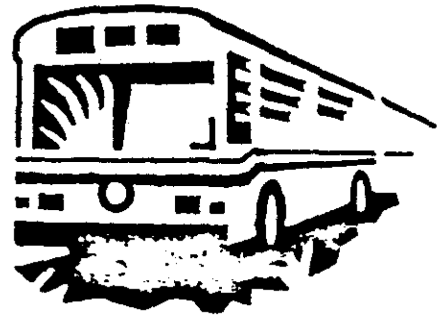
Successful Joint Development With Public Transit Sites and Facilities: *Part I*



By ROBERT C. PEARMAN, ESQ.
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Introduction

In today's tight budgetary climate, many public transit agencies encourage relationships with developers to jointly design and construct projects featuring transit system elements with retail, commercial, and even residential development. Joint development is seen as leading to a number of benefits:

1. Maximizing values of land and other asset holdings of public agencies.
2. Providing additional mechanisms for financing transportation improvements and possible revenue sources to cover operational deficits.
3. Facilitating targeted economic development in an area.
4. Increasing support from the business community and general populace for transit agency objectives.

However, truly there is no free ride. With these potential benefits come risks that are not always clearly identified by public transit agencies in the nascent stages of joint development. Thus, consideration of all the benefits and risks faced by each partner in the process is necessary to form an effective strategy to maximize the beneficial results of joint development. Following are some significant general and specific elements to be analyzed by management of any public transit agency giving consideration to joint development projects.

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Public Agency Goals

In order to successfully negotiate with a private developer, the transit agency must initially consider and, during the negotiation, focus on the benefits it seeks to obtain and the operational imperatives that it must retain through the joint development process.

A. *Protect, Enhance and Plan for Transit Needs*

There are two components in this area, the first being to protect and project for the anticipated growth and expansion of transit facilities and services over time. This can involve everything from using longer or additional combinations of rail cars for service, going to double-decked or longer, articulated buses, or adding extra HOV road lanes. The agency would have to ensure that there are no physical constraints on its potential transit expansion by virtue of the accompanying private development. Longer trains may involve designing for additional station platform lengths, increased bus lengths or widths will involve protecting minimum clearance needs and turning radiuses, and property development may be encumbered by easement areas that could reduce available property, if warranted, by future widening of the transit right-of-way.

A second key component is to ensure, both during the construction phase and upon completion, that the necessary access to transit facilities for operation and maintenance is preserved. Attention should be given not merely to regular and routine maintenance, but also to the possibility of natural calamities such as earthquake or flood and emergency access needs (e.g., in the case of large scale power outages). In planning for the minimum required space needed for transit operation in connection with the joint development, it is important to note that the need for both air space and subsurface rights and clearances — for the transit facilities and related utility and ancillary elements — is important.

B. *Increase Mass Transit Usage in High Population/High Density Corridors*

Joint development involves the transit agency playing the role of a community planning entity to a more significant degree. Joint development can simply follow existing centers of activity. Or, by combining the transit sites with a critical mass of retail and office development, the agency can foster and target new development corridors.

There are numerous salutary by-products to the linkage between transit station development and commercial development which will impact the targeting of the selected joint development locations. These include reduced auto traffic, congestion and travel time, and demonstrated air quality and vehicular emission benefits. A related consideration is that by tying the transit element to a high density joint development site, an additional ridership source is already built-in which would utilize the transit system.

C. *Revenue Participation*

By sharing in retail profits, rental income, ground and air space lease returns and project sale proceeds, the transit agency has a potential for very significant returns. These returns can help supplement the often insufficient fare box revenues to benefit transit operations, and could defray the costs of the related station site's transit facilities. The agency could recapture part of the land acquisition costs and maximize its realization of value from its land and asset holdings through such revenue participation.

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D. Identity

The possibility exists that an aesthetically outstanding office tower profile or retail center surrounding an adjacent station site could provide a unique identity and give the transit agency (and its facility) greater visibility and more positive recognition in the community.

Benefits to the Developer

In determining potential sites which might be suitable for joint development, the agency must keep in mind the inventory of benefits and concerns that typical developers will bring to the table. If the private developer's most important objectives do not dovetail with the agency goals, a particular site with respect to a particular transit system, the agency should take a realistic view and focus consideration of joint development only on those sites where the transit agency's requirements can fit most comfortably with the deal package a developer would insist upon. The agency must not lose sight of its main purpose as a transit service provider and foolishly attempt to force a joint development where there really is not a proper fit.

A. Use of Public Financing

Developers will certainly be interested in the potential for favorable interest rates via tax exempt, or even public agency-issued taxable financings (e.g., bonds, Certificates of Participation).

B. Readily Available Tenants

The transit agency itself and its related consultants and contractors (e.g., engineers, suppliers and contractors) could provide a ready made source of tenants to facilitate significant pre-leasing of commercial space, a very valued commodity in today's retail and lending market.

C. Possible Addition of Building Area Rights

The public agency could aid the developer by contributing air rights over its transit way, or ancillary agency-owned property to permit the developer to construct a building larger than applicable zoning will otherwise allow. The agency might sell or contribute such additional density air rights in return for its participation in project revenues. Further (and some jurisdictions have legislatively recognized this fact), additional building area rights may be obtained by the developer in return for its construction of transit beneficial improvements tied into the joint development (e.g., those that facilitate and increase transit riders' access nd ease of circulation).

D. Increased Identity/Wider Public Knowledge of Site

By having a "partner" in the form of a public transit agency, the opportunity exists for greater visibility and public awareness of the commercial portion of the development. Perhaps the developer can bargain for some secondary station name and signage which will create promotional opportunities throughout the entire transit system via station maps, rider information telephones, etc.

E. Built-in Users of Commercial Facility

Transit patrons are an additional source of consumers for products and services offered at the site, thus improving, for example, retail leasing opportunities. And of course, those potential customers who make the deliberate choice to shop at the development are provided convenient, secure and low cost access by the transit system.

F. Mitigation of Parking Requirements

The developer may be able to construct its facility with reduced on-site parking based upon the access to the transit system. This results in lower construction costs and more buildable area available for retail and office space. Furthermore, by combining its development with a public agency partner, it may be possible to avoid or mitigate certain normal permitting requirements that private developers have to face. In any event, there may be the very practical, though hard to define, benefit of having a public agency help run interference through the maze of local zoning and planning departments to facilitate the commercial end of the development.

The developer may also be able to obtain necessary land at a better price, or, through an easier process the land may be already assembled by purchase or condemnation by the transit agency. Furthermore, portions of the infrastructure needs of the project may already be in place, or partially funded by the transit agency as they may be equally necessary for its transit facility development. ☐

In Next Issue: Part II discusses specific deal points and available financing options.

Successful Joint Development with Public Transit Sites and Facilities: *Part II*

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Specific Deal Points

Negotiations between the transit agency and a sophisticated private developer will not be easy and can be quite drawn out. Despite many compatible points, there are also significant differences in the way the management and financial parameters of private developers differ from a public agency. Something as basic as the public agency's inability to benefit from certain income tax items, such as depreciation or certain expense deductions or operating losses, could create opportunities, and yet present difficulties in reaching agreement. From the public agency perspective, the following negotiating considerations will often be essential.

A. Integrated, Blended Theme of Design Elements

This point has both functional and aesthetic considerations. The smooth-functioning operation and maintenance of the transit system must be integrated with the property development. However, to make the combined project aesthetically pleasing and attractive to potential business tenants may require greater construction costs due to the need to design around necessary transit interfaces.

B. Property Management and Marketing

Assuming there is non-public agency space for lease, who should undertake that task, and who should take the risks if the space is not fully leased? In general, that should be assigned to the private developer, since the developer is more skilled and experienced at that role than the public agency.

D. Build So As Not to Preclude, Via Phasing, Future Additional Development Around Site and Future Transit Linkages

A successful initial project may mean that future increments would be favorable and profitable to both parties. This aspect has two dimensions: not only must consideration be given to additional commercial development near the site, but the possibility of future additional transit linkages must be retained if possible (i.e., additional connecting rail lines, access roads or busways).

E. Incentives to Timely Completion

The public agency has a two-fold concern. It is certainly interested in timely commencement of the project so that its participation in the building revenue stream can start, but, as importantly, a delayed project could also jeopardize the start-up of its transit operations. There are a number of options to help the agency feel comfortable that the timeliness objective can be met. These options include liquidated damages or increased agency revenue participation if the project is not timely completed. In all cases, a guaranteed maximum costs of construction contract should be obtained if at all possible.

F. Scope of Agency Participation

The agency will seek to participate in net cash flow and sales proceeds from the joint development. What constitutes "net" may be a heavily negotiated item. A developer may typically seek to obtain significant revenues in the form of fees for development services, leasing and marketing, and construction management, and may try blending many of its pre-development and overhead costs into project costs that may be financed, for instance, through tax-exempt financing issued under the agency's credit.

G. Shared Costs to Construct and Maintain Facilities Which May Benefit or Relate to Private and Transit Projects

A number of the elements of the joint development project could be designed and constructed in a way that makes them a benefit or an enhancement to both the transit facility, as well as the commercial property. The control over the design of such elements and the sharing of costs would be a key negotiating point. These elements could include parking areas which could serve users of the commercial spaces as well as transit patrons, public restrooms, connecting stairways, elevators and escalators, signage, lighting and security.

H. Methodology and Basis for Valuing Real Property Interests Being Contributed

Each party may bring to the project different types of real property interests—fee title, easements for operations, densitytransfer, etc. At the time of entering into a joint development agreement, it is best that the methodology and basis for valuing those contributions are determined. An independent appraisal process can be used with certain criteria established up front as to the valuation process or selection of appraisers. In some instances, the value of real property interests can be agreed upon initially, with certain factors recognized to augment that initial valuation over time (i.e., through CPI increases, supplemental appraisals, etc.).

I. Equal Employment Opportunity and DBE Participation

Many public agencies have Disadvantaged Business Enterprise (DBE) programs and affirmative action employment requirements that would be a feature of any direct contracts they issue. In order to enhance opportunities

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for DBEs, the agency may insist upon extending its requirements to the joint development project, a consideration the private developer may not be familiar with. Similarly, the joint development nature of the project may make the private developer subject to certain public works statutes, prevailing wage laws, etc., and the impact of the applicability of those laws, if any, should be identified.

J. Facility Design Standards

Again, transit operational imperatives cannot be subordinated to the aesthetic preferences of an office building architect. Transit agency needs and applicable health and safety standards related thereto must be implemented in the design process.

K. Decision-Making Structure

The public agency may be burdened with a multi-layered and slow moving decision-making process. This can often frustrate a leaner private developer that may have a very simple and rapid chain of command. The agency should consider establishing a unique project management structure in the joint development case limiting the necessary decision makers, and perhaps including the use of an outside consultant and legal counsel that can solely focus on the particular project.

L. Buyout Provisions

It may be imprudent for the public agency to bind its future boards and commissioners to certain financial arrangements in a joint development situation. The ability to "buy out" of the joint development participation and shift those revenues to future operational needs is a consideration that public agency management cannot prudently ignore. The agency may find itself unable to take on long-term risky positions. On the other hand, this is a very sticky negotiating point if the developer views the relationship as a partnership in which both sides should be prepared to remain for the long haul and take all appropriate risks. As a price for more flexible buyout terms, the agency may have to accept a lesser revenue participation than might otherwise be appropriate in a joint venture situation.

M. Expanded Menu of Financing Options Available

The Department of Transportation and Urban Mass Transportation Administration have already considered funding studies and special demonstration projects for joint development opportunities. Additionally, financing available for the transit facilities may, with careful application, assist with part of the development infrastructure as well. Other financing mechanisms that may come to bear upon a joint development would include: public purpose revenue Bonds and Certificates of Participation, government issued taxable financing instruments, industrial revenue bonds, the use of benefit assessment districts and property increment financing, and Community Development Block Grant-type funds. A slightly indirect but beneficial opportunity arises from government funded related improvements—streets, parking, landscaping, lighting—and the maintenance thereof which could benefit the joint development.

Conclusion

Joint development is not necessarily appropriate at every transit location, and even those sites which on paper present attractive opportunities could instead yield proposals from the private sector which would be adverse to the transit agency's interest.

A carefully considered plan for joint development, with appropriate contributions by both the public agency and private developer, can lead to a "win-win" situation and be a major step forward in maximizing the transit agency's potential and revenues. The foregoing points provide a framework for a successful joint development strategy.