsylvania Avenue provides an excellent example of how the local development climate can impact a public development agency's ability to succeed. Finally, the PADC operated with unique financial resources. While most cities do not have access to the same type of resources, important lessons can be drawn from how PADC used them to further its policy objectives.

Part One of this thesis charts the history of public development, focusing on the role of government in redevelopment. It tracks the evolution of codevelopment from the advent of urban renewal in the fifties to the Urban Development Action Grant (UDAG) program started in the mid-seventies, and defines current day public/private partnerships and the roles and responsibilities shared by cities and developers. Finally, it sets the stage for Part Two of the thesis by giving the history of the PADC.

Part Two identifies those aspects of the PADC's redevelopment experience that were critical in the successful implementation of their public/private partnerships. It starts by laying out the PADC's capital structure and identifying several financial tools used by the PADC to stimulate private development interest. It documents some of the valuable lessons learned and mid-process corrections made by the PADC over its 15-year history. Specifically, it looks at how and why the PADC modified its approach to development competitions and developer negotiations. The methods and strategies used by the PADC in land acquisition and disposition changed significantly over this period, in part because of the success of early PADC projects and in part, in response to the growing strength of the local real estate market.

Part Three looks more closely at some of the policy objectives that the PADC tried to achieve through the deals it made with private developers -- how it priced and valued these objectives. I analyze the agency's approach to setting and achieving affirmative action quotas, historic preservation goals, and, finally, new residential development in an area that is currently void of housing. I also examine how these objectives and the guidelines behind them have changed over the course of the last 15 years. Three projects are the focus of this analysis: The Willard Hotel, the first project completed through a development competition; Market Square, the first PADC project to incorporate a significant residential component; and Lansburgh, the most recent development competition, one which will restore a historic department store, and when completed in 1991, will be entirely residential.

Part Four looks at public/private partnerships as we move into the nineties. Drawing on the experiences of the PADC, it discusses how the lessons learned can assist cities looking to the private sector for new investment. By studying the PADC's capital structure, cities can better identify separate sources and corresponding uses for funds, and, by doing so, leverage revenue-generating property, whether it be owned by a public development agency (PDA) or through tax increments generated by private investment. PADC's effort to include minority investors in its projects also provides insight into means cities can employ to carry out a commitment to improve the quality of life for its residents. This section of the thesis also comments on the efforts made by the PADC to create housing in the Pennsylvania Avenue area, and how the lack of an affordable housing component has impacted its success to date. PADC has been very successful, in planning as well as implementing its projects. While other public development agencies might not enjoy the same level of resources or the fortuitous market conditions that contributed to the successful implementation of PADC's plan, they can learn -- the effect of preparing a complete master plan, how careful planning of resource allocation allows PDAs to assist private developers, that policy objectives can be achieved while stimulating private redevelopment, and that even careful planning and access to financial resources does not insure that all objectives can be achieved.

PART ONE

PUBLIC DEVELOPMENT AND THE PADC

The role of government in real estate development dates back to colonial times, but it was not until the advent of urban renewal that the public sector attempted to significantly alter the market-driven pattern of private development. The urban renewal program, which began with Title I of the Housing Act of 1949, was designed to reverse a pattern of urban deterioration and blight that had woven its way into the fabric of American cities. Through the infusion of huge sums of public funds for the assemblage of private land and subsequent clearing for redevelopment, the federal government hoped to revitalize cities. With the power of eminent domain local redevelopment agencies acquired, cleared and disposed of land within designated urban renewal areas that were deemed blighted. The federal government provided the necessary funding and absorbed any land cost write-downs.[1] City agencies did not involve developers in the planning of projects slated for urban renewal. By statute, the planning activities of local agencies were directed towards the elimination of slum areas, which may or may not have coincided with demands of local real estate markets. In combination with poor planning, this led many agencies to overestimate the development potential of an area designated for redevelopment. Furthermore, after they had sold these cleared parcels to developers, city agencies then removed themselves from the actual development process, which meant that they had no way of insuring that developers would follow through with new development. The consequences of these actions included the permanent displacement of long-time residents and businesses, as well as the massive bulldozing of major tracts of land which lay vacant for many years until a developer could be found. Inexperience, poor planning, and lack of joint participation between public development agencies and private developers are some of the reasons that urban renewal has been widely criticized by urban scholars.[2]

The phase out of urban renewal in the early seventies left cities searching for alternative strategies and funding sources. The need for redevelopment was still present for aging cities trying to compete with the continued expansion of suburban development. In place of the federal urban renewal funding, cities turned to local sources -- tax increment financing, tax abatement, the leasing of air rights -- and one federally sponsored program -- the Urban Development Action Grant (UDAG) Program.[3]

Established in 1978, the UDAG program sought to unite public agencies and private developers for the purpose of joint redevelopment. The program provided cities with "gap" money to fund the increased costs of development within cities. The program's guidelines required cities to identify development opportunities and to secure private-sector interest before funds would be made available. The UDAG program contributed significantly to the form of public/private partnerships that we have today. Elimination of federal appropriations has shut down this program, and effectively shifted responsibility for stimulating redevelopment to the state and city level. While not long-lived, the UDAG program taught cities the fundamentals of public/private deal making.[4]

What is a Public/Private Partnership?

Perhaps one of the toughest challenges facing cities today is the revitalization of their urban core. For many cities the creation of public/private partnerships has been fundamental to revitalization. Public/private partnerships unite public agencies, and the resources available to them, with private development interests, for the purpose of stimulating development activities in areas that might not otherwise attract private development. By joining private interests, which are primarily concerned with the financial feasibility of a project, with public development agencies looking to stimulate economic activity, a win/win situation is created. Only because of their willingness to share in the risks of development have cities been able to attract development and redevelopment in areas where market driven development was unlikely, that is, areas with few amenities or services.[5]

Unlike traditional development, public/private partnerships force developers to work hand-in-hand with public development agencies, from the planning stages through construction and, sometimes, during the operations phase. Through this collaboration and sharing of risks and rewards, significant mutual gains are achieved, for both the city and the developers. For developers, the city provides financial incentives to develop, as well as powers to implement activities that are often beyond the political or legal means of private developers -- land assembly, tenant relocation, installation of public infrastructure improvements, parks and open space, as well as master planning of future development and redevelopment. In exchange for these incentives, cities look to share in project profits, and to implement policy objectives designed to benefit the public at large.[6]

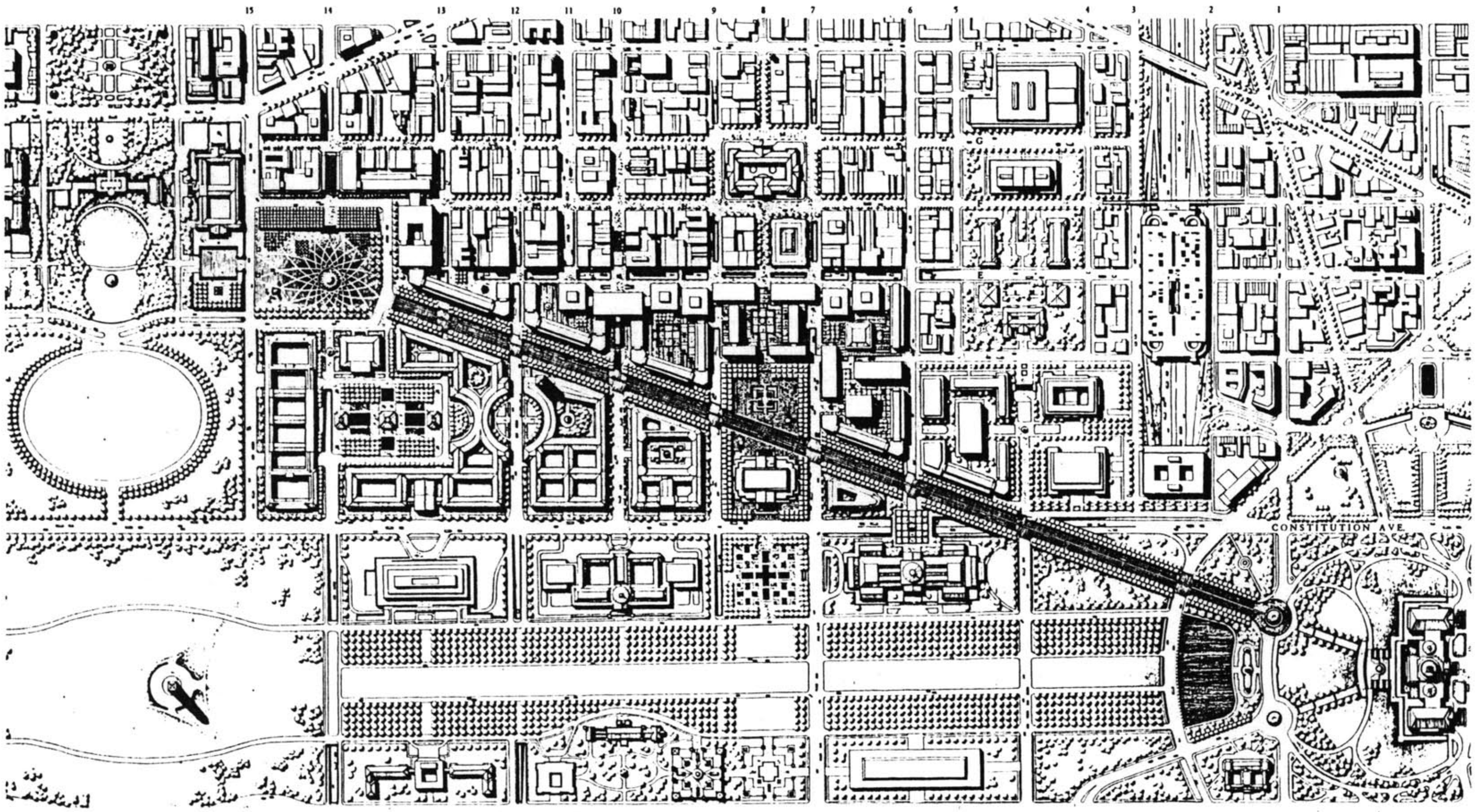
The Pennsylvania Avenue Development Corporation

The Site: Pennsylvania Avenue

When Major Pierre L'Enfant was commissioned by President Thomas Jefferson to plan the nation's capitol he envisioned the boulevard between the President's house and the Capitol as a place of great ceremony and much activity. L'Enfant's concept of the city revolved around the triangle created by the White House, the Capitol, and the Washington Monument, including in this area their connecting axes. (See Figure 1). Beginning with Jefferson's inaugural parade, and continuing with the development of shops, saloons, boarding houses, and residences, Pennsylvania Avenue became the focal point of commercial and social activity.

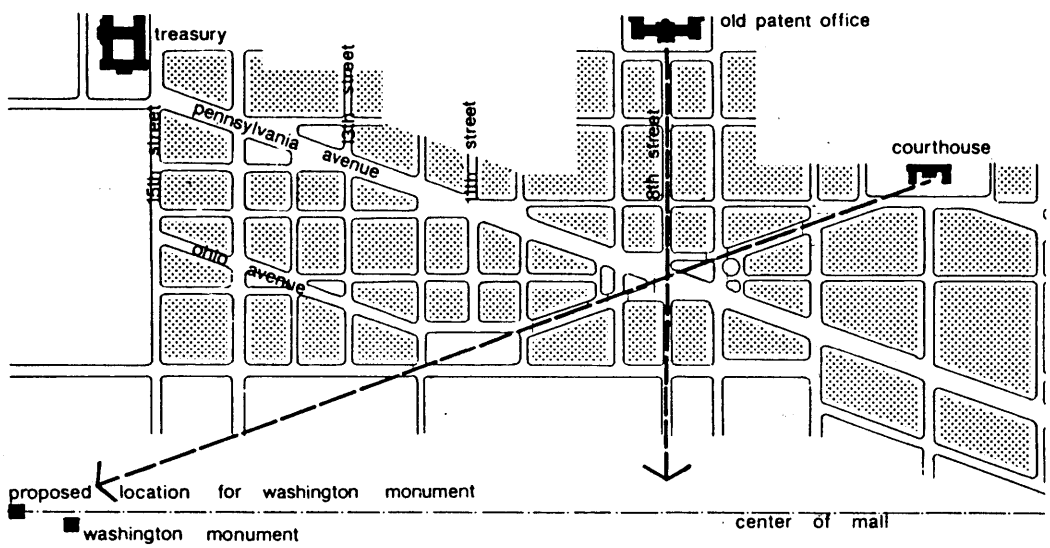
It was not until the construction of the Federal Triangle in the 1930s (see Figure 2) that increased development of government buildings divided the Avenue and pushed the commercial core of the city to the area north and west of the White House. The post-World War II weakening of the Washington, D.C. real estate market which lasted into the seventies, left Pennsylvania Avenue void of activity, and consequently, any new development. By the early sixties disinvestment along the Avenue and rapid deterioration of the existing buildings had become a public issue highlighted by President Kennedy's inaugural parade

FIGURE 1

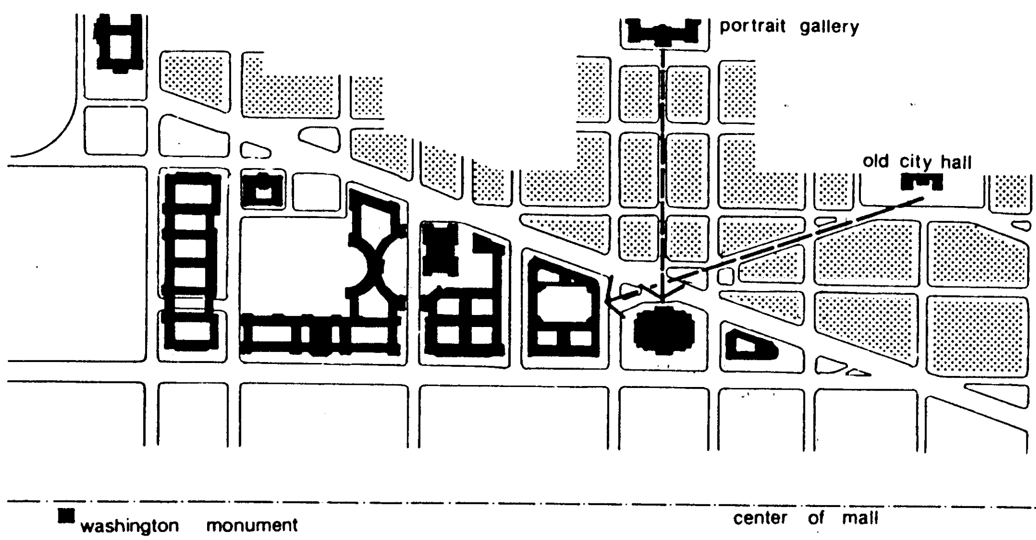


PENNSYLVANIA AVENUE

FIGURE 2



Plan of the Federal Triangle Area According to L'Enfant's Principles



The Federal Triangle Today

THE FEDERAL TRIANGLE

televised on national television. Soon after his inauguration, President Kennedy formed the Advisory Council on Pennsylvania Avenue which was given the responsibility to prepare a master plan for the redevelopment and revitalization of the nation's most prominent boulevard.[7]

Creating a Public Developer

Preparation of the master plan continued through the Johnson and Nixon administrations with both Presidents' full support. The plan, completed by the White House in 1969 without the participation of Congress, city government, or District residents, caused much debate. Many local residents and businesses felt that, while addressing the historic significance of the Avenue, the plan focused too much on government plans and did not address the needs of the residents and businesses located in the area. It was in response to this resistance that President Nixon initialized legislation to create a government corporation to oversee the redevelopment of the Avenue. The Act stipulated that the PADC was required to consult with the District and community officials, and give primary consideration to the needs and desires of local businesses and residents.[8]

On October 27, 1972 Congress passed Public Law 92-578,86 Statute 1266, establishing the PADC as a wholly owned federal development corporation. In this legislation Congress stated "national interest required that the area adjacent to Pennsylvania Avenue between the Capitol and the White House to be developed and used in a manner suitable to its ceremonial, physical and historic relationship to the government and the community." The law included appropriation of funds to be used by PADC staff and consultants for the preparation of a comprehensive plan for the redevelopment of the Avenue.[9]

Preparation of the plan took nearly two years and involved over 100 meetings with representatives from District and federal government agencies, community groups, and business associations. A preliminary development plan was completed in March of 1974 and sent to both District and federal concerns for a 90-day review period. The PADC sponsored workshops for individuals and businesses to address concerns generated by the plan. The collaboration of government and public interests produced a final Pennsylvania Avenue Plan in October of 1974 that reached consensus on the overall strategy and plan for the redevelopment of Pennsylvania Avenue.[10]

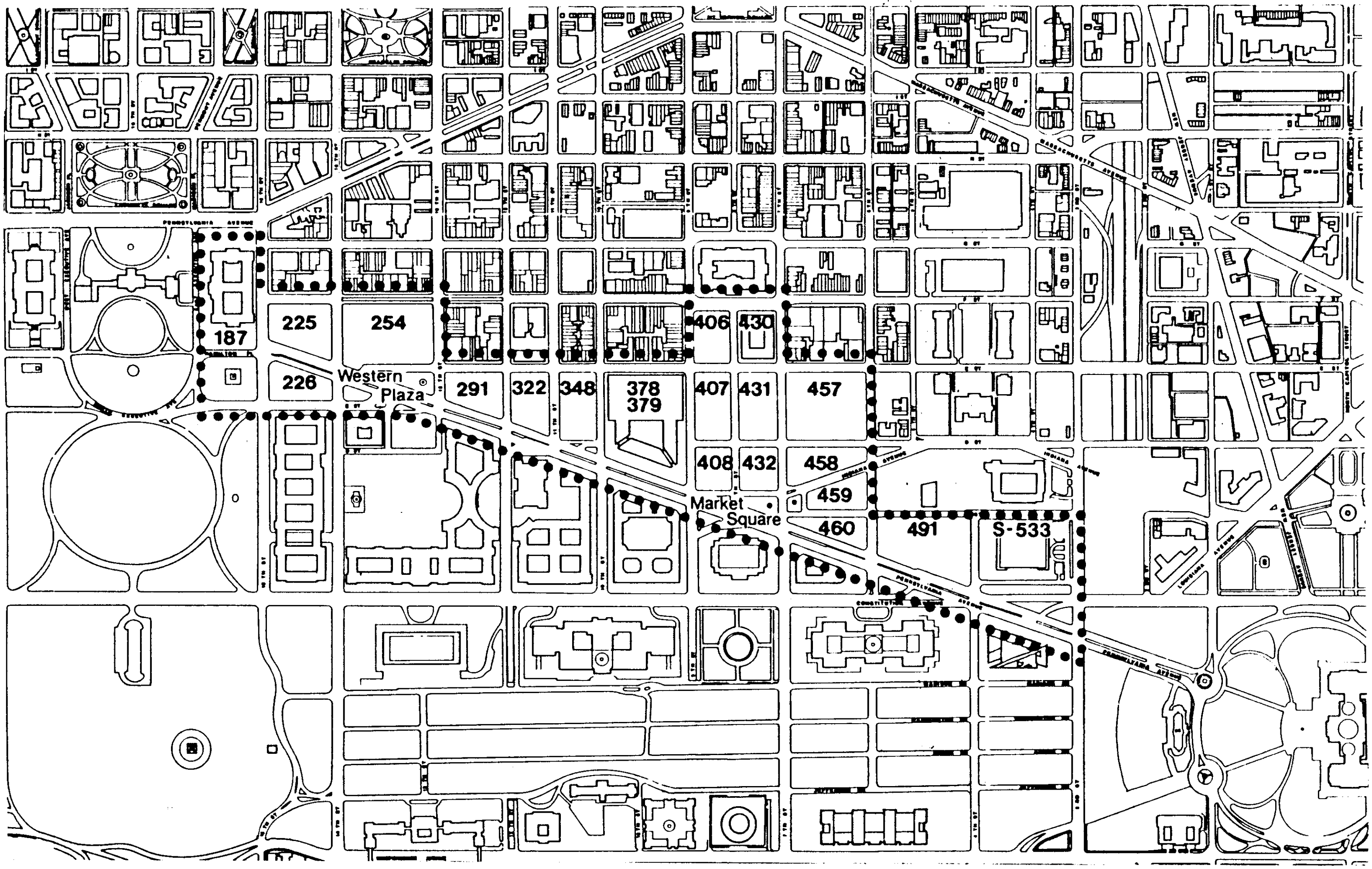
Defining PADC's Mission and Powers:

The area designated for redevelopment was located between the White House (16th Street) and the Capitol (3rd

Street) and bounded by Pennsylvania Avenue on the south and 'F' Street on the north. The scope of the redevelopment was immense -- a 21-block area covering 110 acres. The plan subsequently subdivided the area into two sectors, western and eastern, with the FBI building located between 9th and 10th Streets as the dividing line. (See Figure 3). The "Pennsylvania Avenue Plan 1974" identified proposed land uses and building scopes for each development parcel within the plan area. It concentrated commercial, retail, and hotel uses in the western sector, and targeted the eastern sector for the creation of a residential community, with retail and community arts as a compliment to the residential nature of the area. The plan outlined the role of the PADC in overseeing the redevelopment of the 21-block area. As a public developer it would:

1) acquire and assemble land, and prepare and implement a development program for the site; and
2) oversee and provide assistance, both administrative and financial, for redevelopment activities undertaken by private developers who own land in the plan area. The plan also outlined a unique program providing multiple sources of financial support, in amounts that the PADC believed were sufficient to complete its redevelopment effort.[11]

FIGURE 3



PADC PLAN AREA

A description of the PADC's powers to implement the Plan was included in the enacting legislation. Under the terms of this legislation, the PADC had the authority to:

1) sue and be sued in its own name;
2) acquire land through eminent domain proceedings;
3) construct and rehabilitate buildings;
4) manage property; and
5) establish restrictions and standards necessary to ensure conformance with the master plan.

Like most not-for-profit corporations the PADC was exempt from all taxation, at both the Federal and District of Columbia level. The PADC is, however, required to make payments in lieu of taxes on all property that it owns.[12]

Setting Goals and Objectives

The goals and objectives of the plan were varied and far reaching in their aims. Many objectives were directed towards the physical restoration of the Avenue; others sought to enhance the District's economic base; while still others were directed towards improving the social environment along the Avenue. The plan outlined the goals of the PADC as follows:

1) restore Pennsylvania Avenue to its symbolic position as the "main street of the nation";
2) breakdown the division between the Federal core

and the original downtown of the city;

3) create an attractive area to be enjoyed by residents and visitors alike;

4) provide a mixture of commercial and cultural activities that will stimulate street life;

5) establish a residential area with around-the-clock activities that will support a wide variety of commercial uses;

6) stimulate development on under-utilized land within the plan area;

7) pursue an active historic preservation program, and to retain buildings that are characteristic of the Avenue's history;

8) bring new economic life through the creation of jobs, retail development, and development opportunities;

9) assist existing businesses through a relocation assistance program while encouraging existing businesses to remain in the area;

10) create opportunities for minorities during and after the redevelopment effort, at levels befitting the city with the highest percentage of minority residents of any city in the country;

11) enhance the city's tax base through the intensive development of land in a prime location; and

12) implement the plan in a timely fashion consistent with overall market demand in the Washington, D.C. area.[13]

It was with these objectives in mind that the PADC prepared its development program. When completed in late 1974, The Pennsylvania Avenue Plan outlined the anticipated development of over 6.0 million square feet of new structures. Using its own staff and consultants for market analysis, the PADC projected the development potential as encompassing 1200-1500 residential units, 3.2 million square feet of office space, 900,000-950,000 square feet of retail development, and 400-700 new hotel rooms. The master plan also detailed and overall schedule calling for the entire development to be complete by 1994. The financial program prepared by the PADC staff was all inclusive and estimated costs for all aspects of the plan, including public improvements and infrastructure, land acquisition and associated expenses, historic preservation, tenant relocation, affirmative-action activities, and PADC overhead and administrative expenses. In all, PADC budgeted over $220 million (1974 dollars) worth of public investment.[14]

<u>PADC's Successful Voyage</u>

Over the last 15 years much of the PADC's plan has been implemented with great success. Beginning with the acquisition of the Willard Hotel in 1977, and culminating with the completion of construction on the Market Square North project scheduled for 1993, the PADC will have attained, to a considerable degree, all of its goals. When completed the PADC will have overseen the redevelopment and new development of over 25 projects, including seven which were developed via PADC sponsored competitions, and another eight in which the PADC provided historic preservation assistance. Figure 4 lists these projects and their completion dates, as well as their size and the amount of private investment involved with each. To date, these projects have stimulated over $1.5 billion worth of private investment, providing over 900 housing units and over 5.5 million square feet of office and retail development. In addition, the PADC has undertaken public works projects that included the development of eight parks, plazas and fountains for use by the people who live, work and visit Pennsylvania Avenue.[15] The PADC has revitalized an area void of development activity for nearly 40 years, while preserving the grandeur of Pennsylvania Avenue and implementing public policies for the good of the city.

FIGURE 4

PADC DEVELOPMENT SUMMARY: 1977-1993

Name of Project	Completion Date	Office & Retail (Sq. Ft.)	Housing or Hotel (Units)	Private Investment (millions)
Canadian Embassy	1988	108,000	0	$40.0
601 Penn. Ave.	1986	225,800	0	45.0
Sears House	1984	33,400	0	8.0
Penn. Plaza	1990	175,100	150	84.0
Argentine Naval Bldg.	1982	21,900	0	1.4
Bob Hope USO Bldg.	1985	48,000	0	5.5
625 Indiana Ave.	1989	159,500	0	44.0
Liberty Place	1991	147,700	0	55.0
Gallery Row	1987	38,200	0	7.0
Jenifer Building	1988	43,400	0	8.6
717 D Street	1984	38,200	0	3.6
The Landsburgh	1991	64,000	385	75.0
Market Square	1990	688,600	210	230.0
Market Square North	1994	322,900	201	115.0
Stables Art Center	1987	33,700	0	2.1
1001 Penn. Ave.	1986	798,700	0	160.0
Evening Star Bldg.	1990	212,400	0	85.0
Presidential Bldg.	1992	274,300	0	8.8
1201 Penn. Ave.	1981	422,200	0	52.0
Pennsylvania Bldg.	1987	216,900	0	25.0
1301 Penn. Ave.	1981	206,000	0	21.0
National Place	1984	492,000	774*	180.0
National Press Bldg.	1985	408,000	0	95.0
Willard Hotel	1986	242,900	365*	121.0
Hotel Washington	1989	8,300	344*	12.5
TOTAL		5,525,700	946	$1,485
(*) = # of Hotel Rooms			1,483*	

Source: 1989 PADC Annual Report

PART TWO

ELEMENTS OF SUCCESS

The history of public development has taught us that public involvement does not guarantee success. The problematic legacy of urban renewal would have made many skeptical of a public redevelopment effort of the magnitude undertaken by the PADC. Those backing the creation of the PADC, however, recognized the shortcomings of urban renewal -- the lack of continuous public involvement and testing of market feasibility that should have preceded the bulldozer. Unlike urban renewal, the PADC has succeeded in linking public improvement initiatives with private development interests, through careful planning of the entire 110-acre plan area and the early commitment of substantial resources. This success can also be attributed to the PADC's role as a public development partner, which ensured public follow through till project completion. Throughout its fifteen-year existence, the PADC has maintained a presence along the Avenue with continuing public improvement projects, and, as a redevelopment agency overseeing private development activities, it could advise and monitor the progress of non-PADC projects. It was this kind of commitment and follow through that urban renewal lacked.

This chapter identifies those elements of public/private development ventures -- the capital structure, lessons learned through early projects, and land acquisition strategy -- that have been critical to the success of the PADC. It introduces and details the capital structure of the PADC, including its multiple sources of funding, and how this structure provides the PADC with the financial tools necessary to implement the Plan. It looks at how the PADC used these resources to attract developers to an area long neglected by new investment. It also details the PADC's evolution, and how it changed its approach to issues such as developer negotiations, project scheduling, and preparation of the development prospectus. Of particular note is the means by which the PADC acquired and disposed of property, and how their strategy differed from that followed by private developers. The contribution of market timing to the success of the PADC, is analyzed relative to the timing of the plan implementation.

Unraveling the PADC's Unique Capital Structure

History has shown that some form of public assistance is needed to redevelop in areas that are considered marginal for private development activity. Public development agencies (PDAs) have provided public assistance in many forms, including cash subsidies, low-interest or no-interest loans, below-market terms on ground leases, or publicly provided improvements to the development parcel and/or the immediate area. The PADC activities are no different in this regard. The general lack of development activity and existing developer apprehension in the Pennsylvania Avenue area convinced the PADC that, to be taken seriously, it would need to present developers with a comprehensive plan that outlined planning goals and policy objectives, and a financial plan for the entire 21-block area. With nearly $300,000 (1972 dollars) provided by congress as part of the enacting legislation, the PADC staff developed the Pennsylvania Avenue Plan.[1]

Multiple Funding Sources

The original Pennsylvania Avenue Plan included a financial program that identified several and distinct funding sources available to the PADC -- appropriations from the U.S. Congress for public development activities, and PADC salaries, and expenses; a line of credit with the U.S. Treasury for land acquisition and related costs; gifts and donations; and revenues received from the sale or lease of land owned by the PADC. This type of structure, with which each type of resource targeted for specific kinds of uses (See Figure 5), allowed the PADC to separate those

FIGURE 5

ORIGINAL PADC CAPITAL STRUCTURE

(as presented and approved by Congress in 1974)

Sources and Uses of Funds

Source	Amount	Uses
Public Development Fund	$130 million	Public Improvements Historic Preservation Tenant Relocation Affirmative Action Miscellaneous Expenses
Salaries & Expense Fund	Budgeted on Annual Basis	PADC Salaries Consultants Fees Administrative Expenses
U.S. Treasury Line of Credit	$200 million	Land Acquisition Land Holding Costs: - Legal Fees, Taxes, Interest, Surveys, Property Management, Site Preparation, and Utilities.
Gifts and Donations	Unspecified	Sponsor events Residential Activities Public Relations
Project Revenues	Unspecified	Repay U.S. Treasury Debt Secure Bonds Acquire addt'l property

Source: Pennsylvania Avenue Plan 1974

costs and expenses that could be financed from those that were strictly public improvement projects and overhead expenses and, as such, nonfinanceable. The Pennsylvania Avenue Plan was approved by Congress as submitted. When the PADC began to implement the Plan in 1977 it had the advantage of some unique financial tools with which to do so.

A. Federal appropriations -- two types:

1. Salaries and Expense Fund. Covering operating expenses, including salaries of PADC employees, administrative expenses, and PADC's consultant fees. These funds, budgeted and approved on an annual basis, are based upon anticipated need for the upcoming fiscal year. They do not have to be repaid and are not capped at a maximum amount. For fiscal year 1991, for example, the PADC has requested $2.465 million for 28 employees and expected administrative expenses.

2. Public Development Fund. A one-time $130-million capitalization for infrastructure improvements, parks and open space development, historic preservation, affirmative action activities, tenant relocation assistance, and other public sector costs was approved in whole

as part of the 1974 Pennsylvania Avenue Plan. These costs were viewed by the PADC as public investments, and therefore would not be financed with proceeds from the sale or lease of PADC owned land. This appropriation was approved on a "no-year" basis, which gives the PADC to access these funds until the entire project is complete. Annually, the PADC identifies public improvement projects and submits a Public Development request to Congress as part its annual budget. The PADC also expected to use these appropriations to fund cash shortfalls on parcels where a change in use (from commercial to residential) precluded the PADC from recovering all its acquisition costs through the disposition of the land. However, the success of PADC's early projects and the revenues generated by them has eliminated the need for using appropriated funds for that purpose.

B. Revolving line of credit: The PADC has the power to borrow up to $200 million from the U.S.Treasury, to assist prospective developers through land assembly activities. These funds can be used to purchase land; to fund a range of costs during the predevelopment and planning stages (appraisals, surveys, closing costs, as well as insurance, legal fees, taxes, property management services, and utility expenses); and to finance demolition, site preparation, interest charges, and other costs associated with holding the property until disposition. In establishing this line of credit congress also required that all funds borrowed by the PADC for the acquisition of land, including all costs identified above, be repaid with interest to the U.S. Treasury. Because it is a federally owned corporation, the PADC is entitled to borrow money at the U.S. Treasury borrowing rate. This rate fluctuates on an annual basis, but has typically been between 8% and 9%. Loans from the U.S.Treasury that are outstanding after the project is completed will be repaid through the sale of long-term (40 year) guaranteed bonds secured by existing PADC ground-lease revenues.[2]

C. Gifts and Donations: All gifts given to the PADC or donations made by individuals, institutions, or corporations are used to sponsor events in PADC parks, public relations, informational literature about PADC and its projects, and residential community activities.[3]

D. Project revenues: Revenues generated from the sale or lease of PADC-owned land is first used for the repayment any debt obligations to the U.S. Treasury. Any revenues in excess of debt obligations are used by the PADC to acquire additional land or to subsidize residential components of PADC-sponsored projects. Early success on the Willard, National Place, and Market Square projects has generated surplus revenue and allowed the PADC to avoid using appropriated funds for repayment of Treasury borrowing obligations where write-downs were needed, due to land use changes from commercial to residential. Upon completion of the entire project in 1994, revenues from ground leases will be used to secure the sale of long-term guaranteed bonds. After U.S. Treasury and bond debt service payments have been made, surplus project revenues will be used for maintenance and property management within the plan area.[4]

The PADC 1989 Annual Report indicates that at the end of fiscal year 1990, the PADC had used $134 million in public development appropriations, $28.4 million in salaries and expenses, and $100 million of its borrowing authority. In the same time period the PADC had generated

$160 million in revenues through sales or leases of real estate, which it has used to retire Treasury debt, acquire additional parcels, and also assist in subsidizing the residential components of the plan. Figure 6 shows how the PADC has utilized these funding sources over the course of its tenure. It is expected that by 1994 when the plan is complete, PADC investment will have leveraged over $1.7 billion worth of private development activity.[5]

Using the Capital Structure to Create Opportunities

With its capital structure the PADC has been given a unique set of tools to implement the 1974 Plan. These tools have provided the agency with guaranteed resources and assurances that are not available to all PDAs.

The Salaries and Expense Fund makes the PADC somewhat unique among PDAs, in that its salaries and consultants are fully funded with appropriated monies. While it is true that the PADC's annual budget requests are not always 100% funded it does not have to rely on sources other than congressional appropriations for paying for its overhead. In contrast, most PDAs must rely heavily on revenues from completed projects or city budget funds which are subject to competing uses. Some agencies, like the Boston Redevelopment Authority, now rely solely on project revenues for salary and expense funding. Additionally, the

FIGURE 6

PADC FUNDING

Fiscal year 1977 - Fiscal Year 1990

($ in thousands)

Year	Salary and Expense Fund	Public Development Fund	U.S. Treasury Borrowings
FY 73 Supp.	$ 350	$ 0	$ 0
FY 74	350	0	0
FY 74 Supp.	150	0	0
FY 75	824	0	0
FY 76	824	0	0
FY 76 Supp.	218	0	0
FY 77	1,000	0	0
FY 77 Supp.	32	4,081	25,000
FY 78	1,294	12,354	7,500
FY 78 Supp.	29	0	0
FY 79	1,630	12,355	13,400
FY 79 Supp.	29	17,900	19,600
FY 80	1,856	20,110	17,000
FY 80 Supp.	50	500	0
FY 81	2,443	14,1	15,000
FY 82	2,246	13,632	2,400
FY 82 Supp.	48	0	0
FY 83	2,350	8,750	0
FY 84	2,275	9,600	0
FY 85	2,254	4,410	0
FY 86	2,215	3,091	0
FY 87	2,397	3,924	0
FY 88	2,516	3,000	0
FY 89	2,334	3,175	0
FY 90	2,375	3,150	100
TOTAL	**$28,373**	**$134,201**	**$100,000**

Source: Pennsylvania Avenue Development Corporation annual salary and expense fund provides the PADC with the resources to continually reevaluate its plan, as has been the case with numerous plan amendments and working papers generated by the PADC staff.

The significant amount of funding committed to public investments in open space and historic preservation was another mechanism by which the PADC was able to attract private developers. The large scale and contiguous nature of the plan area provided the agency an advantage missing in most other redevelopment zones and allowed the PADC to concentrate its public development resources in a single area. Money invested on a park brought immediate benefits to all developers who invested along the Avenue. The Pennsylvania Avenue Plan estimated the costs associated with each parcel of land within the development area as part of their initial funding request. If there was ever a doubt by developers of the PADC's commitment to completing this redevelopment project, $130 million of appropriated funds dedicated for use in improving the development area, was enough of a commitment to attract nationwide developer interest.

The line of credit provides the PADC with a means of assisting developers in a number of ways, in particular, with the flexibility to modify deals to suit developers needs. For example, being able to repay the Treasury immediately out of project proceeds and revenues or later through by the issuance of 40-year bonds allowed the PADC to offer developers the choice of either purchasing sites or establishing a long-term ground lease. In addition, the PADC could also offer developers supplemental project financing in the form of unsubordinated short-term mortgages. The security inherent with funding by the U.S. Treasury was another feature that gave credibility to PADC projects. A primary obstacle faced by many private developers was their inability to sustain the heavy costs incurred during land assemblage and site preparation. The PADC was able to use this line of credit to assist developers in land assemblage on private development ventures, as well as on its own projects.

Project revenues are another tool the PADC has used to achieve its plan objectives. Since it could rely on the salary and expense fund to cover its operating costs and the public development fund for its capital expenditures, the PADC used its anticipated project revenues solely to repay Treasury debt or subsidize future projects and the agency's nonfinancial policy objectives. The PADC's first development competition, The Willard Hotel and Office Building, which was set up as a ground lease, provides annual revenues in excess of the PADC's U.S. Treasury repayment obligations. Likewise, the Market Square site, sold to the developer at a $5 million profit, will provide revenues allowing the PADC to cover shortfalls in those projects where it had mandated the inclusion of less profitable residential uses.[6]

Having a dedicated source of income like project revenues will allow the PADC to issue the long-term bonds needed to repay outstanding debts upon the completion of the plan. Because these project revenues are not needed to fund public development projects, or PADC salaries and expenses, they can be leveraged to obtain the necessary bond funds.

Learning from Early Projects

By virtue of its 15-year track record and the 110-acre plan area, the PADC has been involved in more than two dozen projects, and had much time over which to learn valuable lessons. It has used the experiences of the first two development competitions to adapt their approach to public development to a changing market and to address inadequacies of these initial competitions. Since the first development competition in 1978 the PADC has changed the way it negotiates with developers, modified the development competition format and prospectus, and even changed its land acquisition strategy. By reviewing the changes made by the PADC we can see how the public sector has evolved as a developer, and how it has adapted to changes in the market.

The First Competition

Built in the 1800s, the Willard Hotel had been mothballed for nearly fifteen years before the PADC acquired it in 1976. After partially restoring the deteriorated hotel and preparing a development prospectus, in 1978 the PADC invited developers to submit development proposals for the restoration and redevelopment of the Willard. In its first development competition the PADC selected the developer on the basis of the design proposal, and then negotiated the terms of a ground lease, the level of restoration assistance, and the project schedule with the successful bidder. Because the terms of the lease were not identified in the prospectus and because the developer had not yet committed funds to the project, negotiations dragged on for nearly two years. When an agreement was finally reached, the developer was unable to attain financing and a second developer had to be brought on board to complete the project. As a result, it was not until 1986, ten years after the PADC had acquired it, that the Willard reopened.[7]

Modifications to the Prospectus

The PADC learned many of its most valuable lessons from this project. In the Willard competition it did not prequalify developers on the basis of their financial capability to build the project; it did not require deposit monies to guarantee schedules; nor did it stipulate minimum financial terms for the ground lease. Instead it chose to leave them as negotiable items. This one-stage approach to the selection process led to significant delays in developer negotiations, project financing, and the search for a new developer.[8]

Several changes were made as the PADC prepared for the Market Square development competition 1982. The one-stage development competition was replaced by a two-stage competition which prequalified developers based upon their financial capabilities and project experience. The successful developer was required to submit deposits totaling several thousand dollars, all of which would be returned as the developer met key progress milestones -- including deal negotiation, site preparation, shell completion, and occupancy. For the first time, the PADC also included the minimum acceptable land-disposition terms which were based upon market analysis and feasibility studies performed by the PADC or its consultants. In the development competition for the Landsburgh in 1986, the

PADC even went one step further by telling the developers the discount rates to be applied when determining the present value of their proposed ground lease terms. In all development competitions since 1982, the PADC has required developers invited to participate in the second stage of the competition to complete a pro forma analysis of the project cash flows as part of their development proposal. So that the PADC could evaluate all proposals more readily, developers were require to complete their pro formas on standard forms provided by the PADC. The Landsburgh prospectus even included a computer template to be used by developers.[9]

Land Acquisition: PADC Response to a Changing Market

The way in which the PADC acquired land in this 110-acre redevelopment effort has had a significant impact on the success of the overall project. As part of its enabling legislation, PADC was granted the power to acquire and dispose of land in its own name, in particular the authority to use eminent domain as a means of land assembly of land. With these powers the PADC was able to assemble parcels of land that might otherwise have been too small or too expensive to induce private developers seeking land assemblages for new commercial development. The power to acquire land, either through direct acquisition or eminent domain, was a tool by which the PADC could acquire land, demolish existing structures, and prepare a site for individual use or combine it with additional parcels for a project of larger scope. This process would save the private sector the high cost of private land assembly and the risk of possible hold-outs, land owners who, in asking high prices for the remaining parcel for a site, might actually preclude the project from going ahead.

The approach that the PADC uses in land acquisition has changed over the course of its 15-year history. The initial strategy the agency used was to acquire the land through a negotiated purchase or eminent domain taking and hold it until its staff identified a development opportunity. The concept was to acquire land early, presumably at a lower cost, and absorb the project holding costs until a the final project concept was specified and a developer selected. It was thought that the appreciation of the land between the time of acquisition and disposition would exceed the costs incurred during the holding period. Through this method of land acquisition, the PADC hoped to capture the value created by their public investment in the plan area and channel it into public initiative efforts, such as residential development, affirmative action, or historic preservation.

The PADC, however, underestimated the initial inflation of land prices that coincided with the announcement of their intentions to redevelop Pennsylvania Avenue. This unexpected land value inflation, in conjunction with protracted negotiations with developers and delays in project start up, meant that the PADC incurred holding costs in excess of the land value appreciation. In the case of the Willard Hotel, for example, eight years passed between PADC acquisition of the site and the negotiation of a ground lease with a developer. While the Willard was still a financial success, it forced the PADC to rethink its land acquisition strategy. In a 1983 internal memo, Al Milin, PADC's Director of Finance, commented:

> If we [the PADC] continue to acquire land and hold it until a development opportunity is identified, our holding period costs may exceed our gains from appreciation. If this scenario is borne out it raises the question of where we will find the necessary funds to repay monies borrowed from the U.S. Treasury to acquire the land and the costs incurred while we decide what to do with it.[10]

The alternative to the initial strategy was to defer land acquisition until a specific development opportunity was identified. With land prices increasing and uncertainty about whether it could recoup the heavy carrying costs incurred, the PADC changed its land acquisition strategy to a method more widely used by public redevelopment agencies. The PADC would wait to acquire land until a development opportunity had been identified and a preliminary development plan completed. In this way the PADC could minimize the holding costs associated with interest payments, maintenance and upkeep of existing buildings, security, property management and other similar carrying costs. Using its eminent domain powers, the PADC was able to acquire land at the "current fair market value." In the competitive Washington, D.C. market, the PADC operated under the premise that developers were prepared to pay fair market value for the land, plus the cost of land assembly incurred by the PADC. This was a reasonable assumption because the PADC's cost of land assembly would be considerably less than that of a private developer who faced the prospect of hold-outs and unknown delays.

The new strategy also insured that a project would go ahead when the market dictated its viability. Having used this approach on Market Square, the Lansburgh, and other PADC sponsored projects, the PADC has been very successful. In Market Square, for example, the PADC sold the site to the successful bidder for $26.1 million. When the development prospectus was prepared in 1982, the PADC called for a minimum purchase price of $25 million, which covered PADC's projected total costs. Over the course of the next three years it assembled and acquired the land necessary for the proposed project. Reduced holding costs and a higher than minimum bid allowed the PADC to extract a $5 million profit on the project.[11] This more conservative approach to land acquisition has worked well for the PADC. By waiting until a project opportunity is identified, holding costs were minimized because of the shortened time period between acquisition and disposition.

Project Timing and the PADC Plan

While the careful planning and resources provided by the PADC has contributed much to its overall success, perhaps the single largest contribution was something out of its control -- the timing of the Washington real estate boom. Pennsylvania Avenue had been the subject of redevelopment discussions since the Kennedy administration prepared the first redevelopment master plan in the early sixties. During this period commercial development activities had migrated to the new central business district (CBD) located north and west of 'F' and 16th streets, leaving Pennsylvania Avenue void of any new development activity. This lack of development led to stagnation and decay along the Avenue, a pattern that continued throughout the sixties into the seventies. The availability of space in the new CBD, in conjunction with the lack of overall demand for space did little to change this pattern.

During the period between the PADC's creation in 1972 and the implementation of the Pennsylvania Avenue Plan in 1976, the pattern of real estate development in Washington, D.C. began to change. The implementation of the plan coincided fortuitously with an increasing demand for space, while vacant parcels suitable for development in the CBD became harder to find. At the same time, the federal government was finishing two office buildings in the Pennsylvania Avenue area, and construction of METRO subway lines through the plan area was already underway. Buoyed by this improving real estate market, the PADC introduced plans to oversee the development of nearly six million square feet of new development over the course of the next fifteen years.[12]

As Al Milin pointed out:

> All things considered, the timing of our plan had about as much to do with our success as any single planning feature. If we had tried to implement the Pennsylvania Avenue Plan in the late sixties instead of the late seventies, it would never have worked. In the sixties no one would have considered any kind of commercial development east of 16th street. As land in the old CBD became more scarce and land prices rose, developers were starting to look outside of the traditional development areas. This coincided with the release of the Pennsylvania Avenue Plan. The

PADC's announcement of its intentions to rehabilitate Pennsylvania Avenue in combination with the resources committed to it gave the plan instant viability. The PADC's announcement in 1978 that the Willard Hotel was going to be part of a development competition finally raised developers eyebrows regarding the possibility of new development [in the plan area].[13]

With the completion of the first design competition for the rehabilitation and expansion of the Willard Hotel in 1978, the PADC sent a message to developers that Pennsylvania Avenue was a valuable area for redevelopment as well as for new development. Through a combination of increased demand and the short supply of commercial grade property, the announcement of PADC's plan in 1974 attracted considerable attention. For example, the Willard prospectus, issued in 1978, generated development proposals from nine development teams; later in 1982, the Market Square competition, which required developers to submit $50,000 deposits as evidence of their commitment, produced four development proposals. In general, all of the PADC development competitions have generated a similarly high level of interest.

The timing of the plan implementation was not entirely a case of being in the right place at the right time. The PADC was able to use their resources to conduct many necessary market analyses and project feasibility studies during the time period leading up to the plan implementation. Had the studies indicated a lack of demand or an oversupply of space elsewhere within the city, the PADC would have delayed implementation of that project.

The planning and financial stability surrounding the PADC's plan, and its subsequent success with early project, has allowed the PADC to foster and fuel a healthy development climate over the course of its 15-year history. The economic benefits of a development this size have been numerous: increased real estate taxes, sales taxes and income taxes; new jobs; and increased retail activity. Success also has positioned the PADC to set and achieve policy objectives, described in the next part of this thesis, that provide public benefits beyond those derived from new jobs and a higher tax base.

PART THREE

USING PRIVATE INVESTMENT TO OBTAIN PUBLIC BENEFITS

The PADC has used its success as a public developer to attain several non-financial policy objectives. As it prepared the Pennsylvania Avenue Plan in 1974, the PADC targeted specific public benefits that might not be provided through private development efforts. Its plan called for the creation of a residential neighborhood within an area that was zoned for commercial uses. By infusing 1200-1500 housing units, the PADC hoped to revitalize the area. The Plan also outlined an affirmative action plan that sought to include minorities, women, the handicapped, and veterans of the Vietnam era in all aspects of PADC projects. In addition, the plan called for the preservation and restoration of many Pennsylvania Avenue historic landmarks.

This chapter uses examples provided by the Willard Hotel, Market Square, and Lansburgh competitions to detail the methods the PADC used to set, implement, and enforce these policy objectives. By using projects that span the fifteen years of PADC's activity, I will show how the changing real estate market has positively influenced the agency's ability to reach goals that were set in the early seventies. In particular, these cases illustrate the effect of escalating land values on the PADC's residential development plan, and how the agency used its portfolio of projects to meet its residential development goal.

The Three Cases

The Willard Hotel and Office Building

In 1978 the PADC selected the Willard as its first development competition. Built in the early 1800s the Willard Hotel was originally a hostelry. When the redevelopment effort was completed in 1986, the Willard had been transformed from an old decaying hotel into a completely restored 365-room hotel with 24,300 square feet of retail space and 218,600 square feet of prime office space.

By following federal historic landmark guidelines when it prepared the general development program, the PADC committed itself to a plan for restoring the Willard to its original condition and use as a hotel. This decision was in large part the result of an investigation into the structural integrity of a building that had been vacant for nearly fifteen years. The consultant's reports indicated that the PADC needed to begin restoration immediately if it wanted to save the hotel. The PADC felt the Willard's proximity to the existing central business district (CBD) and two-block walk to the White House would help attract private interest to an area that had been void of development activity for many years. The decision to restore the hotel, versus demolishing it for a new office building, forced the PADC to make cash subsidies to the developer to offset the higher development costs associated with building around and repairing the existing structure while complying with federal historic restoration guidelines.[1]

Market Square

After the Willard competition and the protracted negotiation period and search for a second developer, the PADC revised its selection format to include a prequalification stage that screened development teams based on their prior development experience and financial capabilities. The first project to use this format was Market Square. When finished in 1990, Market Square will consist of 585,500 square feet of office space, 104,100 square feet of retail space, 800 parking spaces, and 210 units of housing.

The original development program outlined in the prospectus called for 225 residential units to be constructed as part of a larger mixed-use project. Other program requirements called for the maximization of office and retail uses that compliment the residential character of the area. In the course of negotiations with the developer reduced the total housing units in the project were reduced from 225 to 210. Later in Part 3 I will use this negotiation to illustrate the PADC's ability to adjust the development program, while maintaining their long-term objectives. This project will be used to show how the PADC has maintained a proactive role to meet affirmative action objectives. While developers of previous PADC projects had maintained the needed overall 75% compliance on affirmative action guidelines, the developers were unable to meet the 10% equity participation guideline set by the PADC. During the Market Square competition the PADC took steps to correct these deficiencies.[2]

The Lansburgh

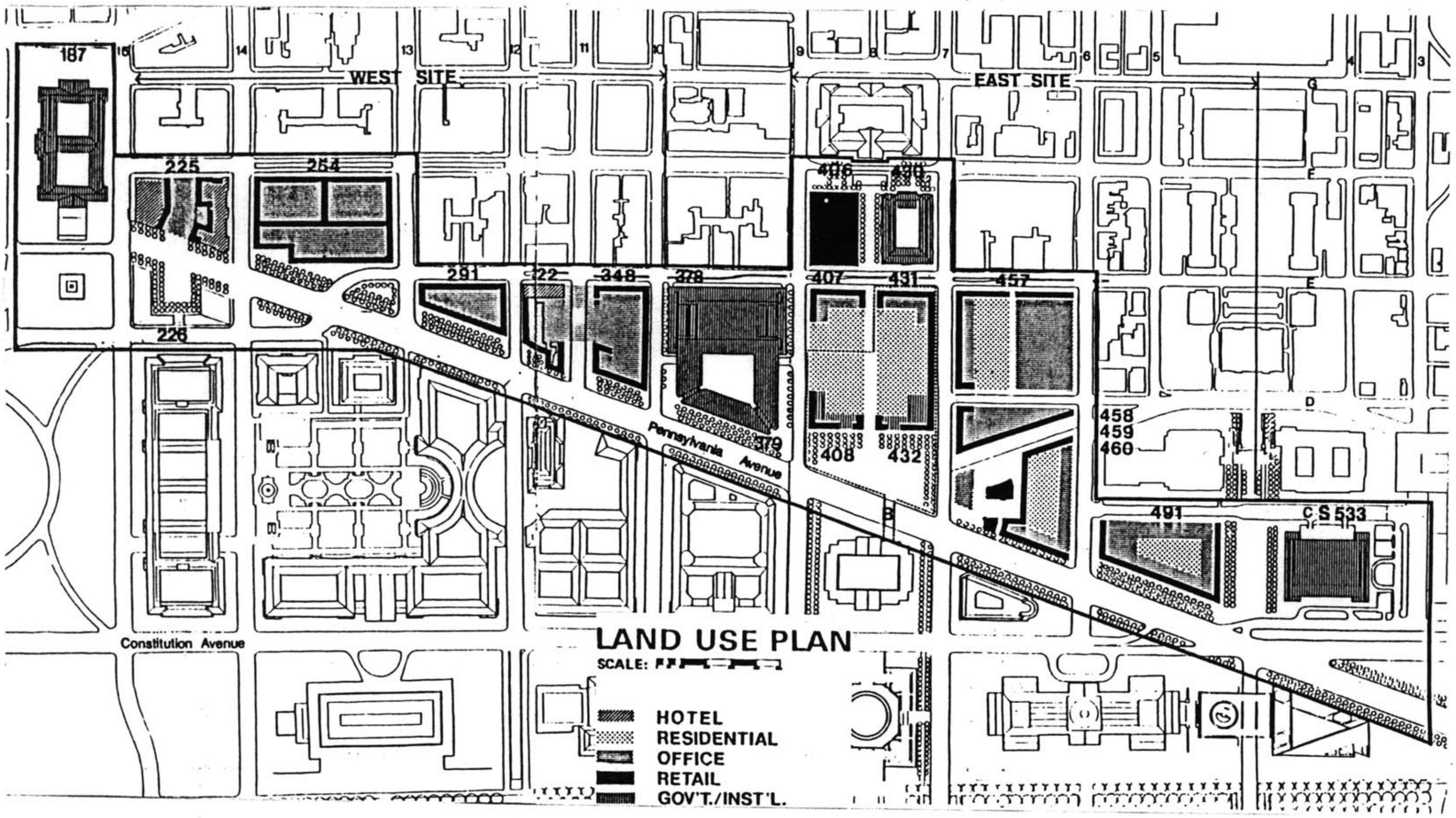
Built in 1882, "Lansburgh's" was a Washington, D.C.-based department store that had operated at its 'E' Street location until a slump in the retail market forced its closing in 1973. When this PADC sponsored project is completed in 1991, the building will reopen as 369 residential units, 44,500 square feet of retail space, a 30,600-square-foot community arts space, and 365 parking spaces. The successful developer, selected primarily because they were the only developer to submit a proposal that was 100% residential, was the first developer to receive unanimous support from the PADC during the selection process. The unanimous selection was a strong indicator of the PADC's overall desire to create a significant residential presence along the Avenue.

The original prospectus called for a mix of uses consisting of a minimum of 225 residential units, retail, community arts space, and an optional office component. To the delight of the PADC, the developer proposed far in excess of the minimum housing requirement and no office space. As part of its prospectus, the PADC provided financial incentives to developers, if their proposed development program exceeded the number of housing units specified by PADC. These financial incentives would be funded by the proceeds from the Market Square project and surplus lease revenues on other properties. The Lansburgh site was also designated as a historic landmark and consequently required additional financial assistance from the PADC for the added costs incurred by the developer.[3]

Residential Development in a Commercial Zone

The most visible evidence of the PADC's ability to pursue and attain policy objectives was the creation of a new residential neighborhood within the eastern sector. (See Figure 7.) The Pennsylvania Avenue Plan of 1974

FIGURE 7



PADC LAND USE PLAN

called for the housing component to be concentrated between 7th and 9th Street and between E Street and Pennsylvania Avenue. The Corporation recognized that the creation of this residential neighborhood in an area with no existing housing would require that the residential development and its supporting uses function as a self-sufficient community. Together with its housing consultant, the PADC decided that the critical mass necessary to achieve this result was between 1200 to 1500 units. The PADC felt that a combination of rental and for-sale housing would best suit the needs of the area.[4]

Downzoning for Residential Development

The area targeted by the PADC for this community was at the time zoned for commercial uses. Residential development in Washington, as in most cities with high density development, has traditionally been less profitable than commercial development. Since the Pennsylvania Avenue Plan also called for an increase in the allowable floor-area-ratio for commercial development in this area, it created a situation where the PADC would purchase land zoned for commercial development at a price commensurate with the highest-and-best commercial use, then down zone it to residential, and have to sell or lease the property at a price to make residential development feasible. The PADC could have sought a rezoning from commercial to residential to drive down land values, but its staff and consultants estimated that the legal expenses and the time lost in disputes with current land owners would out weigh the costs of the PADC absorbing the land cost differential. Because the creation of a residential neighborhood was seen by the PADC as an essential component of this plan, it set aside $20 million of the $130 million appropriated for public development activities to cover the cost difference between the acquisition and disposition prices.[5]

Again, the timing of the plan, and the excitement and attention generated by PADC's early successes, played a key role in the implementation of the housing initiative. In the prospectus for Market Square, the PADC set the minimum land disposition price at $25 million, provided that the developer include a minimum of 225 housing units. The developer could choose to reduce the number of housing units, but only at an additional cost of $80,000 per unit for every unit less than 225. There was a limit, however. The developer was not allowed to propose less than 100 housing units. Consequently, the disposition price varied from $25 million (for a proposal with 225 units) to $35 million (for a proposal which included only 100).[6] Through this pricing, the PADC recognized that the developer would be trading cash for the opportunity to develop more profitable commercial space, and that, in doing so, it could use such funds to subsidize housing on other sites.

To establish the disposition price and trade-off allowance for the Market Square site, the PADC conducted several market analyses of comparable commercial and residential sites surrounding the plan area. Then it applied the estimated pricing guidelines to its site and established the different values for commercial and residential uses. The PADC also added one additional consideration to the pricing of the residential units. Since the area that they wanted to develop into a neighborhood had no existing housing, new housing would be extremely risky, especially since the area was void of commercial development as well. To explicitly define this risk, the PADC included in its pro forma a longer than usual lease-up and sales schedule, and lower rental and sales values for the units in this previously nonresidential area. The sites along Pennsylvania Avenue were considered more valuable and were estimated to have shorter lease-up periods than those parcels located off the Avenue.[7]

When the D.C. real estate market took off in the early eighties so did land values in the plan area. As a result, the PADC acquired the land for Market Square at a time when land values were still rising. The appreciation during the holding period between acquisition and disposition was sufficient to allow the PADC to repay its Treasury borrowings, including write-down costs associated with the residential down-zoning, and still pull out approximately $5 million in profit. It was through minimization of holding costs and increased appreciation that the PADC eliminated the need to rely on appropriated monies to fund the residential objective.[8]

The $5-million upside of the Market Square project allowed the PADC to push ahead with the next development competition -- the Landsburgh, another project slated to have a major housing component. Using the same analytical strategy as employed in the Market Square project, the PADC arrived at a disposition price for the property. The success of the Market Square competition and the ever increasing development activity along Pennsylvania Avenue allowed the PADC to restructure the development program for the Landsburgh project. Instead of charging developers more money and allowing them to reduce the quantity of housing units, the PADC specified the minimum number of units -- 225 for the Lansburgh -- and provided an incentive for developers who chose to build more housing units. The land disposition price was set at $10 million, and with the success of the Market Square competition, higher estimated rental rates, and better locational attributes along the Avenue, the PADC was able to reduce the credit to $52,500 for each unit provided over 225 units. The maximum rebate was $8.4 million. This set of terms allowed developers to propose a 100% residential scheme that had anywhere from 225 to 385 units. With the profits from the Market Square project and surplus revenues from other development activity, the PADC was once again able to repay its U.S. Treasury borrowings and associated land acquisition costs without using appropriated monies.[9]

Housing for the Rich?

Market Square and the Landsburgh represent more than half of the 1000 housing units that will be built in the entire plan area. When most of the residential units are ready for occupancy in mid-1990, the PADC will have been quite successful in establishing the critical mass necessary to sustain a residential neighborhood in this part of D.C.. However, the one area that the PADC has fallen short of its initial objective is affordable housing. When the Plan was first written the PADC targeted 250 of the anticipated 1200 units for low-income housing, with the expectation that federal subsidies would compensate developers on low-income units.[10] With the elimination of Sections 235 and 236 subsidies of the

National Housing Act, these affordable units were subsequently dropped from the PADC's program. The reasons were many and justifiable. Commercial land costs in the Pennsylvania Avenue area, where no housing currently existed, were so high that the subsidies required to fund one unit could provide assistance for many units in other neighborhoods already zoned residential. Thus, Section 8 subsidies that were available for low-income residents of Washington, D.C. were targeted by government officials for other areas within the city. Because the PADC was obligated to repay all U.S. Treasury borrowings used for land acquisition, PADC staff reasoned that the agency could not provide the substantial subsidies required to offset the higher development costs. In addition, increased land costs reduced the overall number of housing units from the projected 1200-1500 units, down to 1000. This reduction in the total number, attributable to the higher land prices, also contributed to the elimination of the affordable component. The end result was that housing along Pennsylvania Avenue consists of 100% market rate units, many of which are being used by corporations as "hotel suites" for employees in town for business. This consequence detracts from the PADC's goal of creating an area of intense activity, because much of the housing will be underutilized. Critics claim that these transient uses will preclude the development of a true neighborhood atmosphere and the activity generally associated with one.[11]

Affirmative Action

Washington, D.C. has the highest minority population, as a percentage of total city population, of any major urban center in the United States.[12] As a result, the PADC decided to insure minority participation in all aspects of the redevelopment of Pennsylvania Avenue by including significant minority business and worker requirements in each development prospectus, as well as by providing financial incentives to developers who met or exceeded these minimum guidelines. This section looks at how the PADC set the guidelines and the way in which it has adapted its approach in response to unexpected shortcomings in its initial guidelines.

Establishing the Guidelines

The PADC used the federal guidelines outlined in regulation number 36 CFR 906.2 as a basis for its own requirements, however, it chose to increase the minimum acceptable percentages for all categories of affirmative action hiring. The high percentage of minorities and the prominent status of Washington, D.C. as the nation's capitol figured prominently in the PADC's decision to raise the performance criteria that developers had to meet on its projects. The categories and participation guidelines were designed to cover minorities, women, handicapped persons, and Vietnam era veterans in all aspects of the real estate development and targeted specific services in the following ways:

1) Equity Participation -- 10% participation by minorities, women, and/or minority owned businesses,
2) Contracts for Professional Services -- 20% of total contracts value to minority-owned businesses,
3) Individuals Providing Professional Services -- 20% should be provided by minorities, women, handicapped persons, or Vietnam-era veterans,
4) Construction Contracting -- 15% of total construction value to minority owned businesses,
5) Construction Employment -- 35% of construction hours worked shall be by minorities, women, handicapped persons, or Vietnam era veterans,
6) Purchasing -- 20% of total purchases are to be provided by minority-owned businesses,
7) Hotel Employment -- 20% of all employees, 15% of all employees earning more than $2,000 per month (1978 dollars), and 60% of all hotel trainees shall

be minorities, women, handicapped persons, or Vietnam-era veterans; and

8) Leasing -- 15% of all retail space shall be leased to minority-owned businesses.

As part of the development proposal submission, developers were required to include an affirmative action plan which documented how the development team planned to meet these guidelines. This plan included the designation of an affirmative action officer, progress tracking and reporting plans, and any additional affirmative action plans beyond those called for by the PADC.[13]

Developer Incentives

The PADC staff recognized that by requiring developers to meet affirmative-action requirements, it was asking developers to provide something not required in a private development venture. They also recognized that preparing and implementing the affirmative-action plan would represent a significant cost to the developer. In recognition of these costs, the PADC planned to offer the successful developer financial incentives to meet the affirmative action guidelines specified in its development prospectus. In most PADC development competitions the developer was allowed to choose whether they would purchase the land or lease it from the PADC, so the PADC developed several incentive formats so that a developer could be compensated, upon completion of the project. The PADC established a 75% threshold as the minimum compliance level. This meant that to receive the incentive, the developer had to meet or exceed the minimum quota for at least 75% of the eight minority-hiring guidelines specified above. The developer was required to submit an affirmative-action plan to the PADC for approval. In addition, the developer was required to submit quarterly reports indicating the compliance level for each of the eight affirmative-action guidelines. If, after an affirmative-action plan has been approved by the PADC, the developer falls below the 75% level he forfeits any incentive, until such time as he is able achieve compliance levels. The PADC offered developers a choice of one of the following incentives:

1) Reduced-Rate Mortgages. In general, the PADC would offer developers unsubordinated short-term mortgages, at 12.5%, as supplementary project financing. If, however, the developer elected to receive this form of supplemental financing and he then complied with affirmative-action requirements, the PADC would reduce the mortgage rate to 10% for the duration of the loan, usually until construction was completed. If the developer failed to maintain

minimum quotas they would be forced to return the funds, with additional interest (2.5%) from the date that the rate was reduced.

2) Land-Purchase Credit. Should the developer elect to purchase the site, the PADC would offer a cash credit to the developer if he reached and maintained the 75% compliance level with respect to the overall affirmative-action requirements. In the Market Square project, for example,the PADC offered to deposit $500,000 dollars in an interest-bearing account, payable to the developer upon successful implementation of an affirmative-action plan, payable upon project completion.

3. Rent Deferral. Should the developer elect to lease the site, the PADC offered developers a rent deferral during the construction period. The rent deferral, set up to assist developers during the early stages of projects when cash flows were critical, was to be repaid by the developer with interest upon construction completion. The interest rate would be established at the same level that the PADC paid on borrowings from the U.S. Treasury.[14]

The PADC staff established these incentives after completing an in-house analysis to estimate developer costs associated with the creation and implementation of an affirmative-action plan. While all three incentives were estimated to have the same present value, the PADC recognized that the developers submitting proposals would have different capital structures and would not necessarily approach the project in the same fashion. Developers who met the 75% overall compliance level and were able to maintain it throughout the project, received the incentive upon project completion. Those who fell below the 75% level during the project, but were able to make adjustments and finish the project at the 75% compliance level, were still able to receive the incentive, which was adjusted downward for the period that the developer was not in compliance. Federally developed plans for other affirmative-action programs were also used as a template for PADC guidelines and cost estimates.[15]

The Impact of Affirmative Action

The timing of the plan implementation and the competitive Washington, D.C. real estate market figured prominently in the success of the PADC's affirmative action plan. With the first development competitions, the PADC staff was unsure whether developers would be able to comply or how much pressure the agency could apply, outside of the incentives, to achieve its policy objective. The prospectus for the PADC's first two competitions stated that preference would be given to those developers who included with their development proposal an affirmative-action plan. With these incentives the PADC had no trouble generating proposals that included affirmative-action plans. After the successful completion of the Willard and another 1978 competition, National Place, both of which included affirmative-action plans, the redevelopment area was attracting much attention, from both public and private investors. As a result, although Market Square, the Lansburgh, and the PADC's five subsequent development competitions offered similar financial incentives, the development prospectus made it clear that only developers who included affirmative-action plans in their proposal would be considered.

Buoyed by the success of the Washington real estate market and the knowledge that it could require an affirmative-action plan from all developers, the PADC continued to seek greater minority participation in those categories that were falling short of their targets. While all developers were able to meet the overall 75% requirement, none had met the 10% equity participation by minorities, women and/or minority-owned businesses. The PADC surveyed developers and local minority leaders in an attempt to find out why this target was not being met. The results of the survey indicated that developers were unable to find interested minority equity partners; minority leaders suggested that developers did not know how to establish connections with eligible investors. Instead of reducing the minimum requirement so that developers were able to meet the goal, the PADC staff, assisted by minority organizations, established a list of eligible and interested minority businesses and individuals and made it available to developers as part of the development prospectus. With additional input, developers of the most recent PADC development competition, Pennsylvania Plaza, were able to meet the 10% minority equity participation requirement.[16]

Historic Preservation

> "At the heart of the Corporation's work to revise the Avenue and its environs is a deep concern for the tradition of urban design and architecture that have shaped the City of Washington."[17]
>
> 1983 PADC Annual Report

Since its inception in 1790, Washington D.C. has been the most prominent symbol of American history. When it was designed by Charles L'Enfant in 1791, the focal point of the city was the triangle formed by the White House, the Capitol, and the Washington Monument. Although not by design, Pennsylvania Avenue soon developed into the main commercial and business street of the city. During the 19th century many of the structures built on Pennsylvania Avenue were of French chateaux, Gothic and Romanesque architectural styles. The Avenue's pattern of grand design continued into the early 20th century as the United States became a world power and it continued with the construction of many federal buildings, in the area that is now called the Federal Triangle.

Recognizing the importance of the Avenue, the PADC designed a historic preservation strategy, which it laid out in the 1974 Pennsylvania Avenue and the 1977 Historic Preservation Plans prepared by the PADC staff. The strategy called for the retention and restoration of all National Register Landmark buildings and the creation of a historic district within the plan area.[18] During the preparation of the capital budget PADC staff analyzed all historic buildings within the plan and prepared estimates for expected restoration costs. Due to its flexible and abundant sources of funding, the PADC was able to budget approximately $11.1 million of the Public Development Fund, to assist private developers in the preservation and restoration of these public landmarks. This it has done in two ways -- by providing financial assistance to private developers as an incentive to rehabilitate existing structures and by acquiring historic structures that might otherwise have deteriorated beyond repair.[19]

In the case of the Willard Hotel the PADC's reports indicated that immediate action was required if the hotel was to be saved. After acquiring the hotel the PADC invested the necessary funds to shore up the structure and make it weathertight. It then held the first PADC sponsored development competition, during which the PADC specified that the hotel was to be saved and restored to its original condition. When the PADC wrote the development prospectus for the Willard it chose not to include a disposition price for the parcel, due to the unknown extent of restoration required and the total cost of such an effort. As the project was designed, and later built, the PADC worked with the developer, providing financial assistance for those restoration costs not covered by the Federal Historic Preservation funds.[20]

The PADC has also used public development appropriations to plan historic restoration projects years in advance. On eight PADC projects, including Market Square and the Landsburgh, the PADC has paid for the removal and storage of facades, lobbies, and other irreplaceable parts of buildings until such time as they can be incorporated into specific development projects. In the case of Market Square, these facades could not be used, however the PADC included in a subsequent prospectus a requirement for the reuse of the existing facades into any design proposed by the developer. In subsequent negotiations with the successful developer, the PADC provided additional assistance for the restoration and installation costs associated with reusing these facades.[21]

Whether it was the rebuilding of internal structures, restoration of facades and slate roofs, or the dismantling and storage of existing buildings, the subsidies available through the nationally sponsored historic preservation fund programs were insufficient to cover the tremendous expense incurred. To date, the PADC has used over $8 million to assist developers, including $5 million for the restoration of the Willard and $500,000 for the Landsburgh restoration. The PADC staff believes that the amount of financial assistance it has provided has been more than offset by the private sector dollars invested to save non-PADC projects along the Avenue.

PART FOUR

SUMMARY AND CONCLUSIONS

As we move into the nineties we are a nation faced with an oversupply of office space, a nationwide movement of belt tightening, and corporate consolidation. Efforts by the government to reduce the federal budget deficit will further restrict the few remaining federal subsidies available for development and housing assistance. As state governments face budget crises, they will be forced to look increasingly to the private sector for assistance. Now, more than ever, public/private partnerships will move to the forefront as a strategy for revitalizing our aging cities. That is why it is essential that public development agencies begin to study public/private partnerships that have worked.

By analyzing the PADC one immediately recognizes that they have had unique advantages not available to most public development agencies. Less obvious are those characteristics of the PADC's activities that can be adapted for use by agencies in other cities. In general, all cities, be they large or small, should be able to take away an understanding of how the PADC planned the redevelopment effort, and how, through the successful implementation of the plan, it has been able to provide benefits to the city and its people. This chapter looks to identify the key aspects of the public/private partnerships used to redevelop Pennsylvania Avenue, and how they can be applied to a more generic public/private partnership model. It will address those areas where the PADC initiative has missed the mark, such as affordable housing, and how it could have been avoided.

Planning the Capital Structure

The one characteristic of the PADC that makes it stand out as unique among public development agencies is the capitalization provided by the government. While the resources that the PADC was provided with are beyond the means of most cities, the financial program established by the PADC is not. The PADC prepared a development plan that projected all costs, project and administrative, necessary to implement and complete the plan. Through the separation of its funding sources and their corresponding uses, the PADC was able to accurately prepare a methodology for repayment of debt incurred by the Corporation through its development activities. Furthermore, it recognized the need to budget public improvements, in their entirety, up front, while budgeting for salaries and expenses on as-needed basis. Additionally, the PADC was able to use 100% of revenues generated by its land to secure the bond issues needed for the repayment of its debt.

Most cities use funds gained through the disposition or leasing of land to pay for salaries, public improvement projects, and related expenses, but because PADC overhead expenses were separated from all other costs, the PADC was able to estimate project costs for the entire plan redevelopment. By segregating these costs, the PADC experience demonstrates, how redevelopment efforts can be financed. PDAs that have access to more limited appropriations could use appropriated funds for staff salaries while relying on financing instrument such as tax increment bonds to finance public development initiatives. Thus, preserving project revenues, and proceeds from sales for other goals like residential development, or historic preservation.

Policy Objectives and Public Commitment

The obvious conclusion that can be reached by studying the PADC's approach to affirmative-action objectives is that establishing guidelines is not enough to ensure their success. When the PADC set its affirmative-action guidelines it did so with a dual purpose. With a high percentage of minorities as residents of the District, the PADC felt that increasing the normally recommended guidelines was an important and visible example to set.

Secondly, the PADC actively particpated in the assistance of plan implementation on a project-by-project basis. It was through this active participation that the PADC was able to recognize that developers were unable to achieve 10% equity participation by minority investors. Rather than decrease the level of participation, the PADC actively sought out candidates that could be presented to private developers as interested and qualified investors. This constant interaction is primary reason that the PADC has been able to increase participation above federal guidelines, and successfully achieve 100% compliance with the guidelines established by the PADC. It was because of this determination and commitment to involve minorities and residents in all aspects of projects that the PADC has not only succeeded, but managed to find a way to get minorities involved as equity partners and owners along the Avenue.

<u>Changing the Use: Commercial to Residential</u>

Changing the land use from commercial to residential, in the eastern sector of the plan area to accommodate the PADC's desire to integrate a residential component into the plan raised many challenging issues. Among them was how to establish the value of the land at its new use. The PADC could have down zoned the area and then taken the land through eminent domain proceedings, but faced with the prospect of resistance, legal expenses, and extended delays, they chose another route. Instead, the PADC chose to acquire the land at fair market, change its use, then sell or lease the land to developers at the fair market value for the combination of commercial and residential uses desired by the PADC. The PADC estimated sales costs for residential land, then it offered the land at prices commensurate with the less profitable residential use. While the PADC was forced to finance a portion of the residential development through other project revenues, it provided the means to induce developers to provide the uses desired by the PADC.

A related issue was the way in which the PADC actually structured the incentive. It chose to set the disposition price of the land based on its commercial value, plus the value of the minimal amount of acceptable housing. The PADC then offered a rebate on each additional unit of housing above the minimum that the developer provided. The developer would pay the full purchase price at the closing, and the PADC would return the incentive after the project was complete. This served the dual purpose of insuring that the proposed scheme is actually built, and also allowed the PADC to use the developer's funds for the duration of the project.

How Successful was it?

The residential development of nearly 1000 housing units in an area previously void of residential activity is viewed as a great success by the PADC. It is felt by some that without the residential development the overall plan might not have been such a success. It is true, that when completed, the residential neighborhood will bring much activity to the plan area, but the market rate housing created is priced such that most Washington residents cannot afford to live there. Designed to bring around-the-clock activity to the area, high prices, and the proximity to government and business activities have led to corporations purchasing units for use as corporate apartments which are not occupied by permanent residents.

As stated in Part One, it was intended that 20% of the units be provided as affordable housing units. The PADC, however, incorrectly assumed that federal subsidies would be available to fill the gap created between tenants ability to pay and developer costs. More thorough research by the PADC would have shown that the federal subsidies that were available were not sufficient to fill the gap created by the high price of new housing. The high land costs associated with the new residential development made it impossible to develop affordable units. Instead, Section 8 subsidies went to existing neighborhoods that were already residential and to areas where land costs were priced such that normal subsidies were sufficient to fill the gap. Developers, who were already paying land costs that were prorated for both commercial and residential uses, could not be expected to fund this gap, either through proceeds from market rate units or from office rents. In preparing its redevelopment plan the PADC recognized that the creation of a residential neighborhood would involve downzoning and the need for the PADC to fund this land use change. It should have gone a step further and recognized the need to make provisions in the plan to partially subsidize the affordable units. Either the PADC should have recognized the need to augment federal subsidies through the use of appropriated funds, or perhaps it should have considered allowing higher residential densities to developers who provided, at their own cost, affordable housing units. This is one of the few instances where the PADC set a goal -- 250 affordable units, and failed to properly analyze the feasibility of their assumption and provide the resources needed to meet their objective.

While I agree that the overall development of a housing component is important, it seems that in this time of a national housing crisis, the half-hearted attempt to follow through on the PADC's initial affordable housing objective has fallen far short. I think that there were opportunities for the PADC to make some mid-course corrections that would have provided the funds necessary to fill the subsidy gap. When the PADC recognized that appropriations would not be needed to fund the land use change from commercial to residential, it could have redirected these funds to assist with the realization of the affordable housing component. Also, it could have utilized profits from earlier projects and surplus lease revenue to fill the gap or to offset below-market ground leases.

"The D.C. Market"

Perhaps the single largest conclusion to be drawn from this analysis is that without a cooperative real estate market it is highly unlikely that the Pennsylvania Avenue redevelopment effort would have succeeded to the degree it has. The Washington, D.C. real estate market has been in a boom mode for the last ten years. All seven PADC sponsored projects as well as the 17 related private development ventures along Pennsylvania Avenue have been initialized during this ten-year span. While it is impossible to quantify the impact of the general market conditions on the successful implementation of the plan, it is reasonable to suggest that the PADC might not have achieved some of its goals had market conditions been less favorable. The PADC's success on early projects allowed them to mandate the inclusion of affirmative-action plans. A lack of demand most certainly would have given them much less bargaining power in their negotiations, and less surplus revenues, thereby leading to different results. Likewise, if more land had been available in the traditional commercial area, the PADC would not have been able to price their parcels as they did.

Summary

The PADC has accomplished much in 15 years as a public developer. In critiquing the PADC it is important to review its accomplishments in light of goals and objectives set in 1974 when the original Pennsylvania Avenue Plan was prepared. With the exception of affordable housing the PADC has succeeded to a large degree in meeting the goals it had set for itself. While it was uniquely capitalized, the PADC demonstrated a financial planning process that, subject to dramatic changes in the D.C. real estate market, allowed them to commit resources to specific uses, thus allowing them to do the long-range planning necessary for a project of this scope and duration. The successful implementation of the PADC's policy objectives can be attributed not only to good timing but to careful planning and relentless follow up. Continuous monitoring and effective mid-process modifications ensured the preservation of historic structures, participation of minorities and city residents, and the creation of a new neighborhood to support extensive commercial development. The overall success of the PADC is evidence to support the up-front planning and commitment of capital that is needed for successful public development.

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