

Building a More Sustainable Economy

Economic Development Strategy and the Use of Public Incentives in Austin

Executive Summary

From a national perspective, Austin's remarkable economic growth over the past three decades is viewed with awe. But for many who live here, it is not clear where Austin's economic development strategy comes from, how it is implemented, or what institutions and actors shape our economic development policies and programs.

Recently, these local economic concerns have focused on the issue of city incentives. Why should public money be given to private firms? How much are we giving? And what are we getting in return? Though incentives are just one piece of the city's overall economic development strategy, the public and policymakers should clearly understand what they are giving and what they are getting in return. Furthermore, it is essential that we understand the role incentives play in our larger economic landscape to make more informed decisions about what will truly benefit our community as a whole.

In recent decades, the City of Austin has used a variety of incentives to attract business investment and to shape the physical development of our community. In just the last ten years, Austin City Councils have approved over \$100 million dollars for a variety of incentives to private businesses intended to spur economic activity. Economic development incentives, largely in the form of substantial property tax rebates, played a role in stimulating major investments in the high technology sectors that have contributed to Austin's stunning growth since the 1970s. In addition to spurring or guiding growth, city incentives can affect jobs, wages, tax rates, traffic and other factors that influence the quality of life in our community.

While many have lauded the overall economic development performance of city government, Austin is now experiencing growing tension between continued growth and important aspects of our quality of life. Individual incentive deals have come under increasing criticism and there is a growing belief that the economic development process is detached from community priorities, that it is secretive and removed from informed decision-making and accountability.

In response to these concerns, Liveable City commissioned a review of Austin's economic development efforts and incentive policies.

In this report, we examine the city's economic development strategy and its relationship to community priorities and sustainable growth opportunities. We identify the major city and civic institutions involved in economic development policy and review the record of public subsidies for private development. We distinguish two major categories of incentives, firm-based and project-based, and evaluate them separately. In both cases, we attempt to illuminate the process – how the city decides if and what kind of incentives it will offer.

Finally, we provide policy recommendations regarding needed reforms for incentives and for the economic development process as a whole.

The Use of Firm-Based Incentives in Austin

Firm-based incentives, usually in the form of substantial tax breaks, are subsidies offered to encourage companies to locate or expand in Austin. From 2000 to 2007, the City of Austin approved five firm-based incentive deals involving tax subsidies totaling more than 64 million dollars. In the area of firm-based incentives, we found that Austin's lead economic development institutions – the Greater Austin Chamber of Commerce and city government - do many things well, though we also found aspects of the process that would benefit from significant reform.

Compared to many other communities, the city and Chamber have demonstrated a sophisticated approach to economic development and have been reasonably disciplined in the granting of public incentives to desired firms. The Austin Chamber, through its Opportunity Austin initiative, has substantially upgraded its business recruitment and retention efforts, adding a major new effort to promote retention and expansion of resident firms to its traditional firm recruitment portfolio. The Chamber has also recently identified a new set of potentially fast-growing target industries, such as green industries, to diversify our economy and augment our traditional strengths in the microelectronics and computing sectors.

The way that the Chamber and the city structure public incentives to encourage firm investment also has several positive features. The city employs a formal review and scoring process that incorporates reasonable criteria to screen companies seeking incentives. The city also recently set aside its former requirement that incentives only be offered to large establishments, allowing resources to be targeted to small- to medium-sized firms to promote a more varied economic landscape. Another strength of local policy is that most incentives are granted based on the annual performance of the firm that receives them: before the city pays out, the firm must first prove it has met agreed-upon job creation and investment commitments.

Though the past use of firm-based incentives has been generally sound, Austin would benefit from a fuller public discussion involving a broader range of stakeholders about overall economic goals to determine when firm-based incentives should be used and how they should be targeted. Such a discussion should include an accounting of the full costs and benefits associated with firm location or expansion, such as the number of jobs created, the number of jobs expected to be filled by in-migrants versus Austin residents, income and tax gains as well as additional infrastructure costs, environmental impacts and service costs such as healthcare. In addition, the cost-benefit methodology used by the city in judging proposed firm-based incentives should be considerably strengthened. Both the public and policymakers should have access to clear, concise information about proposed incentives with sufficient time for informed deliberation before decisions are made.

The Use of Project-Based Incentives in Austin

In addition to firm-based subsidies, the city also employs project-based incentives. Incentives of this type have been used to encourage larger businesses, such as Computer Sciences Corporation, to locate in central Austin, rather than in outlying areas; to

stimulate residential and retail development, such as the Domain; and to promote a new model of denser mixed-use development on major transit corridors, such as the Triangle project.

City subsidies to encourage denser, mixed-use projects in Austin's Desired Development Zone have had certain environmental payoffs, but the overall record on project-based incentives is decidedly mixed. In general, project-based incentives would benefit from the same thorough public discussion and rigorous cost-benefit analysis summarized above for firm-based incentives. However, project-based incentives involve additional issues that must be addressed more effectively by the city.

While individual projects such as the Mueller Redevelopment and the preservation and reuse of the Seaholm site have had strong public input, the city's overall policies on redevelopment or the weighting of community benefits associated with project-based incentives were not the result of an open participatory process. Project-based incentive policies were established without broad public discussion or consensus about specific community benefits that might warrant direct city incentives. Such a discussion is now crucial to clearly prioritize the community benefits that can be leveraged from new development in the context of larger citywide planning efforts.

In addition, it is extremely difficult to determine how much the city has actually spent, directly or indirectly, on past projects or to accurately assess the net tax or other community benefits that these projects may have generated. After intensive research by the author and a former city auditor for this report, we were unable to fully determine from the publicly available documents the complete costs of many recent project-based incentives or what benefits the city may have derived from these investments of public funds. A clear and simple accounting of the costs and benefits of project-based deals is crucial to ensuring community support for these initiatives.

This report uses the Domain project to underscore troubling flaws in the current incentive-granting process. The Domain incentives were poorly considered and stand out as second-rate economic development practice. In fact, the use of project-based incentives to stimulate retail business generally is very difficult to do in a way that yields net benefits to the city.

To understand the problems inherent in retail incentives, it is important to recognize that retail activity is generally the result, rather than the cause, of economic growth in a city or region. Retail activity cannot grow faster than disposable income within a given economy. To the extent that new or expanding retail establishments grow faster than local purchasing power, there will likely be crowding out of existing retail establishments. In most cases, retail incentives simply shift economic activity from one place to another, rather than generating new products or jobs. This is why it makes little sense to offer public incentives to retail except in special cases such as trying to bring basic retail services to underserved neighborhoods.

Similarly, the continued use of direct retail incentives simply to promote mixed-use development should be questioned. At one time, these incentives may have been justifiable to introduce the mixed-use concept to the Austin market. Now that it is established as a profitable and desirable model, the further use of incentives for this purpose should be very carefully considered.

As a community, Austin must have an open and informed debate about exceptional cases in which retail incentives might be warranted, such as bringing retail to underserved communities, adaptive reuse of important historic properties or perhaps spaces that support local artists. This discussion is especially crucial in light of the upcoming November ballot initiative to severely restrict incentives for retail development.

Incentive Process Needs Significant Revisions

For all types of incentives, we find that Austin's current process of awarding public subsidies needs to be significantly revised.

Currently, neither the public nor the city's policy makers have access to clear and concise information about the costs and benefits of Austin's economic development initiatives.

Under the current screening process, the full cost of incentive deals to city taxpayers is not clearly delineated, nor are the job, income and tax benefits fully estimated.

The current process also fails to provide sufficient time or space for serious deliberation of proposed incentive deals by policymakers or the public. Full and accurate information and a more open process are both crucial elements for wise decision-making about allocations of scarce public resources. Our current incentive process must be redesigned to ensure these conditions are met.

Reforms Needed to Ensure a Unified, Sustainable Economic Strategy

The report concludes that Austin's economic development strategy and incentive-granting process need significant reform to meet future challenges. Continued success demands an economic development process that is more inclusive, rigorous and diversified in its approach. The fundamental questions about our city's future development must be addressed as a community. What kind of jobs and industry growth do we want to encourage? How do we want our city to grow? How do we better balance economic growth with the preservation of our quality of life?

As a community, we must build the foundation for future growth in emerging industries, such as clean energy, environmental services and artistic and cultural industries, with the same passion and attention we devoted to seeding the microelectronics industry in past decades—and with the public fully informed and on board. At the same time, we must ensure that Austin remains livable for all its citizens, providing equitable and affordable opportunities in housing, employment, education, transportation, healthcare, and other critical areas.

One area for which the community has already demonstrated strong support is sustainable development, generally defined as that which "meets the needs of the present generation without compromising the ability of future generations to meet their own needs."¹ In light of a softening economy and a profound need to reduce the environmental impacts of growth, Austin should undertake a comprehensive discussion about our economic future that places sustainable development at the center of the local economic development

¹ Brundtland Commission Report, World Commission on Environment and Development. established by United Nations General Assembly, 1987.

process. Other cities including Rochester, Seattle, Portland, London, and Toronto have laid aggressive plans to propel economic growth in ways that conserve water, fuel, air quality, and affordability. Austin's many existing assets and well-founded initiatives to promote green industries can be better leveraged in this effort, both to attract the growing sector of new green industries and to ensure the highest possible environmental standards for our community.

Recommendations for an Improved Economic Strategy:

Based on our review of local economic development policies and best practice lessons from other cities, we recommend the following policy initiatives to better position Austin for the challenges ahead:

- Increase Community Involvement and Investment in Local Economic Goals and Strategies
- Create a Unified Economic Development Budget
- Reform the Process of Evaluating and Granting Incentives
- Reformulate Goals and Policies on Physical Development and Project-Based Initiatives
- Reform Process of Evaluating Community Benefits for City-Supported Development Projects
- Prioritize Sustainable Development of Green Industries and Green Jobs

1. **Increase Community Involvement and Investment in Local Economic Goals and Strategies.** The city should engage a much larger group of institutions and stakeholders in the economic development planning process, as has been successfully done in Atlanta and Rochester, New York. Working with stakeholders, the city should create an ongoing public outreach campaign that includes an annual "Economic Development Summit" to review goals, strategies and specific initiatives, and to forge a new sustainable economic development plan with strong community support.
2. **Create a Unified Economic Development Budget.** The city's Economic Growth and Redevelopment Services Office (EGRSO) should produce an annual unified economic development budget that maps city departments and sub-departments to specific policies, expenditures and activities directed to economic development.

This document will: (1) provide the public with clear information about all the city's activities and spending related to economic development; (2) help the city avoid duplication of effort, allowing it to direct responsibilities and funding to the most appropriate and competent departments; and (3) enable the city to assess performance and returns on public investment to promote more efficient resource allocation.

The city should also produce and publicize an annual report updating progress on all ongoing incentive packages including a performance review of each firm or project receiving incentives and an accurate account of public funds associated with each deal.

3. Reform the Process of Evaluating and Granting Incentives.

The current incentive evaluation process should be made more rigorous and open, without compromising efficiency and timeliness, through adoption of the following measures:

A. Disclosure of Competing Cities by Applicant.

The city should require disclosure, by either firm representatives or site selection consultants, of other cities that are competing for a firm location as part of the application process for any city incentives.

B. Disclosure of All Costs by City.

The city should disclose, in a simple format, all costs related to a proposed incentive package including tax incentives, fee waivers, infrastructure improvements, Austin Energy subsidies, site-related improvements, or other costs.

C. Adoption of Rigorous Cost-Benefit Methodology.

The city should create a technical advisory committee charged with developing a rigorous methodology for performing cost-benefit analyses on all city incentive deals.

D. Third-Party Cost-Benefit Analysis for Major Deals.

For any significant incentive proposal, the city should require a full and thorough cost-benefit analysis conducted by a neutral third party (e.g., neither city staff nor consultants to the city) based on the adopted cost-benefit methodology. The Capital Area Council of Governments (CAPCOG) has expertise in this area and may be the appropriate entity to conduct this analysis.

E. Public Hearings.

All major proposed incentive deals should include a full public hearing *before* the City Manager makes a recommendation to the City Council regarding the proposed incentive. An information package, including the complete cost-benefit analysis, should be publicly distributed at least 21 days before the initial public hearing, which should be well-publicized in news outlets, on the city's website and other outreach venues. At the hearing, the City Council should conduct a non-voting open review of the project with public testimony. After the initial hearing, a recommendation may be made by the City Manager and the matter may be referred to the Council for a vote, again with a well-publicized two-week notice. Any changes or revisions in the deal after the initial hearing should be made public before the next two-week notice is issued and should require an additional public hearing before the Council votes.

4. Reformulate Goals and Policies on Physical Development and Project-Based Initiatives.

The goals animating the city's policies on project-based incentives including density bonuses should be reviewed and revised through a participatory process involving neighborhoods, developers, policymakers, and other community leaders. City project-based investments should flow from broader community-based planning efforts and not be considered as individual "stand alone" deals.

In particular, this reformulated process should limit direct or indirect incentives for retail to very exceptional cases where community benefits are clear. It should also explore models, such as those used by Denver and San Diego, to provide affordable housing in central locations close to jobs. In any case, a strong public consensus on a new scoring process for project-based incentives is needed to ensure that incentives are linked to the specific benefits most valued by the community.

5. Reform the Process of Evaluating Community Benefits for City-Supported Development Projects.

In light of clear problems with the city's project based incentive policies, we applaud the December 2007 resolution of the City Council ending public incentives to private developers. However, the city must develop a much more rigorous and open process to evaluate projects involving redevelopment of public land or other development processes with direct city involvement, such as Waller Creek or the Green Water Treatment Plant. This process should first include the identification of clear priorities about the types of community benefits expected in city-supported development. Once a new set of community benefit priorities are established, an open and deliberative evaluation process should be implemented that includes: (1) a thorough cost-benefit procedure that provides accurate and legible information on all direct or indirect incentive costs associated with supporting a development; and (2) a public deliberation procedure similar to that recommended above for granting city firm-based incentives.

6. Prioritize Sustainable Development of Green Industries and Green

Jobs.

Green industries are widely expected to experience rapid growth in the coming decades and Austin should take immediate steps to establish itself as a leader in these high growth sectors. The City of Austin, the Chamber of Commerce and other organizations are engaged in the push for greener, more sustainable economic development. At the same time, Austin lags significantly behind states such as California and New York and regions such as northern California in the actual development of green industries.

The city and Chamber should undertake a major study and planning initiative to focus resources more effectively on green industry development, with the goal of building a more diverse, sustainable economy. Austin already boasts many assets in this area, which can and must be far better leveraged to ensure a truly sustainable future for our city.