PDC | PORTLAND DEVELOPMENT COMMISSION
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DATE: April 8, 2015

TO: Board of Commissioners

FROM: Patrick Quinton, Executive Director

SUBJECT: Report Number 15-21

Work Session on Portland Development Commission's Long-Term Financial Sustainability

BOARD ACTION REQUESTED

No action is requested; information only.

SUMMARY

At the April 8, 2015, Portland Development Commission (PDC) Board of Commissioners meeting, PDC staff will facilitate an open conversation with the PDC Board on PDC's long-term financial sustainability. The intention of the work session is three-fold:

1. Provide an update on near- and long-term financial trends and realities;
2. Share best practices in resource generation from other economic development and redevelopment agencies; and
3. Seek PDC Board support and direction on creating a business plan (Business Plan) that will guide the agency's resource generation efforts for the next twenty years.

BACKGROUND AND CONTEXT

Throughout its history, PDC has relied almost exclusively on tax increment financing (TIF) to fund all activities and operating costs. A status quo financial projection shows that funding activities solely with TIF is not financially sustainable. The geographic and investment restrictions of TIF also limit PDC's ability to implement PDC's strategic priorities. The attached Report on PDC's Long-Term Financial Sustainability (see Attachment A) reviews status quo projections that assume April 2015 adoption of amendments to six urban renewal area plans, and includes a 2012 review of six economic development agencies.

Should the PDC Board support creating a Business Plan, following is anticipated scope and schedule:

- Assemble Steering Committee to advise staff — Spring 2015
- Complete Business Plan — Fall 2015
- Present PDC Board with recommendations — Winter 2015

ATTACHMENTS

A. Report on PDC's Long-Term Financial Sustainability

REPORT ON

PORTLAND DEVELOPMENT COMMISSION'S LONG-TERM FINANCIAL SUSTAINABILITY

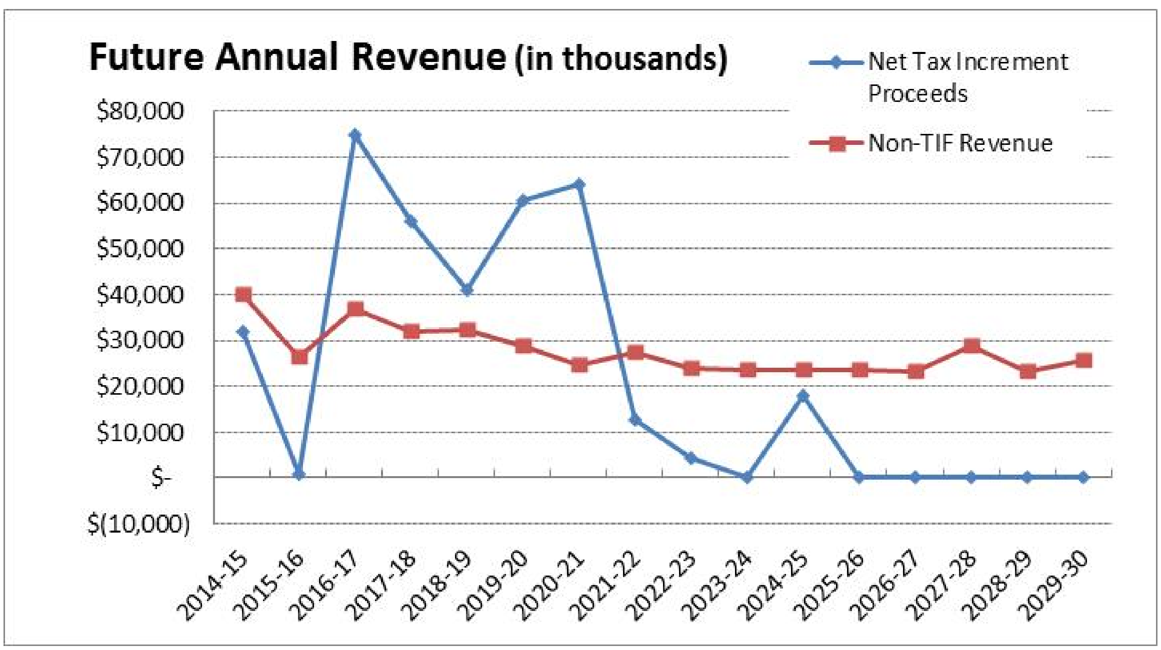
April 2015

Contents

I. Introduction

PDC is a multidisciplinary agency that invests in place making and quality of life, job creation, and economic opportunity. Throughout its history, PDC has relied almost exclusively on tax increment financing (TIF) to fund all activities and operating costs. While this funding source has resulted in investments across a range of iconic and catalytic private and public projects, TIF has been an awkward and, at times, ineffective tool for economic development activities due to usage restrictions – TIF can only be invested in physical improvements to real estate within urban renewal areas (URAs). In addition, TIF has only served a narrow number of city neighborhoods due to state statute (Oregon Revised Statutes (ORS) 457) which limits urban renewal to a maximum of 15 percent of the city's acreage or assessed value, whichever is lower.

Due to a rash of expiring URAs, this funding source is running out. By 2021, new TIF revenues will be limited to several URAs and will completely expire by 2025, taking into account proposed extensions.



Past resource development efforts have focused on accessing additional TIF or changing the enabling legislation, ORS 457[1], to better serve the city's needs. Unfortunately, a resource strategy that continues to rely on TIF will not solve PDC's projected declining revenue for a number of reasons, including:

- **TIF debt repayment periods:** The highest assessed value land is within current URAs with long-term debt. Once URAs have reached the final date to issue debt they require additional time to pay off the bonded indebtedness, often years after the investment period. For example, the Gateway Regional Center URA will issue final debt in 2022 and is projected to pay off all debt by 2030. Under the current River District URA scenario, final debt is estimated to be issued by 2021, but total debt is projected to be paid off by 2025 due to the strength of the district. All URA debt is projected to be paid off by 2030. Acreage within URAs paying off debt will not be released from the 15 percent cap until the debt is paid off.
- **The lack of support for new URAs:** The political climate for new or amended URAs is challenging, both locally and statewide. Proposals for new URAs have been justly scrutinized in light of the financial impacts on taxing jurisdictions. Recent amendments to URAs by Portland City Council, which expand two existing URAs but close or reduce four URAs, are aimed at reducing rather than increasing the use of TIF.
- **The long lead-time required to generate new TIF:** Because new URAs start from essentially a zero value base, meaningful TIF growth, without large-scale new development, requires at least five years, and most new URAs generate the bulk of their resources in the second decade of their life. This reality means that even if new URAs are created, they will not materially change the resource picture for another 15-20 years.

This report provides a detailed review of status quo financial projections based on current investment policies and funding sources. PDC will need to adopt a new funding plan if it is to continue to deliver on its mission and implement its emerging 2015-2020 PDC Strategic Plan (Strategic Plan). Actions must be considered to transition the agency toward a less TIF-reliant financial plan.

To help the PDC Board consider a new direction, a 2012 review of similar agencies and how they fund their activities follows the status quo information. Similar in age and mission as PDC, these agencies generally possess a more diverse funding base and lower reliance on public funding than does PDC. The purpose of this information is to stimulate a discussion of whether Portland might want to move in this similar direction.

II. Problem Statement

Given the decline in the legacy-funding source for PDC, how should the agency proceed towards long-term financial sustainability?

- What are the best tools for carrying out the agency's mission, vision, and draft Strategic Plan?
    - A draft goal in the Strategic Plan is to harness and expand PDC's tools for place making, job creation, and economic opportunity. The Strategic Plan calls for a significant increase in non-TIF resources in funding the agency's operations.

- How must the agency change to fund investment towards the plan's goals? What 21st century civic networks locally, nationally, and internationally will provide new access to capital markets?

[1] *Oregon Revised Statute 457 (ORS 457)* defines urban renewal in Oregon. Urban renewal exists for the purpose of removing, preventing or reducing blight or blighting factors that are detrimental to the safety, health, or welfare of the community. A blighted area is characterized by the existence of one or more conditions including deteriorating buildings, inadequate streets and utilities, depreciating values and many more defining conditions. PDC is the designated urban renewal agency for the City of Portland. ORS 457 restricts urban renewal areas to no more than 15 percent of acreage and 15 percent of the assessed value of a city.

  - Many cities with longstanding and successful economic and redevelopment agencies operate with greater non-public self-sufficiency while carrying out public objectives.
  - What degree of self-sufficiency (i.e., reliance on non-TIF resources) should the organization seek?
  - What would a diverse revenue source look like?
- Should a new business model also include a different approach to investing existing assets of fund balances, owned real estate, and staff?

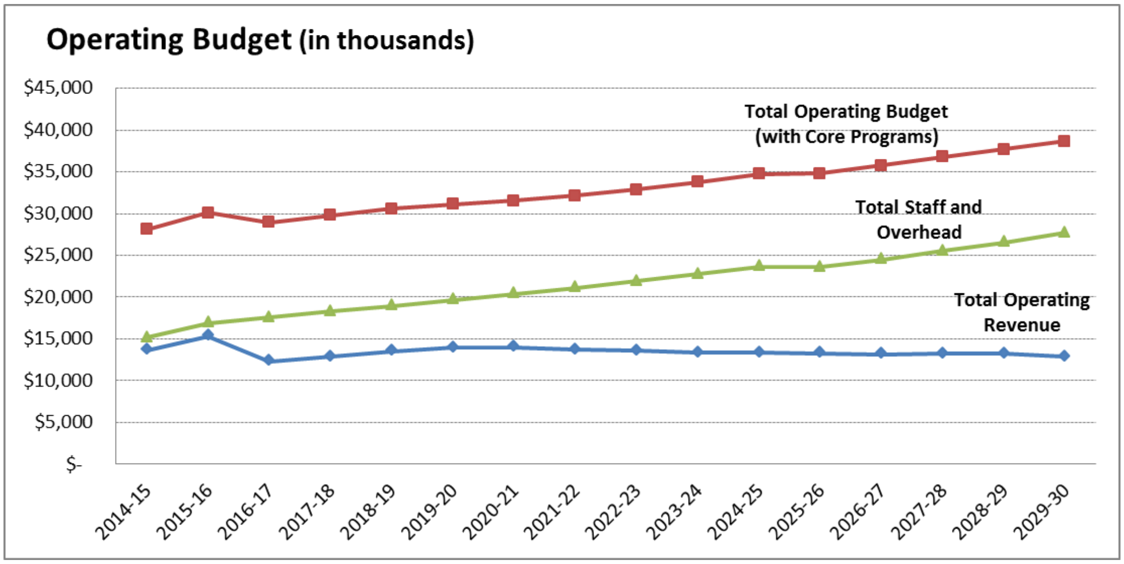
III. Business Model: Status Quo

One measure of self-sufficiency is the ability of the agency to fund its operations from funding sources other than TIF. The charts below represent PDC's non-TIF revenue operating budget and the anticipated deficit over time in funding operating expenses if no changes are made to the current PDC business model. Operating expenses are defined as staffing, overhead administration, and core economic development and grant programs funded by a mixture of resources (see figure A). Figure B demonstrates how the Operating Budget is expected to grow over time.

Figure A. PDC FY 2014-15 Operating Budget (in thousands)

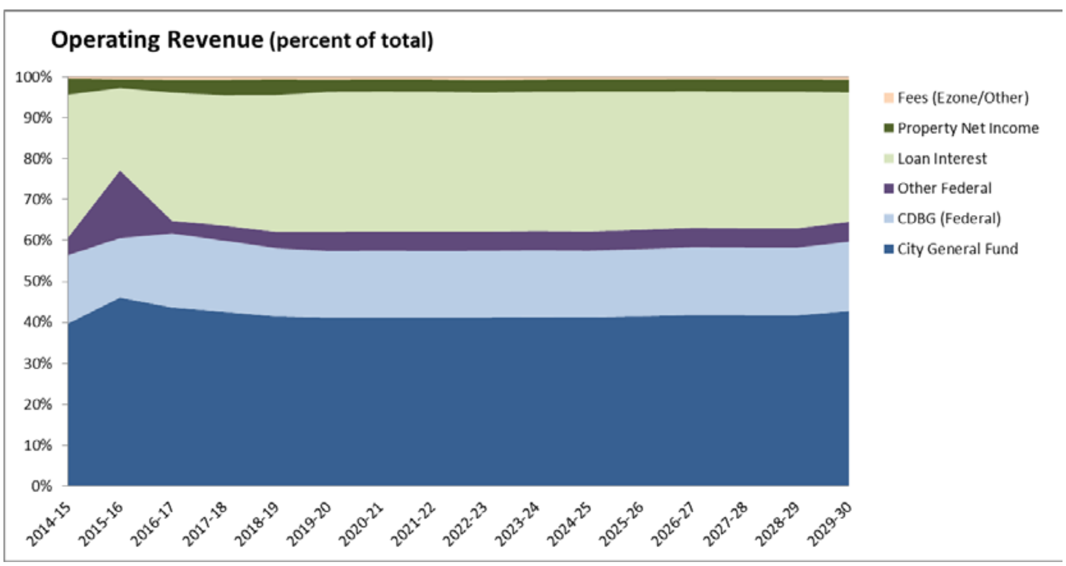
Revenues		**2014-15**	**Percent**
Public Funding			
General Fund	$	5,426	39.7%
Federal - CDGB	$	2,286	16.7%
Federal - Other Grants	$	583	4.3%
Loans			
Net Interest Income - Existing	$	3,654	26.7%
Net Interest Income - Mission	$	1,126	8.2%
Real Estate Net Operating Income	$	544	4.0%
Ezone Admin	$	49	0.4%
Total Revenues	**$**	**13,668**	**100.0%**
Expenditures			
Programs			
Traded Sector (Cluster Development)	$	2,229	7.9%
Small Business Development	$	1,448	5.1%
Workforce Development	$	3,531	12.6%
Community Capacity Building	$	1,033	3.7%
Community Redevelopment Grants	$	4,724	16.8%
Total Programs	**$**	**12,965**	**46.1%**
Personnel	**$**	**10,812**	38.4%
Adminstrative Materials and Services	**$**	**4,347**	15.5%
Total Expenditures	**$**	**28,124**	**100.0%**
Surplus / (Deficit)	**$**	**(14,456)**	

Figure B.



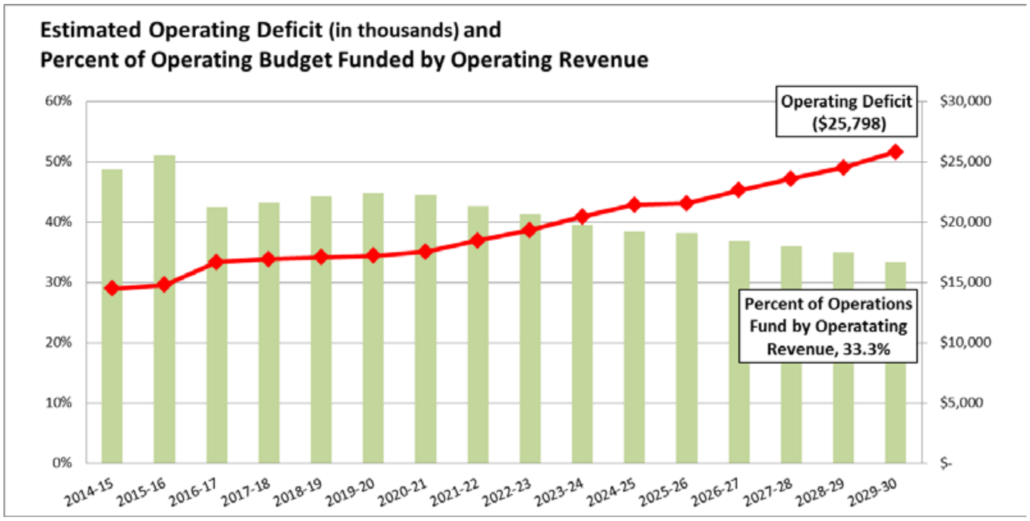
Status-quo non-TIF operating revenues (see Figure C below) are relatively flat over the projected period. The largest components are public funding: City of Portland (City) General Fund and federal Community Development Block Grant (CDBG) resources that fund economic development and workforce development programs and staff. Loan interest, primarily from TIF commercial and business lending portfolio, makes a significant portion of the forecast. Historically, these resources have been treated as TIF and have only been used to fund ongoing programs associated with those URAs.

Figure C.



The operating deficit is funded by TIF resources and allocated to staff work and core grant programs in existing URAs. Currently, PDC's operating deficit is 50 percent, which means that approximately half of PDC's operations are funded by TIF resources (see Figure D). With regular cost of living increases, PDC's ability to fund status-quo operations using non-TIF resources will fall to 40 percent over the next five years and ultimately decreases to 33 percent by 2030. Without a new source of revenue to replace TIF, PDC will need to cut between 60 to 70 percent of operating costs by the end of the next decade.

Figure D.

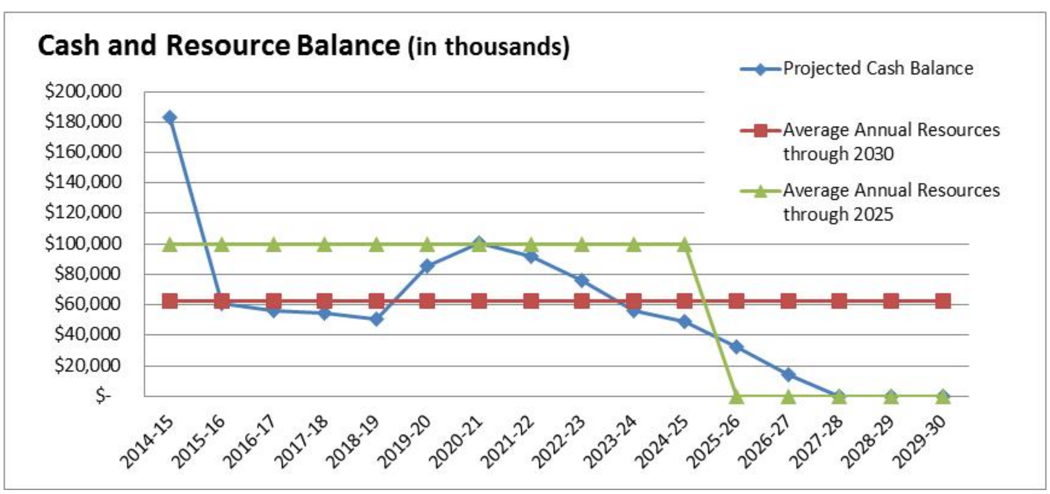


In addition to funding PDC operations, TIF has historically been and continues to serve as the primary source of funding for PDC's projects and programs.

Over the next decade, PDC is forecast to have access to approximately $1,000,000,000 in resources, primarily through TIF. If spent out evenly, this averages out to $100,000,000 per year until 2025. Annual expenditures of less than $100,000,000 could extend the life of these resources but eventually this pool of funds will run out.

The expenditure rate is likely to be much higher over the next five years, with several large projects projected to move forward (e.g., Multnomah County Health Headquarters, Veterans' Memorial Coliseum renovations, Centennial Mills, United States Post Office), and significant investment in targeted action plans (e.g., Old Town/Chinatown, Lents). If these investments happen as planned, PDC's expenditure rate is likely to track the downward slope in the graph below, with spikes in available resources matching the last dates to issue debt for several URAs between 2020 and 2022. Cash balances would then approach minimal amounts beginning in 2026.

Figure E.



PDC possesses two other categories of assets that offer some opportunities for new resource generation. PDC has been an active lender during its existence and currently manages a loan portfolio of nearly $64,000,000. Because of the high risk and mission driven nature of PDC's lending activity, this loan portfolio is worth substantially less than its paper value. In addition, while PDC's portfolio comprises 190 different loans across a range of different asset classes, the portfolio is highly concentrated, with five borrowers representing over 54 percent of the portfolio, and ten borrowers representing 74 percent of the portfolio.

Figure F.

March 31, 2015			
Loan Type	**# loans by Type**	**Portfolio Balance**	**Balance After Loan Allowance**
Commerical Amortized	162	37,738,245	35,662,642
Cash Flow	3	4,141,409	207,070
Defered Payment	25	22,146,152	11,073,076
Total	190	$ 64,025,806	$ 46,942,788

PDC's other major asset is its real estate portfolio. As a normal part of its redevelopment activities, PDC has acquired property regularly throughout its history. While the agency has worked to dispose of its owned properties in recent years, the portfolio still has a book value of $72,000,000. Staff's internal analysis of market values for the portfolio, given the range of unique properties, estimates that $40,000,000 could be realized through the sale of all properties.

PDC has not historically managed its real estate portfolio to maximize either value or return to the agency, so much value in purchased real estate has been contributed to projects that achieve public benefits that do not provide any immediate or long-term financial benefit to the agency. Establishing priorities for managing this portfolio represents a critical task in developing a long-term business plan.

Figure G.

March 31, 2015 Property Held For Sale Value		
URA	**Book Value - CAFR**	**Proceeds in Business Model**
Airport Way	11,346,646	9,498,475
Central Eastside	1,019,346	1,405,000
Convention Center	11,683,911	3,670,140
Downtown Waterfront	5,262,768	6,708,900
Gateway	4,068,519	940,000
Interstate	6,881,146	590,252
Lents	7,742,978	5,350,279
North Macadam	6,550,041	0
River District	14,035,782	12,300,980
South Park Blocks	3,459,855	0
Other	398,212	0
Total	$72,449,204	$40,464,026

IV. 2012 Economic Development Organization Comparison

In 2012, PDC staff performed an analysis of comparable economic development organizations based on similarities in age, mission, and known success. Most cities the size of Portland have a designated organization tasked with economic development work. They are generally categorized into three types of organizations:

1. *Regional Economic Development Organizations:* These organizations are typically non-profits, have less than ten staff, and rarely do financing. They often lead marketing/branding for the area and business recruitment efforts. Regional entities have private sector investors and receive donations. Many also receive funding from local municipalities, though public contributions often account for less than half of their revenue.
2. *City Bureaus and Departments:* Many cities have an office or a full department dedicated to economic development activities. These departments can range to more than 200 staff. City government organizations incorporate a variety of services into their department or office, typically combining community and workforce development functions in order to be eligible for federal funds. Funding and staffing are smallest for the purely economic development-related work and often do not perform recruitment and other proactive economic development activities. These entities rarely have urban renewal authority and are not focused on leveraging private sector investment.
3. *Self-Sustaining City Economic Development Organizations (EDO):* Many City-based EDOs operate as independent not-for-profits, have a more diverse revenue base and toolkit, and often manage authorities and multiple separate entities created for specific but related purposes. Some City not-for-profit EDOs manage government authorities or organizations on behalf of the City. Typically, the 501c staff administers these government organizations, a model used in cities such as Baltimore, Philadelphia, St. Louis, and Detroit.

Characteristics of Self-Sustaining City Economic Development Organizations

- Not-for-profit entity
- Diverse revenue base and toolkit
- Manage authorities and other bodies with specialized roles
- Independent boards appointed by local elected leadership
- Extensive use of fees for service
- Manage assets strategically, particularly real estate, for revenue generation
- Cross-subsidize revenue to fund non-revenue generating programs (e.g., community development)
- Create special entities to offer different financing and investment options

Boston Redevelopment Authority, Invest Atlanta, and Pittsburgh Urban Redevelopment Authority all create and operate multiple in-house 501c entities and administer those entities with the same staff. Larger EDOs reduce their dependency on direct subsidies by making investments which generate long-term consistent returns such as property leasing, parking, and loan programs, as well as episodic revenues from financial transactions. Many EDOs that provide financing have used Community Development Block Grant or other federal funds to capitalize multiple loan funds, a source that while dwindling annually, is primarily directed towards affordable housing in Portland.

Figure H below compares the operational size and resource mix of other organizations PDC staff examined during the 2012 study.

Figure H.

ENTITY	OPERATING BUDGET	PERCENT PUBLIC RESOURCES	PERCENT OTHER RESOURCES
Boston Redevelopment Authority	$50,000,000	40 percent	60 percent
Detroit Economic Growth Corporation	$8,000,000	16 percent	84 percent
NYC Economic Development Corporation	$140,000,000	0 percent	100 percent
Philadelphia Industrial Development Corporation	$10,000,000	25 percent	75 percent
Pittsburgh Urban Redevelopment Authority	$90,000,000	70 percent	30 percent
St. Louis Development Corporation	$22,000,000	35 percent	65 percent
Portland Development Commission	**$34,500,000**	**89 percent**	**11 percent**

The most successful, self-sustaining economic development organizations – both public and private – rely on a much smaller percentage of public resources than PDC. Many of these organizations are in cities with a tradition of stronger non-profit and private sector involvement in economic development, including a deeper and more established network of philanthropic foundations.

Organizations that serve as models for PDC have the greatest flexibility and creativity for revenue generation. These tools include the extensive use of fees for service, strategic use of assets (i.e., real estate), and creating special entities to offer different financing and investment options.

Diversification of revenue options is the key to self-sustaining EDOs. Revenue generation is best modeled in autonomous city organizations, including the Boston Redevelopment Authority, the New York Industrial Development Corporation, and the Philadelphia Industrial Development Corporation.

*Boston Redevelopment Authority (BRA)**:*** The BRA has broad development authority and is staffed to focus on planning, economic development, guiding large-scale projects through the zoning process, job training, and workforce development. The BRA inherited a significant real estate portfolio from the City of Boston, including Boston's Marine Industrial Park. The majority of BRA's revenue comes from the rental, lease, and long-term agreement income for property it owns. BRA receives some project income from land and building sales and equity participation from percentage rent payments from tenants of the Marine Industrial Park.

With more than 200 employees, the BRA is structured as two different entities:

1. The BRA, an independent government agency, and

2. The Economic Development and Industrial Corporation (EDIC), a 501c3. EDIC also manages the Boston Local Development Corporation and Boston Industrial Development Financing Authority. The BRA/EDIC makes much of its revenue from owning and operating the Marine Industrial Park.

New York City Economic Development Corporation (NYCEDC): NYCEDC is a not-for-profit economic development corporation charged with administering economic development programs on behalf of the City of New York. NYCEDC has a component unit, the Apple Industrial Development Corp. (Apple), created in 1980 to provide management and maintenance services for City- and NYCEDC-owned and leased properties. Similar to BRA, NYCEDC benefited from inheriting Times Square and other key properties from the City of New York in the 1980s. NYCEDC’s business model is driven through resources generated by ground leases and other real estate transactions. The agency also oversees the New York City Industrial Development Agency, which provides tax-exempt bond financing.

Philadelphia Industrial Development Corporation (PIDC): Founded as a joint venture between the City of Philadelphia and the Greater Philadelphia Chamber of Commerce, PIDC is a private, non-profit regional development corporation that operates independently. PIDC has six different entities under common control to carry out its work and also manages a government authority, the Philadelphia Authority for Industrial Development. PIDC’s loan funds, capitalized by New Markets Tax Credits and other transactions, are self-sustaining.

PIDC's business model is built around being a transactional organization that performs a variety of activities on behalf of the City due to limitations in the City charter. PIDC has fewer than 60 employees and a $10,000,000 operating budget, funded primarily by loan origination and servicing fees, grant management fees, fees from managing an affiliate that administers the New Markets Tax Credit Program and fees from management contracts with the City of Philadelphia. A quarter of PIDC’s revenue comes from the City through a land bank; the remaining 75 percent of revenue comes from transaction fees.

PIDC has benefited in particular from EB-5 projects. As an EB-5 Regional Center for immigrant investors since 2003, PIDC has an exclusive operating agreement with CanAm Enterprises which has resulted in $550,000,000 in project financing between 2003 and 2012.