Liveable City Ballot Study

City of Austin Charter Proposition 2
Stop Domain Subsidies Amendment

November 4, 2008 General Election Ballot

Accepted by the Liveable City Board 10.21.08

The Liveable City "Stop Domain Subsidies" Ballot Study

The Board of Liveable City designated a Board study team to review and report on the proposed "Stop Domain Subsidies" Charter Amendment (Proposition 2) which qualified for the November 4, 2008 General Election Charter ballot through a citizen initiative. Proposition 2 is one of two charter propositions on the ballot and will be voted on by City of Austin and Austin's extraterritorial jurisdiction voters. The purpose of the study is to present a review of the arguments for and against the proposed amendment to assist Austin voters in making their decision on this important public matter.

The Ballot Study is the latest in Liveable City's ongoing interest in Austin's economic development and growth management policies. Beginning with *The Economic Impact of Local Businesses Versus National Chains*, to the *Community Priorities for a Healthy Economy Survey*, and most recently *Building A More Sustainable Economy, Economic Development Strategy and Public Incentives in Austin*, Liveable City studies identify reforms needed to create a unified, sustainable economic strategy, embraced by the community, to better position Austin for future economic challenges and opportunities.

About Liveable City

Liveable City works to build a shared and sustainable vision for Austin's future. Dedicated to civic engagement, Liveable City examines public policy, develops best practices and provides strategy support to community building groups.

Liveable City's mission is to safeguard Austin's long-term social, environmental, and economic well being by focusing on the interconnections among issues while educating, informing and empowering Austin's citizenry to improve the community's quality of life.

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Liveable City "Stop Domain Subsidies" Charter Amendment Ballot Study

Executive Summary

"Austin needs to develop a well defined incentive policy to ensure that future public investments are prudent, provide tangible public benefits commensurate with the funds involved, and do not unfairly favor one business over another."

The Board of Liveable City designated a study team to review the "Stop Domain Subsidies" Charter Amendment (Proposition 2) which qualified for the November 4, 2008 General Election ballot through a citizen initiative. Proposition 2 is one of two charter propositions on the ballot and will be voted on by City of Austin and Austin's extraterritorial jurisdiction voters. The purpose of the study is to present a review of the arguments for and against the proposed amendment and to provide analysis to help assist Austin voters in making their decision on this important public matter. The study reviewed the use of economic incentives and found that the Domain Agreement was a significant departure from Austin's previous economic development strategy.

The Charter amendment resulted from the belief that subsidies to the Domain were damaging to local businesses. Brian Rodgers, a local small business owner, had led a legal challenge to the deal, which resulted in a settlement agreement with the developers allowing cancellation of the Domain Agreement without penalty, in the event that the city's failed to appropriate funds pay for the agreement. Mr. Rodgers subsequently organized the "Stop Domain Subsidies" Charter Amendment effort that placed Proposition 2 on the November Charter ballot.

A review of the amendment language shows that Proposition 2 would prohibit the City with some exceptions from issuing tax subsidies to developments that include retail uses. It would also impact some subsidies already granted, including the subsidy to the Domain mixed-use development. The language includes a number of exceptions to the subsidy prohibition including local businesses, Tax Increment Financing Districts (TIFs) and revitalizing distressed areas.

Proposition 2 supporters argue that the developers misrepresented the profitability, jobs created, local business support, open space, and revenue that the development would generate. They also claim that the city's legal position and the Mueller Redevelopment Project would not be jeopardized by the proposal.

Opponents argue that the city should not go back on its word by changing rules after developers have incurred substantial costs. They claim that the proposal will reduce corporations' willingness to conduct business in Austin, that it will threaten the city's ability to create affordable housing in mixed-use developments and that a city resolution has already prohibited future retail subsidy deals.

Liveable City's review shows that while the Domain will generate additional tax revenue and jobs, the city didn't require "new" jobs, but instead allowed jobs to be simply relocated from existing stores. Because of the location, it is likely that the site would have been intensively developed even if the subsidy had not been granted. A cost–benefit analysis of the agreement shows that the Domain deal will return more subsidy dollars to the developer than benefits to the Austin taxpayers.

Based on this review of the "Stop Domain Subsidies" Charter Amendment, Liveable City presents the following conclusions:

1. The Domain Agreement was not a good financial deal for the City and the city failed to protect the taxpayer's interest. If Proposition 2 does not pass, the city should renegotiate the deal.

2. While the Domain developers may have met the terms of the final written agreement, the city government did not live up to its contract with the public to ensure the agreement reflected all promises made regarding the project and constituted a prudent investment of public funds.

3. Proposition 2 may require some restructuring of the Mueller redevelopment agreement with the participation of all parties; however, its passage would by no means spell the end of that agreement or that project.

4. It is unlikely that passage of Proposition 2 would have any appreciable effect on industrial subsidies or on Austin's overall business climate.

5. Passage of Proposition 2 is unlikely to affect the city's ability to maintain a good bond rating.

6. Although there is a Settlement Agreement in place which addresses legal rights regarding the Domain Development Agreement, as is always the case, legal challenges remain an available means of impacting public policy decisions.

7. Questions remain regarding Proposition 2's effects on some tools typically used to promote affordable housing in mixed-use projects. However, many of these tools - including TIFs, nonprofit participation and grants, and infrastructure cost–sharing - would be unaffected by the amendment.

8. Austin needs to develop a well defined incentive policy to ensure that future public investments are prudent, provide tangible public benefits commensurate with the funds involved, and do not unfairly favor one business over another, as recommended by Liveable City in its 2008 report on economic incentives. A charter amendment provides the strongest foundation for such a policy, though these goals could also be achieved through a well-crafted ordinance.

9. The city council's resolution prohibiting retail subsidies does not have the force of law and can be overturned on short notice by a simple majority of the council. The city should keep its word to Austin residents by ensuring that public investments are well-considered and offer tangible public benefits for the greatest number of residents, not just financial benefits for a few.

Read the full *Liveable City "Stop Domain Subsidies" Charter Amendment Ballot Study* or to review other information on the use of public incentives, see *Building A More Sustainable Economy: Economic Development Strategy and Public Incentives in Austin* at www.liveablecity.org.

Stop Domain Subsidies Proposition 2 Ballot Study

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I. Introduction

Background

Proposition 2 on the November 4, 2008 City of Austin ballot would amend the Austin City Charter. The charter is Austin's constitution, and lays out the form, powers, and limitations of Austin city government. The charter was first written in 1909 and has been amended many times since. Amendments can be proposed in two ways: by a vote of the City Council or by citizen initiative. All amendments must go before the voters and are only added to the charter if a majority of voters agree. Nevertheless, no charter may contain any provision inconsistent with the Texas Constitution or any state law. Proposition 2 is one of two charter amendments on the November 4, 2008 ballot.

This ballot study examines the issue of financial incentives for retail development and the merits of arguments put forth by supporters and opponents of Proposition 2. It discusses the primary benefits and costs of the proposition to Austin residents and provides conclusions based on this analysis.

Proposition 2 Amends the City Charter

The full text of the Proposition 2 Charter Amendment is provided in Appendix A. Only a short synopsis of the proposition appears on the ballot to help voters understand what the proposition would do. This ballot language is determined by a majority vote of the Austin City Council. In this case, the council adopted the following language:

> **Proposition 2.** Shall the City Charter be amended to prohibit the City from entering into future agreements to provide financial incentives in connection with the development or redevelopment of property that includes one or more retail uses, and to stop the City from providing financial incentives under certain existing agreements in connection with the development or redevelopment of property that includes one or more retail uses?

Short Explanation of Ballot Language

The city is currently allowed to refund sales and property taxes to proposed developments it believes will improve the city's economy. If Proposition 2 is adopted, the city would be prohibited from doing so, with certain exceptions, if the development includes retail uses (stores, restaurants, and bars). Additionally, the city would not be allowed to provide free land, roads, water lines, sewers, and other infrastructure, make cash grants, or forgive loans, except to the non-retail portion of the development. The city would still be free to make grants or loans to small, locally-owned businesses (including stores, bars and restaurants), spend money through a Tax Increment Financing (TIF) district, or refund taxes for the purpose of conserving energy, improving water quality, or revitalizing distressed areas.

II. Background

Economic Development Incentives

Like cities throughout the country, Texas cities have the authority to issue tax refunds, waive fees, or provide free land, infrastructure, and job training to businesses for the purpose of economic development. This practice of *economic development incentives* was developed in the 1970s for use in economically distressed areas. The original idea was that businesses would be unwilling to site factories and offices in poor neighborhoods because the costs (in terms of worker inconvenience, crime, or lack of appreciation of their property) would be too great. By offering a subsidy, cities with distressed neighborhoods hoped to level the playing field and make the net costs of developing in poor areas no greater than the costs of developing elsewhere. This would presumably encourage further development in poor neighborhoods and improve job prospects for the people who lived there.

Since the 1970s, the concept has broadened considerably. Cities and states nationwide now issue subsidies to encourage economic development throughout their jurisdictions, not just in poor neighborhoods. The objectives have changed, as well. Instead of focusing on reducing unemployment and improving distressed areas, state and local governments now use incentives as a means of competing with other jurisdictions. Some astute corporations have instigated "bidding wars," pitting one government against another in hopes of getting the best tax breaks.

Although Austin has provided some incentives in the past, its high economic and population growth rate have kept it out of most of these bidding wars. Since the 1860s, the Austin metro area has doubled in size every 20 years; during the 1990s, Austin's economy grew faster than that of any other metropolitan area in the nation. Despite the occasional "bust," the Austin City Council and other local governments in Central Texas rarely found it necessary or desirable to fuel further growth by issuing subsidies.

There were exceptions, of course. In 1983, Austin lured the Microelectronics and Computer Technology Corporation (MCC) to town by subsidizing its office lease and providing low-interest mortgage loans to its employees. In 1988, Austin partnered with the State of Texas and the University of Texas to provide a large subsidy to Sematech, Inc., a consortium of semiconductor manufacturers. And in 2006, Austin promised a $50 million tax break to Samsung Electronics in exchange for its new wafer fabrication facility. Although these companies all brought new jobs to town, the primary justification in each case was strategic. As high-profile research and development facilities, MCC and Sematech would ensure Austin's position as a high tech center worldwide and encourage further expansion among semiconductor, computer, and software manufacturers; Samsung would secure Austin's position for the next generation of semiconductor manufacturing. Austin has also issued smaller subsidies for other businesses, including Home Depot,

Hewlett-Packard, and Heliovolt, but the combined cost of these incentives is less than $10 million. Since 1991, Austin has entered into 19 economic development agreements, compared with 67 for San Antonio, 91 for Houston, and 208 for Dallas. Austin has been considerably less aggressive in providing incentives than other Texas cities.

Retail Incentives and the Domain Deal

The Domain subsidies represent a departure from the city's previous economic development strategy. In 2000, Austin retained its position as the commercial and employment center of the metropolitan area. Although population, jobs, and retail sales continued to grow in the city, growth was even faster in the suburbs and Austin's percentages of the regional population and of regional retail sales were decreasing. The recession in the high tech industry caused Austin's sales tax receipts to drop in 2002. About one-fourth of Austin's general fund is paid for out of sales tax receipts, and the drop forced a cutback in the city's budget and reductions in some city services. In 2003, Endeavor Real Estate approached city staff with a proposal. If the city could subsidize its proposed Domain development, located near the intersection of North MoPac and Braker Lane in northwest Austin, Endeavor believed it could bring in Neiman-Marcus and several other high-end retailers as anchor tenants. This would presumably shore up the City's sales tax revenues and reduce the need for further cutbacks.

The Domain deal was unprecedented in size. Endeavor would receive property and sales tax breaks worth $25 million in 2003 dollars, approximately 20 percent of the total cost of the development. Although similar in magnitude to the MCC, Sematech, and Samsung deals, this was a far larger percentage of the total development cost than any previous subsidy offered. In exchange, the Domain would provide over 1,000 jobs with an average wage of $27-$35,000, and sales and tax revenues considerably greater than would have been provided had the land remained fallow. The Domain would also provide 30 or more units of affordable housing and improve opportunities for small contractors to become involved in construction of the project and for small, locally owned stores to locate in the development. The city's cost-benefit calculations found that benefits would be roughly 50% greater than the subsidies.

The city's primary objective was to ensure that Neiman-Marcus and other high-end retailers located within the Austin city limits and the city achieved this objective. However, it did so by giving the developers an enormous tax break. This may have put competing retail centers at a disadvantage.

Brian Rodgers, an owner of several small shopping centers in Austin, sued the city and Endeavor Real Estate in 2003 to stop the subsidies, arguing that they were damaging to local businesses. The suit was settled, but as part of the settlement, the city and the developer agreed to a change in the Development Agreement, allowing the city to effectively cancel the contract without penalty by failing to appropriate the funds to pay. Although this meant that the city could stop the subsidies, it did not ensure that the City

Council would cancel the Agreement. In December 2007, the council in fact reaffirmed its intention to honor the agreement. Mr. Rodgers led the Stop Domain Subsidies effort to obtain the 18,000 signatures needed to put the proposed charter amendment – Proposition 2 – on the ballot.

III. **What Does Proposition 2 Say?** (Full Text in Appendix A)

The proposed proposition would add a new Section 13 to Article XII of the Austin City Charter. The proposed new section would do the following.

(a) Statement of Intention

The amendment states an intention to restrict the city's ability to provide tax subsidies or other financial advantages to developments that include retail uses. The stated reason is "to ensure that small retail businesses are not disadvantaged" by subsidies given to their competitors.

(b) Restriction

The amendment prohibits the city from providing incentives for retail use, specifically: "The city shall neither provide nor enter into an agreement to provide any Financial Incentive in connection with the development or re-development of any real property that includes one or more Retail Uses."

(c) Applicability

The amendment prohibits the city from subsidizing retail uses in the future, but also applies to "any pending agreement" if the agreement makes payment "…contingent on or subject to the city's appropriation of funds for the payment of the Financial Incentive."

(d)(1) Financial incentive defined

The amendment defines "financial incentive" to include some methods used to subsidize development, but not all. Included (and thus prohibited) are rebates of property and sales taxes; donation of land and special rights to use of land; forgiveness of loans; and grant of funds.

The amendment also defines what is <u>not</u> considered a "financial incentive." The proposition explicitly does not prohibit construction of street and utility improvements, so long as the developer pays that share of the cost needed to serve the retail development; grants or loans to small businesses located in Austin; expenditures associated with a Tax Increment Financing (TIF) district; and incentives to promote efficient energy use, renewable energy or decreased water usage, for regional drainage detention, regional water quality facilities or other public improvements, or to revitalize distressed areas. Any incentives given by the state or federal government are also allowed, even if the city must give its approval.

(d)(2) Retail uses defined
The amendment defines "retail uses" as use of improvements to real property for sale directly to the public of "any commercial or consumer goods" which includes stores, restaurants, and bars. Because the amendment prohibits financial incentives to any development that includes retail uses, mixed-use developments would not be eligible for financial incentives of the kind listed above, even if they were mostly for residential, office, warehouse, or factory use.

The amendment also defines what is not considered a retail use. "Retail uses" do not include factories, wholesale or distribution centers, medical, counseling, nursing, or day care facilities, non-profit or government enterprises, public or private schools, performing arts venues, museums, or libraries.

(e) Enforcement
The amendment states that any Austin resident can assert a claim for declaratory or injunctive relief for a violation of the Charter Amendment. This would allow any Austin resident to file suit to stop the subsidy.

IV. **Arguments Pro and Con**

Arguments Advanced by Proposition 2 Supporters

Supporters argue: The City should not be subsidizing retail development. The retail business is extremely competitive; small retailers, in particular, run very close to the margin. Any action that puts some retailers at a disadvantage is likely to run some of them out of business. Due to the extremely political way in which subsidies are determined, large national retailers are the most likely beneficiaries of any future subsidy agreement. The City should not be in the business of picking winners and losers, especially when the losers are likely to be local businesses that keep more of their earnings inside central Texas and are more involved in the local community.

Supporters argue: The developers misrepresented the Domain development. Proponents of the amendment list seven misrepresentations:

- The Domain subsidies were not necessary because the development would have been highly profitable, even in the absence of a subsidy;
- The jobs provided pay much less than the promised $27,000 to $35,000 per year;
- A $1 million "special inducement" for small, local businesses was extended to almost all businesses, not just small locally-owned enterprises;
- The Domain includes only 1.4 acres of open space, not the 4 acres promised;

- Revenue benefits assumed that the development would open in 2005, two years before construction could have been completed;
- The developer's projected property tax benefits could not be achieved since the agreement froze assessed values for several years;
- The developer set its retail sales expectations artificially low to hide its expected compensation.

Supporters argue: The developer also set an artificial timetable of one week for City Council consideration, for the stated purpose of allowing the developer to use the subsidies to bring in high-end anchors at an impending trade fair. This developer-imposed deadline prevented the public and city staff from giving the deal the scrutiny it deserved.

Supporters argue: The developers have agreed that the City can get out of the Domain contract without paying the subsidies. As part of its out-of-court settlement with Mr. Rodgers, the developers agreed that tax rebates would only be paid if the city council appropriated these payments in the city budget. If the council fails to appropriate the funds in the budget, the developers have the option to cancel the agreement. This means that they could cancel any remaining support for small, locally owned stores and cease to provide affordable housing. The city would be released from any obligation to provide further tax rebates. Thus if Proposition 2 passes (or the city just decides not to pay), the agreement is canceled and neither the developer nor the city would have any further obligations. Supporters argue that, because the city should not subsidize retail development, and particularly because of the misrepresentations associated with the Domain subsidy described above, the city should stop appropriating funds, effectively canceling the contract.

Supporters argue: Proposition 2 does not jeopardize the Mueller Development Agreement. Although the city has also agreed to subsidize retail development as part of its larger agreement with Catellus Development Corporation, the City Council can amend this agreement in such a way that it is not restricted by Proposition 2. The council has failed to amend this agreement mostly so it can use the popular Mueller redevelopment as an argument against Proposition 2.

Arguments Advanced by Proposition 2 Opponents

Opponents argue: The city has given its word and should not go back on it. Although bundled together by opponents of Proposition 2, this statement is really three arguments. The first argument is that it is unfair to the Domain and Mueller developers to change the rules and cut off their subsidies. These developers have incurred substantial costs under the assumption that these costs will be defrayed by the subsidies. Removing the subsidies forces the developers to lose any funds invested.

The second argument is that canceling these agreements will reduce business's willingness to make future agreements with the city. The opponents' website states that passage of Proposition 2 would "tell people everywhere that they can reasonably expect Austin to cross our fingers behind our back as we're shaking their hand." They say it may have a chilling effect on the city's business climate generally.

The opponent's third argument pertains to financial issues. They claim the Domain and Mueller developers may sue the city to recover their sunk costs. Also they claim that canceling these agreements may cause national bond rating agencies to downgrade Austin's bond rating. If so, this may require the city to pay more for borrowed money in future, at substantial cost to future taxpayers. Thus adopting Proposition 2 may cost the city more money than it saves.

Opponents argue: Developers are only paid if they meet their obligations. After voting to offer a subsidy, the city signs a contract with the business or developer. This contract typically requires the developer or business to meet certain conditions. In Austin, tax incentives are provided as a "claw-back," meaning the developer pays taxes as usual, and the city only rebates these taxes if the contractual obligations have been met. The Domain and Mueller developers have both met their obligations so far, according to city staff.

Opponents argue: Proposition 2 will eliminate affordable housing in mixed-use projects. The free market largely produces housing for households making 85% of median-family income or more. But housing for people making lower incomes must typically be subsidized and Proposition 2 eliminates some sources of subsidies for projects involving both residential and retail uses. Opponents argue that this will hamstring efforts to include affordable housing in mixed-use projects.

Opponents argue: Future agreements are already prohibited by City Council resolution. In November 2007, the City Council voted not to issue any further subsidies to retail and mixed-use developments. Thus Proposition 2 will never apply to any development other than the Domain and Mueller.

V. Discussion of Proposition 2

As stated by proponents and opponents, the arguments for and against Proposition 2 make it difficult for even the most conscientious of voters to make an informed decision. In this section, we examine each side's claims and draw conclusions.

Was the Domain a good deal for Austin taxpayers?

The principal argument put forth by proponents of Proposition 2 is ultimately that the Domain development is not a good deal; opponents of the proposition argue that it

was. Although the primary effect of Proposition 2 would be to prohibit further deals of this kind, it would also cancel the Domain deal. Perhaps more important, a close review of the Domain deal will help to explain the benefits and costs of making similar agreements in future. We summarize findings here; details are provided in Appendix B.

In theory, the Domain will benefit Austin residents in five ways: It will increase the city's sales and property tax revenues; it will provide 1,100 jobs; it will provide new opportunities for small businesses; it will provide 30 or more units of affordable housing; and it will provide substantial amenities not provided in the average shopping center. In exchange, the city will rebate 80% of sales tax receipts for the first five years of operation and 50% for the next 15 years. The city will also rebate 25% of the increase in property tax revenues for 20 years. Total rebates are capped at $25 million in discounted 2003 dollars.

Below we examine each of these issues using the cost benefit analysis in Appendix B that was developed for this report:

Property and sales tax revenues. Over the 20-year contract period, the city can expect to receive about $2.8 million each year in sales taxes, and about $468,000 each year in property taxes, as a result of the Domain agreement.

Jobs. Retail sales and the jobs they provide follow population and disposable income. As a result, even if the Domain had not been built, these jobs would have been "created" by some other retailer, somewhere else in the region, anyway. The jobs at the Domain are valuable, but based on their generally low pay-scale and the fact that many of these are not new jobs, but simply jobs relocated from existing retail stores, there does not appear to be sufficient justification for subsidizing them.

Small business opportunities. The Domain developers gave small business contractors opportunities to bid on parts of the construction contract, and established a fund to help five small local retailers locate at the Domain. These activities cost the developers about $1 million.

Affordable housing. The developers set aside 10% of their 390 housing units for low-income tenants, at an annual cost of about $190,000. Over the 20-year contract period, this benefit is worth about $2.4 million to Austin residents.

New Urbanist form. The Domain's amenities are consistent with those provided by other high-end retail "lifestyle centers" nationwide. They were provided for sound business reasons and would likely have been provided even if the city had not subsidized them.

The key benefit is, of course, the sales taxes. The key to establishing a fair price is to estimate the likelihood that, in the absence of a subsidy, the Domain developers would have shopped their development (and the sales taxes it would provide) to another jurisdiction. The attractiveness of the location chosen and the experience with other cities that have issued subsidies suggest that this is not very likely. As shown in Appendix B, a fair price for the Domain deal over the 20-year period is between $9 and $13 million, considerably less than the $25 million the city is expected to pay out.

Conclusion #1: The Domain Agreement was not a good financial deal for the City and the City failed to protect the taxpayer's interest. If Proposition 2 does not pass, the city should renegotiate the deal.

Have the Domain Developers Lived Up to Their End of the Agreement?

The principal argument against Proposition 2 – that it requires the city to go back on its word – only applies if the developers have lived up to theirs. The city has reviewed the developers' activities and found that they have complied with the contract in all respects.

In a larger context, however, the poor contract negotiated by the city lacked due diligence and failed the taxpayers interests. When they sought tax subsidies in 2003, the Domain developers made a variety of promises in oral presentations to City Council: that the Domain would include 4 acres of open space; that jobs provided there would pay $27,000 per year; that these jobs would be "new," not simply moved from nearby locations; that finish-out assistance would be a special inducement provided only to small, locally owned businesses. These original promises did not find their way into the contract and the developers have not had to comply with them. This is not so much a breach of promise on the developers' part as it is a breach on the part of city government to protect Austin residents and assure that the deal they were promised was the deal they got.

City government failed to protect its residents in an even bigger way in the assumptions it used to estimate the benefits of this project. It assumed that all tax revenues obtained from the Domain stores would be new and that the increased competition would have no effect on revenues obtained from current stores. It assumed that the Domain stores would themselves be new entrants to the Austin market, not current stores relocating from other locations. And it assumed that the Domain site would remain vacant for the entire 20-year period, if this particular project was not built. The practical effect of these assumptions was to overstate dramatically the public benefits of the Domain, allowing for a similarly dramatic overestimate of allowable costs.

Conclusion #2: While the Domain developers may have met the terms of the final written agreement, the city government did not live up to its contract with the public to ensure the agreement reflected all promises made regarding the project and constituted a prudent investment of public funds.

Would Proposition 2 Affect the Mueller Agreement?

The city also has agreed to use sales and property tax revenues to subsidize the Mueller redevelopment as part of its larger agreement with Catellus Development Corporation. Specifically, the city-issued bonds, supported by sales and property tax revenues from the first phase of the development, that provided "seed money" to help finance the roads, water and sewer lines, and drainage improvements needed to support the rest of the Mueller development. Because the first phase was entirely retail and the entire project is mixed-use, this agreement might be construed as a retail subsidy of the kind prohibited by Proposition 2.

The Proposition's proponents contend that the Proposition does not affect the Mueller Development Agreement because it was written with exemptions to exclude that agreement. In particular, the sections excluding tax increment financing districts and allowing sharing of infrastructure costs between the city and the developer were apparently included to hold the Mueller agreement harmless. If the project is looked at as a whole, the developer is clearly paying enough of the infrastructure costs to more than cover service to the project's retail uses. But this is not true for the first few years, so if "project" means only the first phase, it may not comply with Proposition 2.

Recently, the City Council contracted with an outside law firm to research the situation and provide legal advice. It is not yet clear that the framers of Proposition 2 succeeded in excluding Mueller entirely.

Whether the Mueller agreement is exempt or not, the city has several options for revising this agreement to keep it basically intact. The city has a pre-existing contract with bondholders, and it could reasonably claim that state laws mandating that bondholders be repaid supercede any provision of the city charter. The City of Austin has never defaulted on a bond and will not default on these. If necessary, the city could also restructure the Mueller contract and the $12 million of contract revenue bond.

Conclusion #3: Proposition 2 may require some restructuring of the Mueller redevelopment agreement; however its passage would by no means spell the end of that agreement or that project.

Would Proposition 2 Affect Austin's Business Climate?

Much of the debate over Proposition 2 has focused squarely on the case that prompted its proposal – the Domain deal. The proposed charter amendment was written carefully to apply to the Domain and - according to proponents - to exempt the Mueller redevelopment, the other most notable case where the city has given tax subsidies to a mixed-use development. The proponents of Proposition 2 may or may not have succeeded in excluding Mueller, but the narrowness of the amendment – and the narrowness of the debate – argues for a narrow interpretation of any public mandate.

Neither proponents nor opponents have described Proposition 2 as a referendum on subsidies in general; Samsung, Hewlett-Packard, and Heliovolt simply haven't come up. A yes vote on Proposition 2, even an overwhelming one, is not mandate to end all industrial or firm-based subsidies. Nothing in the language of the proposed amendment would support such a view and the fact that debate has focused entirely on the value of retail subsidies may arguably be seen as evidence of tacit approval for industrial subsidies.

The argument that Proposition 2 will damage the business climate of the city is not supported by firm location decisions. Most firms make investments in Austin because of crucial location factors that are favorable to the firm's business – proximity to markets, a well-educated and experienced workforce, access to technology, and a high quality of life. Tax incentives are typically way down, or not even on, the list of factors influencing firm investment decisions. None of these factors is endangered by the passage of Proposition 2.

Conclusion #4: It is unlikely that passage of Proposition 2 would have any appreciable effect on industrial subsidies or on Austin's overall business climate.

Would Proposition 2 Affect the City's Bond Rating?

Generally speaking, bond ratings are based on the rating agency's assessment of a city's ability to repay its debts. Specifically, agencies base their ratings on the structure of a particular bond issue and the financial security backing the bond. In the case of general obligation bonds, they assess the city's current and projected revenues and its assets. Raters also consider the city's managerial capability, current debt burden, and economic conditions within the city that affect projections of future revenues. For revenue bonds, such as those issued by Austin's utilities, raters also examine the coverage ratio, which is current, and projected revenues divided by annual debt service. Also they examine the size and structure of the utility's reserve fund, which covers debt service in the event of a revenue shortfall. By all of these measures, Austin is an exceptionally low default risk; nothing about Proposition 2 affects any of these measures.

If Proposition 2 passes, it will be interpreted as a signal that Austin residents are unwilling to pay the Domain subsidies. If bond rating agencies were to extend this interpretation to unwillingness to pay broadly, this might conceivably affect their assessment of the default risks. Nevertheless, just as there is no evidence whatever that Proposition 2 extends to industrial subsidies, so is there no evidence that ending payment on the Domain subsidies would extend to bonds of any kind. More important, the differences between the Domain agreement and a general obligation or revenue bond are enormous. Unlike the Domain contract, the city is legally required to pay its bond debt, and failure to pay has substantial fiscal consequences. Austin has never defaulted on a bond. It is not going to start now.

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Conclusion #5: Passage of Proposition 2 is unlikely to affect the city's ability to maintain a good bond rating.

Would Proposition 2 Lead to Lawsuits?

The citizens have the right to propose and pass amendments to the City Charter. The substance of Proposition 2 – prohibiting some types of subsidies – is appropriate for inclusion in the Charter. The Settlement Agreement construes the terms of the First Amendment to the Development Agreement to mean that if the city chooses not to appropriate the funds to pay them, the developer is not entitled to recover any damages from the City on that basis.

Conclusion #6: Although there is a Settlement Agreement in place which addresses legal rights regarding the Domain Development Agreement, as is always the case, legal challenges remain an available means of impacting public policy decisions.

Would Proposition 2 Eliminate Affordable Housing in Mixed-Use Projects?

The city uses a wide variety of methods to encourage development of affordable housing. Depending on the situation, it may provide land, build infrastructure, waive development fees, or provide density bonuses to help projects that provide housing for poor and moderate-income households.

Some of these methods are clearly allowable under Proposition 2. The infrastructure cost-sharing exemption (section (d)(1) requires that developers pay the share of infrastructure associated with retail uses, but the city is free to build or subsidize the residential share. Tax Increment Financing Districts (TIFs) are clearly allowed, as are grants to non-profit corporations and small, locally owned businesses. Small projects of less than 25,000 square feet are also exempt if they are located in distressed areas. The only commonly used methods specifically prohibited by the proposition are land donations and sales and property tax rebates. However, the amendment language does not prevent land donations to a non-profit organization, which could then oversee construction of affordable housing.

Some methods are neither clearly prohibited nor clearly allowed. If the city provides land at less than the appraised value or sells it at a nominal fee, this may or may not be considered as a "donation" of the price discount. Fee waivers may or may not be construed as a "grant of funds." Density bonuses also fall into this undefined category, although proponents and opponents of Proposition 2 have both stated that density bonuses do not qualify as financial incentives under the Proposition.

If Proposition 2 passes, the city retains clear authority to use a variety of means to encourage affordable housing in most mixed-use projects. Though some ambiguous elements may ultimately be resolved by the courts, the city can assert its right to interpret

its own ordinances which could allow these instruments to provide affordable housing if the city so chooses.

Conclusion #7: Questions remain regarding Proposition 2's effects on some affordable housing in mixed-use projects. However many tools used to promote affordable housing in mixed use including TIFs, nonprofit participation and grants, and infrastructure cost-sharing would be unaffected by the Amendment.

Hasn't the Council Already Prohibited Future Retail Subsidies?

Both the City Charter and City ordinances have the force of law. The difference is that the City Charter is more difficult to change, requiring a public vote that can only be held once every two years. Ordinances may be changed on shorter notice by a majority vote of the City Council, though this process can also be time-consuming. Generally, only issues that are considered settled are appropriate for the City Charter. By the same token, if one wants an issue settled with some degree of permanency, there is no better way to guarantee that permanency than to put it in the Charter. The City Council may also express policy by adopting a resolution, but unlike a charter amendment or an ordinance, a resolution has no force of law.

On December 6, 2007, the City Council passed a resolution removing "project-based" subsidies of the kind issued to the Domain development as a program element in the city's economic development program. Specifically,

> "The City Council recognizes that the City's economic development program allowing project-based incentives for large scale, mixed use projects is no longer necessary, and that program element is hereby eliminated."

However definitive this may appear, it is important to recognize that City Council resolutions are not binding ordinances, only nonbinding statements of intention and belief. More important, the last council's action is not binding on the current council or on future councils. If the current council or some future council wishes to provide a subsidy to a retail development or any other project, it may do so at any time. The City Council must simply post the item on a meeting agenda and vote for it at the meeting. Four votes and 48 hours' notice are all that is necessary.

If the City Council's resolution regarding project-based subsidies is overturned, there will be no legal consequences whatever. The resolution is nothing more than a statement of a previous council's intentions at a very specific point in time. The council and the time have passed; the resolution is immaterial.

Conclusion #8: Austin needs to develop a well defined incentive policy to ensure that future public investments are prudent, provide tangible public benefits commensurate

with the funds involved, and do not unfairly favor one business over another – all elements that Liveable City strongly supported in its summer 2008 study of economic incentives. A charter amendment provides the strongest foundation for such a policy, though these goals could also be achieved through a well-crafted ordinance. Whether or not Proposition 2 passes, the City Council should act to adopt such an ordinance to give force of law to its recent resolution on this subject and to provide a detailed structure for such decisions, such as the ones proposed by Liveable City.

Would Passage of Proposition 2 Mean That Austin Doesn't Keep Its Word?

Opponents of Proposition 2 have argued that its passage means Austin will be seen as "going back on its word." While that may be an important consideration, this narrow framing ignores the larger question of how Austin's keeps its word to its citizens.

Governments must retain the public trust, not just of the individuals who do business with it, but also of the public as a whole. Proposition 2 was prompted by a special interest deal conducted in a very short timeframe without benefit of a sound, transparent public process and lacking adequate oversight to ensure that verbal promises were represented in the final written agreement.

The City of Austin made a promise with the Domain developers – arguably an ill-considered one, but a promise nonetheless. However, the city also has an overarching promise to Austin residents: to use all taxes, fees, and the authority conferred through the consent of the governed for the benefit of all citizens. If there is a conflict between a benefit to all and a benefit to a few, that conflict must be resolved on behalf of the greater public good.

In its current form, the Domain deal is clearly not benefiting all Austin residents and there is no reason to believe that future deals of this kind will fare better. Large public subsidies for retail developments are not a prudent public investment. Unlike manufacturing, research and development, and other industries that sell mostly to people and firms outside the city, retail does not create wealth and make a city richer; it just moves existing money around. Because large retail subsidies are only likely to be used for large-scale developments, they put small local business owners at an economic disadvantage relative to big national chains, which ultimately send money outside the region and make the city poorer.

Conclusion #9: The city council's resolution prohibiting retail subsidies does not have the force of law and can be overturned on short notice by a simple majority of the council. The city should keep its word to Austin residents by ensuring that public investments are well-considered and offer tangible public benefits for the greatest number of residents, not just financial benefits for a few.

Conclusions

Based on our review of these issues, Liveable City presents the following conclusions:

1. The Domain Agreement was not a good financial deal for the City and the city failed to protect the taxpayer's interest. If Proposition 2 does not pass, the city should renegotiate the deal.

2. While the Domain developers may have met the terms of the final written agreement, the city government did not live up to its contract with the public to ensure the agreement reflected all promises made regarding the project and constituted a prudent investment of public funds.

3. Proposition 2 may require some restructuring of the Mueller redevelopment agreement with the participation of all parties; however, its passage would by no means spell the end of that agreement or that project.

4. It is unlikely that passage of Proposition 2 would have any appreciable effect on industrial subsidies or on Austin's overall business climate.

5. Passage of Proposition 2 is unlikely to affect the city's ability to maintain a good bond rating.

6. Although there is a Settlement Agreement in place which addresses legal rights regarding the Domain Development Agreement, as is always the case, legal challenges remain an available means of impacting public policy decisions.

7. Questions remain regarding Proposition 2's effects on some tools typically used to promote affordable housing in mixed-use projects. However, many of these tools - including TIFs, nonprofit participation and grants, and infrastructure cost–sharing - would be unaffected by the amendment.

8. Austin needs to develop a well defined incentive policy to ensure that future public investments are prudent, provide tangible public benefits commensurate with the funds involved, and do not unfairly favor one business over another, as recommended by Liveable City in its 2008 report on economic incentives. A charter amendment provides the strongest foundation for such a policy, though these goals could also be achieved through a well-crafted ordinance.

9. The city council's resolution prohibiting retail subsidies does not have the force of law and can be overturned on short notice by a simple majority of the council. The city should keep its word to Austin residents by ensuring that public investments are well-considered and offer tangible public benefits for the greatest number of residents, not just financial benefits for a few.

Appendix A. Text of Proposition 2.

The proposition amends Article XII of the City of Austin Charter to add new Section 13 to provide as follows:

§ 13 Prohibition on Special Benefits for Retail Projects

(a) Statement of Intention. The city is authorized by Tex. Loc. Gov't. Code Chapter 380, and other applicable law to enter into economic development agreements to encourage or foster economic growth. Notwithstanding the foregoing, it is the intention of this section to restrict the use or expenditure of tax revenues or other resources of the city to provide subsidies, financial benefits or advantages for development of real property that includes one or more Retail Uses. It is the intention of this section to ensure fair and equal treatment as between operators of Retail Uses, and particularly to ensure that small retail businesses are not disadvantaged by subsidies and financial benefits given by the city to competing Retail Uses.

(b) Restriction. The city shall neither provide nor enter into an agreement to provide any Financial Incentive in connection with the development or re-development of any real property that includes one or more Retail Uses.

(c) Applicability. Upon adoption of this Section 13, the restriction provided in this Section 13 shall apply to any pending agreement for the payment of a Financial Incentive by the city in connection with any Retail Use if such agreement provides that the obligation to pay a Financial Incentive pursuant to such agreement is contingent on or subject to the city's appropriation of funds for the payment of the Financial Incentive.

(d) Definitions. As used in this Section 13, the following terms shall have the following meanings:

(1) "Financial Incentive" means:

(i) any payment or rebate of any general or special sales tax or ad valorem tax, whether assessed against property proposed to be developed or re-developed or resulting from taxable activity on such property;

(ii) a donation of an interest in real property owned by the city;

(iii) a special right of use, without fair compensation therefore, of any park land or undeveloped land owned by the city that is a right or use not provided for the benefit of all property located in the city;

(iv) forgiveness or discharge of a loan or any part of a loan made by the city; or

(v) a grant of funds.

Notwithstanding the foregoing, the following shall not constitute a Financial Incentive:

(i) cost participation by the city in constructing street or utility improvements (as, for example, oversizing of utility improvements to accommodate future development) consistent with generally applicable city policies and practices,

provided that the developer's or owner's share of such costs fairly and reasonably approximates the cost of construction of such improvements suitable to serve the improvements and uses intended by the developer or owner of a Retail Use benefited thereby;

(ii) a grant or loan to a small business, whose principal office is in Austin, Texas, pursuant to a generally applicable local small business loan or grant program;

(iii) an expenditure of funds (other than a tax abatement) pursuant to the Tax Increment Financing Act, Tex. Tax Code Chapter 311 or tax increment financing effected pursuant to Tex. Loc. Gov't Code Chapter 374, as amended from time to time;

(iv) subsidies or incentives given to promote efficient energy use, the use of renewable energy, or decreased water usage pursuant to a program adopted by the city for such purpose;

(v) a grant of funds which are provided either by the State of Texas or by an agency of the federal government, whether directly to the city, or for the expenditure of which the city must give approval or authorization;

(vi) an expenditure of funds charged by the city and paid by developers of real property for regional drainage detention, regional water quality facilities, or other public improvements; or

(vii) an expenditure of funds pursuant to an economic development program adopted by the city council for the revitalization of economically distressed areas of the city or areas of the city experiencing high rates of unemployment for the development or redevelopment of a project with a total of not more than 25,000 square feet of habitable improvements.

(2) "Retail Use" and "Retail Uses" shall mean the use or proposed use of improvements to real property for the sale directly to the public of any commercial or consumer goods, including but not limited to the sale directly to the public of clothing, appliances, jewelry, furniture, pets, building materials, plants, drugs and personal hygiene goods, home accessories, household items, packaged or prepared food and beverages, recorded music, office supplies, and any other goods sold directly to the public.

"Retail Uses" shall not include a wholesale or distribution center or manufacturing or assembly facility in which goods are stored, assembled, or manufactured for transport off-site for later sale; daycare services; medical, counseling, or nursing care facilities; any enterprise operated by a non-profit corporation or a governmental entity; public or private educational facilities; performing arts venues; museums; or libraries.

(e) Enforcement. Any resident of the City of Austin shall have standing to assert a claim for declaratory or injunctive relief in any court of competent jurisdiction arising out of a violation of this Section 13.

Appendix B. Alternative Cost Benefit Assessment of the Domain Agreement

For the great majority of stores that serve the great majority of people – hardware, garden, grocery, clothing and shoes, furniture, and the like – it doesn't much matter where they are located. Every city can expect to get its share of these stores, and the city government gains no particular advantage by locating them inside the city limits.

This may be different for high-end retail stores like Neiman-Marcus and Tiffany. The goods sold in these stores are so expensive that they generate far more in sales taxes than the average. They serve such a specialized market that we cannot reasonably expect to find very many of them in a metro area of Austin's size. Particularly if they are located together in a high-end development, there is a financial advantage to city government to locate that development inside the city limits.

This is, for better or worse, the strongest argument in favor of subsidizing the Domain. It is important to recognize that this argument will not hold for the vast majority of retailers, only for those selling the most expensive goods to the richest people. It also hinges entirely on where the Domain would have gone (or whether it would have been built at all), in the absence of a subsidy.

In this appendix, we work through the benefits and costs of the Domain deal, and reach reasonable conclusions, using assumptions based on available information, as to the maximum the City should have been willing to pay to ensure that the Domain was in fact built inside the city limits.

Categories of benefits and costs. The developers billed the Domain as better than the average shopping center, and they have a point. The Domain features vertical-mixed use (apartments over shops), wide sidewalks that allow for sidewalk cafes, public art, open public spaces and playscapes, and garage parking rather than strictly open lots. Unlike most large shopping centers, it has streets. In form, it resembles the Triangle development in central Austin and adheres in many respects to the dictates of "New Urbanism." The city has been supportive of such developments in the past, and it can be argued that these are benefits worth paying for. It can also be argued that the marketplace now recognizes the worth of such amenities and will supply them in any case in a high-end retail center.

Because it dramatically intensified the uses on its 53-acre site, the Domain increased the assessed value of the property, thus increasing city property tax revenues. The Domain includes many high-end retail stores, and the city receives 1% of all retail sales in the form of taxes. Supporters of the Domain (opponents of Proposition 2) argue that the City would not have received these taxes had the development not been built within the city limits. Opponents of the Domain subsidies (proponents of Proposition 2) argue that many of these taxes would have been paid by the same businesses in another location (they moved to take advantage of the Domain's superior location), or by other

businesses that would have received more customers had the Domain tenants been in another location, outside the city limits.

In its justification for the subsidy, city staff also cited the jobs that would be created (1,100 permanent jobs with an average wage of around $30,000), support for small, local businesses, and construction opportunities for minority and women-owned contractors. Ten percent of the apartments are affordable to households making 65% of median income; the residential section of the development fits the City's SMART housing guidelines.

In exchange for these benefits, the City will rebate 80% of sales tax receipts for the first five years of operation and 50% for the next 15 years. Two percent of sales tax receipts retained by the City will be reserved for the City's Affordable Housing Finance Corporation. The City will also rebate 25% of the increase in property tax revenues for 20 years. The agreement will end after 20 years, or when the discounted value of the rebates reached $25 million in 2003 dollars, whichever comes first.

This last provision is important to understanding the different claims of both sides. Over the 20-year time span of the agreement, it is very likely that much more than $25 million will change hands. But a dollar today is worth more than a dollar next year. As the City calculates it, next year's dollar is worth about $0.93, once the time value of money have been taken into account. A dollar in two years is worth about $0.87 today; a dollar in three years is worth about $0.80 today, and so on. This process of converting from dollars to current worth is called *discounting*. The City also accounted for inflation, assuming a 2.5% increase annually in property values and a 3.0% increase in retail sales. The City agreed to pay the developers sales and property tax rebates, but only until the point when the sum of the *discounted* dollars reaches $25 million. This means that as much as $50 or $60 million may change hands (as Proposition 2 proponents claim), but they will never be worth more than $25 million as of the time the agreement was signed in 2003 (as opponents claim). Both sides are right; they are just evaluating these dollars in different ways.

In the remainder of this appendix, we examine the benefits of the Domain development in detail. Some were largely as advertised; some are less valuable than the Domain supporters have made them out to be. Then we compare these benefits to the costs, and draw conclusions on the extent to which the Domain deal is worthy of taxpayer support.

Property and sales tax revenues. Let's take sales tax receipts first. At its current size, the Domain includes 538,000 square foot of retail space. In their presentation to the city council in 2003, the Domain developers estimated sales at a very modest $326 per square foot. This is considerably less than the average shopping mall store, which generates about $400 per square foot. Since both figures are obviously much lower than a high-end center could be reasonably expected to produce, let us borrow sales figures from

the nearby (but much less swanky) Arboretum, with sales of about $600 per square foot before the Domain was completed. (This is also roughly consistent with nationwide sales for Neiman-Marcus stores, at $611/sf). At its current square-footage, we can reasonably expect annual retail sales of $600/sf × 538,000 sf = $322.8 million. In 2009, owners of the Domain plan to expand to 670,000 sf. At this time, we can reasonably expect annual retail sales of $402.0 million, in current dollars.

Thus current expected sales tax receipts are 1% of $322.8 million or about $3.2 million. Although the City only retains 20% of this figure for the first five years of operation, let us presume for now that all revenues received count as benefits to the City.

Following the developers' projections, the City estimated that the assessed value of the Domain would be $159 million when it began operations. The City also assumed that the entire project would be built out, but a portion of the retail, office, and residential units remain to be built. Let us assume that the current assessed value is the same proportion of the eventual assessed value as the current retail square footage is of the eventual retail square footage. Thus the current assessed value is about 538/670 ≈ .80 or 80% of the eventual assessed value, or $127 million. Upon final buildout next year, the project will be worth $159 million in current dollars.

Applying the current tax rate of 40.28 cents per $100 assessed value provides a property tax bill of $127 million × .004028 ≈ $511,000. At final buildout, the property tax bill will be $159 million × .004028 ≈ $640,000 in current dollars. Again, we assume that all revenues should be counted as benefits to the City.

This appears simple enough, but it overstates the revenues the Domain provides to the City, for three reasons:

- Some Domain tenants moved to the Domain from other locations nearby. Even if the Domain had never been built, they would have continued selling goods and services and paying sales and property taxes at their old locations. Including them as a benefit of the Domain double-counts these tax revenues.
- Domain stores draw customers away from other Austin stores and restaurants, reducing their sales and sales taxes, and reducing the value of their leases and thus the property they do business in. Because the Domain includes mostly national chain stores, this means that those hurt are more likely to be locally owned stores that put more into the local economy. Reducing the revenues at these stores thus sends more retail dollars out of the city and reduces the Austin economy as a whole.
- If the Domain had not been built in the city limits, it would have increased the time to travel there for most Austin residents and, in fact, for most of the Domain's primary market. Thus a Round Rock or Lakeway Domain would

not have made as much money, and Austin stores and restaurants would have retained more of their customers.

Estimating these costs is bound to be difficult in the absence of a comprehensive study. With little to go on, let us assume that the sales and property tax revenues are overestimated by 30% due to these factors. Higher or lower percentages could be justified.

This reduces the annual sales tax benefits from $3.2 million to $2.3 million at the current size, and from $4.0 million to 2.8 million at full buildout. It also reduces the annual property tax benefits to $358,000 (current) and $468,000 (full buildout).

Jobs. Because the Domain development was phased, so was the City's jobs requirement. By contract, the Domain must provide at least 0.0016 jobs per 94 foot. Since 538,000 square feet have been completed, this means 861 people need to have been hired to comply with the contract. Since 1,647 people have been hired, the Domain is in compliance.

The Domain has complied with the contract, but has it provided anything of value to Austin taxpayers? The answer is not obvious, but understanding it is important to defining the difference between industrial subsidies (such as those given to MCC, Sematech, and Samsung) and retail subsidies.

Industrial subsidies bring new jobs and new money into a city, because the goods and services provided by manufacturers and research and development outfits are mostly consumed *outside* the city. For example, firms in San Jose, Boston, and Denver buy Samsung chips, or pay Sematech for its research on manufacturing processes. Thus industrial subsidies increase the city's *economic base* – the package of goods and services it sells to others, outside the city. Samsung workers then spend their money locally – on housing, food, entertainment, and so on – putting some of their earnings in circulation in the Austin economy. The building contractors, grocery store clerk, and movie projectionist spend some of their money locally, too, and the process continues. Thus Samsung's earnings are multiplied: Every $1 of earnings produces $2 or $3 in benefits to the Austin area, because the original $1 comes from outside Austin.

This is not true for retail sales. Retail does not bring new money into a city; it just moves it around within the city. In general, the amount of goods sold depends on population and disposable income. If population increases, or residents' income increases, more stores will open and more people will be hired to staff them. This is an important and valuable effect of economic development, but it is not economic development itself. A city only becomes richer when it sells goods and services outside the city.

What this means is that Neiman-Marcus, Macy's, Tiffany, and all the other stores at the Domain do not make the city richer. They may give residents more interesting places to spend their money, but they do not increase the amount of money in people's pockets. More important, the sales jobs apparently created by the Domain development were not "new" jobs, at all. If the Domain had not been built, these jobs would have been "created" by some other retailer, somewhere else in the region, anyway. There is in fact considerable anecdotal evidence that many of the jobs at the Domain were at the Arboretum, Lakeline Mall, and elsewhere in the region before the Domain opened. They aren't new at all; they just moved.

As described above, there is some value in having high-end retail stores inside the City of Austin and not elsewhere in central Texas. Austin residents will find it more convenient to shop there, and the City will get the benefit of the sales and property tax receipts. But the jobs themselves are a wash. Certainly there is no justification for subsidizing them.

Opportunities for small business. The Domain developers provided two opportunities for improving business prospects for small, locally owned firms:

- It hired a consultant to contact minority- and women-owned contractors and gave these contractors opportunities to bid on parts of the construction contract;

- It provided a $1 million fund to help five small, local retailers locate at the Domain, designing and constructing interior improvements ("finish-out"), providing collateral for loans and location advertising, and subsidizing rents for up to five years.

The first of these two items is consistent with the City's own procedures for capital improvements and business services procurement, and is intended to ensure that historically underutilized businesses (all of them small and locally owned) obtain their fair share of large city contracts. It typically requires that the contractor (in this case, the Domain developers) spend more money on outreach than would otherwise be necessary, but does not require that any of the small firms contacted be hired unless it makes economic sense to do so. Compliance with this obligation required a small financial outlay (less than $100,000) on the developer's part.

The second of the two is larger in scope. It is very difficult to estimate the value to the city as a whole of the $1 million small business fund, but the value to the small businesses themselves is presumably in excess of the payments made. The developer appears to have complied with its obligations, finishing out improvements for small retailers, paying some of their expenses, and subsidizing their rents. The developer appears to have paid for finish-out to all non-anchor tenants, including those that were not small businesses, so $1 million overstates the extent to which the developer is out-of-

pocket here. It is unclear what other expenses the developer may have had to pay up to this point; because the local retailers must stay at the Domain for this obligation to be discharged, it is unlikely that the entire $1 million has been spent. Nevertheless, the City reports that these obligations have been met so far.

Affordable housing. The developer's original plan called for a minimum of 300 residential units. In its contract with the City, it promised that 10 percent of all units constructed would be affordable to households with 65% of median family income or less, and that all units would comply with the City's SMART housing guidelines. This objective appears to have been met. The Domain developers have constructed 390 units, 39 of which are set aside for low-income tenants; the developers plan to construct another 26 units, three of which will be set aside for low-income tenants.

The lack of affordable housing, especially housing that is affordable for households making less than 65% of median family income, is an important social problem. It is difficult to put a dollar value on these units, but given the City's previous efforts to provide affordable housing it is clear that the City believes the social value is at least as great as the cost of constructing and maintaining it. A simple way to estimate these costs is to calculate the difference in rent between the typical apartment offered at the Domain and an apartment affordable to a typical low-income household. Assuming each studio apartment holds one person, each one-bedroom apartment holds two, and each three-bedroom apartment holds three, this works out to

$1,470	average monthly rent for a Domain apartment
$1,080	average monthly rent affordable to a low-income household
$ 390	per-unit subsidy.

That is, the Domain is subsidizing each of its 39 affordable units by about $400 per month, for a total of about $190,000 per year. This is an important benefit of the Domain development. Over the course of the 20-year contract period, the value of affordable housing provided would be about $1.6 million.

New Urbanist form. The Domain is not your average shopping center. The current owner's advertising touts the "elegantly designed streets," the "overall calming feel," "beautiful and tranquil landscaping," and other "exceptional amenities" of this "five-star shopping center." The development adheres closely to the dictates of New Urbanism, and the City has in fact paid limited amounts of money for some of these amenities in the past, generally in the form of fee waivers as part of its Smart Growth program.

Although it may appear exotic to Austinites, in fact the Domain's form is just the latest thing in upscale shopping malls. Called "lifestyle centers" in the trade, the open-form, heavily landscaped street pattern is valuable to developers because it is about one-third as costly to maintain as the common spaces of a traditional, enclosed mall. Lifestyle centers also require less acreage and usually produce higher sales per square foot of

leasable space. The first lifestyle centers were built in the late 1980s, and the number has increased to about 150 today. Many traditional malls (including several owned by Simon Properties, current owner of the Domain) are adding lifestyle centers as an amenity to bring in upscale consumers and cut costs.

The amenities are nice, and they are consistent with those that the City has been willing to pay for in the past. But there is a sound business reason for these amenities, and no reason whatever for the City to subsidize them.

Retail subsidies and insurance. Adding up the annual benefits in the first year of operation and upon final buildout in 2009, we obtain the following.
(All benefits are expressed in thousands of 2003 dollars).

	year 1	final buildout
Sales tax revenues	$2,260	$3,216
Property tax revenues	358	468
Jobs	0	0
Affordable housing	190	205
New Urbanist form	0	0
Total	$2,808	$3,889

Assuming operations began in mid-2007 and final buildout is achieved in mid-2009, and using the City's usual assumptions for inflation and discount rate, we obtain a net present value for the benefits of the Domain of $42.6 million. Assuming (very conservatively) that the Domain has already provided $1 million in small business opportunity benefits since 2003, the total net present value for benefits to the City is about $43.3 million.

Assuming sales and property tax revenues as described above, the developer's subsidy would be about $28.4 million. Since this subsidy is capped at $25.0 million, however, the contract would expire at the end of 2023 (the 16th year of operation), rather than running the entire 20 years.

Is this a good deal? The city gets $43.3 million in benefits, but has to pay out $25 million in costs. This is a net benefit of $18.3 million, or nearly $1 million per year the Domain is in operation. That's better than nothing.

In a larger sense, however, this is not a good deal at all. Most of the social benefits of the Domain deal go back to the developers, not to the public. Unlike most public contracts, the subsidies are not provided for services rendered on a fee-for-service basis. The developer is not out of pocket. Quite the contrary; because the "service" was to site an already-profitable shopping center in the most profitable location, the developer has reaped the benefits of both the free market and a public subsidy without having to spend much at all.

That said, the developers have done the City a service. They could have located their shopping center elsewhere, but chose to put it in Austin and give Austin the benefit of the tax receipts. If it made economic sense to locate the center elsewhere (either because a location in Round Rock or Lakeway had more rich people within a short drive, or because some other jurisdiction offered a larger subsidy), then failure to offer a subsidy would have caused the Domain to be built elsewhere. This would have lost the City considerable tax revenues. Securing those revenues is worth something.

One way to estimate the (maximum) value of what amounts to a Domain insurance policy is to multiply the total benefits (in this case $43.3 million) by the probability that those benefits would disappear. This would be the most the City should be willing to pay for a fair insurance policy against the likelihood of the Domain's moving to Round Rock. The developer's out-of-pocket costs would be the least the developer should be willing to accept. Anything in between would be defensible, so long as the agreement ran for twenty years and the developers remained in compliance.

As described above, the Domain developers have already paid out about $1 million, mostly in finish-out costs for small businesses and in affordable housing costs. Because housing costs will be accumulating over time, the least the developers can reasonably accept is about $2.6 million (again presuming the agreement runs for the entire 20-year term). The City should be willing to pay at least this amount to get this stream of benefits over twenty years. The more difficult issue in the high-end estimate, because it requires an estimate of the probability that the Domain would have moved if the City did not come up with the right subsidy.

There are good reasons to believe this probability is fairly low. First, the Domain site is more easily accessible to high-income people than a site in Round Rock, Lakeway, or Cedar Park would have been. Neiman-Marcus and Macy's presumably draw their customers from throughout the central Texas region; the best site (the one that would generate the most trips and sales) would thus be centrally located. Second, the nationwide experience with state and local tax subsidies suggests strongly that 70 to 80% of all subsidies are wasted on firms that would have located where they did, even if the subsidy had not been given. Obviously a lot depends on the nature of the individual business and location, but, when combined with what we know about the characteristics of this business and location, this suggests that the chances of the Domain's decamping were between 20 and 30 percent, suggesting a maximum price of $9 to $13 million. The remaining $12 to $16 million is simply an overcharge.

We can also work backward to figure out what the City was thinking. The current deal with the Domain makes some sense as an insurance policy if the proportion of the total benefits that is rebated to the developer is approximately the likelihood that the developer would go elsewhere. In this case, that's 25/43.4 = .577. That is, for this deal to make any economic sense, the City must have estimated that there was a 57.7 percent

chance the Domain developers would have gone over the line and built elsewhere, if they hadn't received a subsidy.

At first blush, this doesn't seem so high. If they couldn't make a deal with Austin, why wouldn't they work with Round Rock? But the Mopac site was clearly the developers' first choice; it was available, easy to develop, at the intersection of two major highways, near an existing shopping center with demonstrated demand among shoppers in the proper demographic (that is, well-heeled), and closer to the wealthiest of Austinites than anyplace in Round Rock. Further, Round Rock would only emerge the victor if they were willing to give up more than Austin, perhaps much more if a suitable site could not be found. The developers' best alternative to a negotiated agreement was almost certainly to have shrugged and developed the Mopac site, even in the absence of a subsidy.

In an important sense, the fact that we are talking about even a $13 million subsidy represents a failure of the free market. Had the market really worked in this case, there would have been several developers attempting to build a similar development. They would have bid against one another, driving the subsidy down to the point where it equaled their out-of-pocket costs, plus a little bit more. The resulting subsidy would have been something like $3 million, and nowhere near $25 million. But the market failed. One developer was able to play one jurisdiction off another and bid the subsidy *up* to two or three times its maximum value. As usual, taxpayers foot the bill for a failed market.

Conclusions. The primary benefits of the Domain deal to the City were sales tax revenues and affordable housing. By ensuring that the development would be located within the city limits, the City secured substantial tax revenues that it may not have obtained otherwise. The maximum subsidy consistent with these benefits is probably somewhere between $9 and $13 million over the 20-year period. The cost of the subsidy actually agreed to ($25 million) only makes sense if one believes the Domain developers would probably have gone to another city if they were not offered a subsidy. Given the attractiveness of the site chosen and the experience of other cities with subsidies, this very likely exaggerates the probability of relocation (and thus the maximum subsidy value) considerably.

Appendix C: Letter from Simon Properties to El Paso Chamber of Commerce Opposing Retail Subsidies 6.18.2008

Dear Fellow Chamber Member,

I am writing to you on behalf of Simon Property Group. Simon owns Cielo Vista and Sunland Park malls in El Paso. Simon has been a member of this community and our Chamber for over thirty years.

You may be surprised to learn that at the June 10th City Council meeting the Chamber's executive committee endorsed tax subsidies for the Regency/Foster Redevelopment plan for the Farah building on 1-10. The tax subsidy is to offset demolition and sitework for a big box strip center. The tenants will be mostly existing retailers in the region who opt to relocate to the new center or choose to open a 2nd, 3rd, or 4th store in the region Regency/Foster is requesting $12 million (net present value) in tax subsidies.

We're puzzled that neither the Board of Directors nor the Chamber membership including Simon was contacted prior to its leadership's quick decision and announcement of this unprecedented and substantial El Paso sales tax subsidy proposal. We believe that the proposal needs a closer look and public scrutiny. We have requested that the city conduct a second public hearing; however, at this point we are uncertain as to whether the city will entertain additional public comment. Therefore, we'd like to share some little-known facts with you.

Simon is in favor of removing the blighted building; we are opposed to a $12 million tax subsidy. Regency's supporting cost estimates show approximately $5 million to demolish the building. It is unclear why Regency is asking taxpayers to fund substantially more than that for site construction and soft costs including utilities, grading, tenant buyouts, legal and city impact fees that are routinely paid for by the developer.

Simon is concerned that an unprecedented subsidy utilizing sales tax revenue can favor one developer over others because it provides flexibility to offer lower rent, tenant inducements and other means to attract existing stores from nearby centers.

Interestingly, Regency is requesting the city and county abolish the TIF implemented in 2004. That TIF contains anti-piracy provisions. The prior city administration included anti-pirating clauses that require no sales tax or ad valorum tax subsidies be given to the developer for a tenant that simply moves from location A to location B. This anti-piracy

clause ensures that all developers are competing on a level playing field. Tenants are free to negotiate and relocate wherever suits them best. That's how a free market works. However, a developer cannot receive a tax subsidy (or incentive) for those tenants.

Regency is requesting the city adopt a new 380 grant (another form of TIF) on the property, which eliminates all anti-piracy safeguards. In other words, they are asking to receive a 50-75% subsidy from sales taxes derived from all tenants regardless of whether the sales tax is simply a shift because the retailer relocates or opens another store.

Simon is concerned that if the old TIF is eradicated and a new 380 grant is adopted without anti-piracy provisions, tenants at Cielo Vista Mall and other shopping centers will be fair game for pirating using tenant inducements made possible because the developer will receive the $12 million in tax subsidies.

This is a very risky proposition economically to the city and county because the Cielo Vista area is a robust retail center and a strong economic driver for the city and county. As an example, we project Cielo Vista Mall alone will conservatively lose a minimum of 15% of its existing sales. In addition, sales will be shifted-from other box centers in the area, which comprise the majority of the square footage of the proposed project. Why should the city give up any of its current sales tax from existing stores and a stable revenue stream just because a tenant walks across the street? Unless there is a budget surplus, the loss could necessitate another property tax or sales tax increases. To summarize, we believe that the proposed tax subsidy is anti-business because it favors one developer over others, requires the city and county to rebate shifting sales taxes from existing retailers, risks the city and county's existing stable revenue stream from sales and ad valorum taxes and in the process creates new blight at existing centers (from tenants that choose to relocate from nearby centers creating new and potentially long term vacancies). The loss to the City from tax revenues merely being shifted from existing locations to the Farah site will necessitate burdensome, additional property tax or sales tax increases on top of the recent storm water fee. It also will open the floodgate for other developers to receive similar retail tax subsidies; unheard of and unnecessary in a robust retail market like El Paso.

We should add that after listening to public comment at the City Council meeting, the mayor acknowledged some of these issues and directed the city to renegotiate a subsidy that includes only new retailers, and theoretically "new" sales tax and ad valorum taxes to the market. Regency is now working with the city manager on a proposal that would

provide a rebate of 100% of sales taxes and ad valorum taxes for 10 years or more on new stores they bring to their big box center. We do not know the status of the negotiations or what the new proposal will look like. Much more analysis needs to be completed to determine if this would be detrimental to taxpayers.

We are still in the process of gathering and analyzing information. Please feel free to telephone me if you'd like to discuss this topic further or have any questions.

Sincerely,

Bill Hammer Senior Vice President of Development, Simon Property Group

Roderick C. Vosper Vice President of Development, Simon Property Group

Organizations Supporting and Opposing Proposition 2

Organizations supporting Proposition 2 (10.18.08)

Alamo Drafthouse, Bookpeople, Fonda San Miguel, Waterloo Records, and over other 500 local businesses
Austin Neighborhoods Council
Better Austin Today
Capital Area Asian American Democrats
Central Austin Democrats
East Austin Republicans
Independent Texans - Austin
Mexican American Democrats
Save Our Springs Alliance
South Austin Democrats
South Central Coalition of Neighborhoods
Southwest Austin Democrats
Texans for Accountable Government
Texans for Public Justice
The Republican Club of Austin
Travis County Democratic Party
Travis County Green Party
Travis County Libertarian Party
Travis County Republican Liberty Caucus
West Austin Democrats
*Austin Central Labor Council member organizations:
AFSCME Local 1624 (state, county and municipal employees), AFT - Local 6249, ATU 1091 (Amalgamated Transit Union), American Postal Workers 299, Austin Association of Firefighters, CWA - 6132, 6150 California Nurses Association, Doctors Guild of Texas #4, Carpenters Union 1266, Education Austin 2048, Education Round Rock 4000, Graphic Communications International 528I, ATSE 205 (Stage Hands & Motion Pictures), IBEW 520, Iron Workers 482I, UPAT Glaziers 1778, IUPAT Painters 130, NALC 181 (letter OPIU 277 & 298 (Office and Professional International Union), Physician's Guild of Texas, Plumbers and Pipefitters 286, Sheet Metal Workers 67, Texas State Employees 6186

Organizations Opposing Proposition 2 (10.18.08)

Capital City Young Democrats
Downtown Austin Neighborhood Association
Greater Austin Chamber of Commerce
Greater Austin Hispanic Chamber of Commerce
Mueller Neighborhood Association
North-By-Northwest Democrats
Real Estate Council of Austin
University Democrats
Austin Chronicle
Catellus Development Group