

TRANSFORMATIVE REDEVELOPMENT

Strategic State Policy for
Gateway City Growth and Renewal



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EXECUTIVE SUMMARY

Massachusetts has entered an era of global competition ripe with both challenges and opportunities. Success in this new age will require bold new economic development strategies that generate innovation and growth by capitalizing on the Commonwealth's unique strengths. Among these assets are the state's Gateway Cities. Massachusetts should target these regional economic centers for transformative redevelopment.

This white paper introduces the concept of transformative redevelopment and proposes it as a strategy for Gateway City growth and renewal. The term describes public and private financial support for projects that catalyze significant follow-on private investment, leading over time to the transformation of an entire downtown or urban neighborhood. This approach seeks to repair weak real estate markets where development costs outweigh returns, creating a gap that impedes the flow of private investment; it contrasts sharply with current policies, which are far too modest to help Gateway Cities restore healthy real estate markets.

While transformative redevelopment is highly targeted geographically, it produces gains for the Commonwealth as a whole: Strengthening core cities in regions across the state will facilitate growth patterns that are economically, fiscally, and environmentally more efficient for all.

MassINC advances the ideas in this concept paper as a starting point. While specific recommendations are offered, these are intended to provide fodder for debate. Our objective is to build support for the model and encourage a robust discussion leading to a coherent transformative redevelopment policy.

The Transformative Redevelopment Rationale

Gateway Cities matter for their regions and for the Commonwealth. They are important to our economy as regional

centers of commerce and they are important to the middle class as physical places where low-income residents should find opportunities to climb the economic ladder. These opportunities have not been plentiful in recent times. Decades of suburbanization and industrial change have drawn economic vitality away from these older manufacturing centers. The pendulum, however, is starting to swing in the opposite direction. Demand for walkable and vibrant urban neighborhoods is returning. While so far the shift has been strongest in larger cities like Boston, there is real opportunity for smaller cities as well.

If Massachusetts can help Gateway Cities tap into this positive trend, it can address some of the state's most stubborn challenges. Reinvestment that strengthens Gateway Cities will increase the state's supply of housing and create attractive lower-cost locations where businesses can grow and expand.¹ By facilitating reinvestment in urban areas, transformative redevelopment will lead to more efficient development patterns, reducing the fiscal cost of sprawl and the threat to long-term growth that a lack of developable land presents for Massachusetts. Removing barriers to growth in developed cities will also help the state protect the quality of life in small New England towns and rural areas; this is a unique asset that must be preserved.

The Approach

While Gateway Cities have untapped potential with investors finding increasing value in vibrant urban places, the economics of today's weak markets make it difficult for even the most well-conceived redevelopment project to capture this value. Projects simply cannot generate enough rental or sales income to cover the cost of complex redevelopment, which includes planning, property acquisition, environmental remediation, historic rehabilitation, vertical construction,

and infrastructure upgrades. The disparity between these costs and return under current market conditions creates a market gap. For both residential and commercial construction in Gateway Cities, the market gap often equates to two-thirds of the cost of redevelopment.

At its core, transformative redevelopment is about providing public resources to fill this gap and restore the healthy function of private markets. To achieve this goal, a comprehensive transformative redevelopment policy must include three dimensions:

- **Financial tools to spur and support transformative projects.** The market gap can be closed through such resources as state equity, loan guarantees, and subordinated debt. These tools must be flexible to serve a wide variety of projects driven by a diverse set of market opportunities, while best positioning the state to recapture its investment when possible.
- **Complementary policies to diffuse impact and accelerate change.** To stimulate private markets and maximize the leverage of the state's investment in transformative redevelopment, it is essential to put in place complementary and coordinated policies, such as tax credits to attract large employers and incentives to increase homeownership in surrounding neighborhoods.
- **Governance structures to leverage capacity and coordinate investment.** Transformative development tools must be accompanied by administrative action that demonstrates the state's commitment to transformative redevelopment in ways that attract a response from local governments and the private sector, guarantees that strong investment decisions are made, and provides the public with assurance that state resources will be invested wisely.

While Massachusetts has many aspects of this three-part program already in place, concerted effort will be required to coordinate existing policies, fill gaps, and add more resources to facilitate projects at a large enough scale to produce real change.

A Strategy for Transformative Redevelopment in Massachusetts

To advance a strong transformative redevelopment policy, MassINC offers the following recommendations as a starting point for discussion. The actions outlined below call for new state investment totaling \$1.7 billion over 10 years. These resources could stimulate approximately \$3.4 billion in new development and reuse, providing funds to make possible at least seven major transformative redevelopment projects and generating total reinvestment in Gateway Cities approaching \$7 billion.² Economic impact analysis suggests this level of reinvestment activity would support approximately 80,000 jobs.³

1. **Commit \$125 million per year for the next 10 years to build a transformative redevelopment fund.** This fund, established in the economic development capital budget, could provide equity to be returned with potential down-the-road revenues through increased cash flow or appreciation on resale.
2. **Create a loan guarantee to facilitate private lending for transformative projects.** A state loan guarantee program backed by money in the transformative redevelopment fund could support up to \$1 billion in private lending.

3. **Create a transformative redevelopment revolving loan fund.** A \$100 million interest-free or low-interest-rate revolving loan fund could provide flexible debt to support construction, upgrading, and fit-out of commercial spaces for marketing and delivery to tenants.
4. **Commit an additional \$20 million per year over the next 10 years to the MassWorks Grant program.** Resources from the economic development capital budget could address the significant new demand created by transformative redevelopment projects for state funds to support infrastructure upgrades.
5. **Provide targeted incentives for homebuyers to significantly increase the catalytic neighborhood revitalization effect of transformative redevelopment.** State income tax credits capped at \$5 million annually could go to households who buy and rehabilitate substandard houses in targeted neighborhoods for owner occupancy; a state-chartered home equity protection insurance program could be self-supported through fees.
6. **Design and coordinate economic development programs that catalyze Gateway City markets.** These programs could include existing Economic Development Program Incentives (EDIP) targeted to new anchor tenants; appropriate long-term state leases; a \$2 million expansion of the Massachusetts Cultural Council's Adams Grant for designated Cultural Districts; and \$75 million for the creation of three satellite UMass campuses from the higher-education capital budget.
7. **Build Gateway City capacity.** This could be done through community assistance teams for early-stage efforts, using existing state economic development personnel; and \$2.5 million to select, train, and place five mid-career professionals to serve four-year terms in Gateway City economic development agencies implementing transformative redevelopment plans.
8. **Make changes to existing state programs and regulations to enhance their ability to support transformative redevelopment.** Changes could include Business Improvement District statute reforms, plus other efforts to use transformative redevelopment as an opening to reform laws that hinder large-scale revitalization initiatives.
9. **Create a strong governance structure.** Structures at the state level could provide a transparent and competitive process guided by rigorous yet flexible selection criteria; parallel structures at the local level could ensure that projects will have capable and sustainable long-term stewardship.
10. **Assemble data to identify market opportunities and evaluate progress.** An annual expenditure of \$150,000 could be used to collect, analyze, and make public resale and other market data in areas targeted for transformative development so that developers, financiers, and policymakers can gain a better understanding of Gateway City markets and the impact of state investments.

I. INTRODUCTION

Massachusetts has entered an era of global competition ripe with both challenges and opportunities. Success in this new age will require bold new economic development strategies that generate innovation and growth by capitalizing on the Commonwealth's unique strengths. The state's Gateway Cities are an example of a distinct economic asset that Massachusetts should build upon to its advantage. Toward that end, this paper lays out a transformative redevelopment policy to unlock the potential of these key regional cities.

Transformative redevelopment describes projects that leverage direct public and private investment to catalyze significant follow-on private investment, leading over time to the transformation of an entire downtown or urban neighborhood.

This introductory section sets forth the rationale for a transformative redevelopment policy by describing why Gateway Cities matter, cataloging their unrealized potential, presenting transformative redevelopment as a way to realize this opportunity, and laying out the logic of transformative redevelopment in Gateway Cities as a clear and compelling economic development strategy for the Commonwealth as a whole.

A. Gateway Cities matter for their regions and for the Commonwealth

MassINC first called attention to the Commonwealth's Gateway Cities with the 2007 report *Reconnecting Massachusetts Gateway Cities: Lessons Learned and an Agenda for Renewal*.⁴ This research came at a time when many had reluctantly accepted the decline of these older manufacturing centers as an inevitable byproduct of industrial change. MassINC advanced an alternative view, describing these communities as "Gateways" and arguing that they still mattered to the state's economic future in three important respects:

- 1. Gateway Cities are "Gateways" to economic activity in their metro areas.** Combined, the state's 24 Gateway Cities represent 1.7 million residents. More than one in four residents of the Commonwealth resides in a Gateway City. The economic significance of these key regional cities extends beyond their weight as population centers. Economic growth is increasingly driven by strong metropolitan economies. Research shows that the success of metro areas is tightly tied to the health of their urban cores. Massachusetts needs these cities to be vibrant and productive places for regions across the state to grow and prosper.⁵
- 2. Gateway Cities are "Gateways" to the middle class.** For generations of families climbing the economic ladder, particularly immigrants and refugees from abroad, Gateway Cities have been a launching pad. Their affordable housing stock, social and educational institutions, and entrepreneurial spirit have provided the necessary ingredients for upward mobility. But economic change over the past two decades has slowed upward mobility, contributing to growing economic inequality.⁶ MassINC research has called attention to the particularly sharp rise in inequality in Massachusetts and the consequences this inequality could have for sustained economic growth.⁷ These deep and systemic issues make it vital for Gateway Cities to continue serving their function as places that support family economic success.
- 3. Gateway Cities are "Gateways" to educational, cultural, and other major institutions.** Whether they be educational institutions such as the UMass Medical Center in Worcester, corporate institutions such as Mass Mutual, a Fortune 100 company headquartered in Springfield, or cultural institutions such as the

Zeiterion Theatre in New Bedford, Gateway Cities are home to organizations that are essential to both the economy and the quality of life in regions around the state. These institutions are not easily to relocate, and the strength of the communities that surround them will have real implications for their future health and competitiveness.

B. Gateway Cities have unrealized potential

Gateway Cities have many features that make them attractive emerging market opportunities, starting with location. Interstate highways, airports, deep-water ports, and freight and regional passenger rail service provide them with excellent connectivity. In an economy that moves at an increasingly fast pace, this existing infrastructure provides a real comparative advantage.

In the past, location made Gateway Cities centers of manufacturing. The vast land area today's capital-intensive factories require means that Gateway Cities cannot maintain manufacturing economies at their historic scale – but combine location with their authentic urban fabric, and Gateway Cities have a recipe for drawing New Economy service industry firms.

With walkable downtowns and neighborhoods, riverfronts, parks, and a plethora of historic and architecturally distinctive buildings, these communities are increasingly desirable for both consumers, who find renewed appeal in urban living, and businesses, who want locations that offer an attractive work environment where employees can interact informally and exchange ideas.

The market has yet to fully realize these opportunities, which gives these cities significant cost advantages for those looking to purchase homes or lease space. On average, home values in Gateway Cities are more than 50 percent lower

than in Greater Boston. In addition to this cost advantage, Gateway Cities often have existing sewer and other public infrastructure with excess capacity, and they are generally pro-growth communities.

C. Unlocking this potential requires transformative redevelopment

While, as described above, Gateway Cities have real assets that many private investors recognize, creating value from these assets requires redevelopment on a scale and character capable of catalyzing positive economic and physical chain reactions. Whether through large projects or through the cumulative effect of multiple smaller activities on a sustained basis, major investment in new construction, rehabilitation, and adaptive reuse, plus improvements to the public realm, are needed to create the quality of place that can indeed make these cities regional communities of choice.

This transformative private investment will require substantial public investment. These communities are all — to varying degrees — what have been called “weak market” cities. Decades of suburbanization and deindustrialization have reduced property values to the point where real estate markets are no longer functioning properly. Low property values mean that in many areas in Gateway Cities, it costs more to restore an old building or build a new development than the developer can obtain in rents or sale prices. Under such circumstances, no rational person would invest money in such a project.

Even when the numbers might work on a pure building-by-building basis, the additional costs often associated with urban redevelopment (compared with building in greenfields in other parts of the state) may make a project unfeasible. The required land assembly and demolition raise development costs, as does the need for higher density, more

expensive vertical construction, and features such as structured parking. Moreover, urban redevelopment often calls for far more than just individual buildings; it may require the transformation of entire areas, including public realm enhancements and expansion or long-deferred improvements to public infrastructure. The effect of these factors is that significant transformative private investment in Gateway Cities is unlikely to take place without significant public investment. This investment needs to be designed and provided in ways that reflect the full range of these impediments as well as the economic constraints affecting the cities, which severely limit their ability to contribute to these costs.

D. Transformative redevelopment in Gateway Cities is a clear and compelling economic development opportunity for the Commonwealth

Transformative redevelopment that helps Gateway Cities realize their full potential would generate broadly shared returns for residents across the Commonwealth by responding to four of the state's major priorities:

- 1. Transformative redevelopment can increase the state's housing supply.** As recent research from Northeastern University's Dukakis Center powerfully demonstrates, housing costs are perhaps the most significant constraint on job creation in Massachusetts, particularly for mature industries with tight operating margins, which provide a wide array of middle-skill jobs essential to middle-class families in all parts of the Commonwealth.⁸ Transformative redevelopment projects that capitalize on opportunities to create desirable urban residential environments in Gateway Cities is one of the most powerful routes available for significantly expanding the state's supply of housing to foster future economic growth.

- 2. Transformative redevelopment can promote more efficient growth, thereby protecting quality of life in smaller towns, providing a hedge against the risk of energy scarcity, and helping the state meet its long-term climate change goals.** Small New England towns are a major selling point for Massachusetts. Growth in established urban areas can help preserve the character of these communities and, at the same time, save taxpayers money by making better use of existing infrastructure. Higher-density development in Gateway Cities is also more energy-efficient. Multifamily units are easier to heat and cool, residents are able to walk or ride public transit to more destinations, and when travel by car is required, trips tend to be shorter. Massachusetts is making a significant investment in policies to decrease the state's reliance on fossil fuels and reduce greenhouse gas emissions. Transformative redevelopment that draws more people and jobs into high-density urban areas is a cost-effective policy to further energy efficiency and address long-term climate change issues.
- 3. Transformative redevelopment will create attractive and affordable locations where companies can emerge and growing companies can expand.** Creating opportunities for tomorrow's entrepreneurs, and retaining innovative and dynamic companies as they move from product development to maturity phases, is a major economic development challenge facing the state. Transformative redevelopment to open up attractive and affordable locations where companies can grow close to their Boston-based research-and-development facilities would not only help the state retain more growing businesses, it would also give the state a significant competitive advantage by offering companies the ability to operate at both

ends of the product lifecycle. In terms of job creation, just as upgrading the workforce is a better strategy than providing incentives to attract individual companies, improving places is another approach to improve local economic conditions and increase the “investability” of cities and their regions.⁹

- 4. Transformative redevelopment will create opportunities for the state’s unemployed and underemployed youth and young adults.** Isolated from opportunity, many young Gateway City residents fail to achieve their potential, a loss in human talent that is costly to the state. While traditional urban regeneration models have often fallen short of providing benefits to low-income residents, transformative redevelopment is about building markets and creating value that can move families up the economic ladder. This value-creation approach is critically needed to provide funding for education, workforce development, transportation and other services that connect Gateway City residents to jobs. Given the state’s aging workforce, businesses will need these fresh workers to grow and prosper in the Commonwealth.

FUELING MULTIFAMILY HOUSING PRODUCTION

Recognizing the critical link between job creation and housing supply, the Patrick administration has established a statewide housing production goal of 10,000 multifamily units annually through 2020. Responding to recent analysis showing future housing demand will largely come from households amenable to urban living, the administration created a new Compact Neighborhoods Program. But the state has no new resources to support this effort (the current five-year capital plan reduces housing investment). As Harvard economist Ed Glaeser noted, spurring residential construction in urban areas outside of the Boston core will take “take stronger medicine” than state housing agencies have at their disposal.¹⁰

II. WHAT IS TRANSFORMATIVE REDEVELOPMENT AND WHAT OBSTACLES STAND IN ITS WAY?

Creating a transformative redevelopment policy that can deliver clear and compelling results begins with building consensus around what qualifies as transformative public investment in the Gateway City context, as well as identifying the barriers to redevelopment in these communities that public resources can be structured to overcome.

What is transformative redevelopment?

MassINC defines transformative redevelopment as projects that leverage direct public and private investment to catalyze significant follow-on private investment, leading over time to the transformation of an entire downtown or urban neighborhood.¹¹

Transformative change can take place through the cumulative effect of many small projects linked by a coherent strategic framework, as well as through a single large project or development. The key is that the redevelopment activity must leverage change through the activities and investments of other parties.

Thus, if a decision by one developer to rehab a building in downtown Lowell for housing leads other developers — spurred by the first developer’s success — to undertake similar projects, the first project can be said to leverage that change. The same can be said of a new theater that draws restaurants to the vicinity, or of revitalization investments that attract new homebuyers into a neighborhood and encourage existing owners to upgrade their properties. In each case, it is possible to point to additional dollars invested and economic activity created, along with increases in jobs and property values, that flowed from the transformative activity, over and above the direct impact of the activity itself.

While it is impossible to predict with certainty that any particular redevelopment effort or investment will leverage change, it is possible to model likely outcomes. To be considered transformative, any redevelopment investment must be grounded in a credible argument or theory that it will leverage change, as well as a credible projection of the nature and level of the change likely to result from the project or investment.

Potentially transformative projects take many forms. Large-scale projects, such as City Square in Worcester or the Hamilton Canal District in Lowell, are the most obvious examples, but not the only ones. A more modest but highly strategic project could also be considered transformative. Similarly, a series of linked small-scale activities that may include development projects, quality-of-life improvements, or other activities by a CDC in a particular neighborhood, if carried out as part of a larger revitalization strategy, could leverage change in the desirability of a neighborhood to its residents and to the marketplace. This change can potentially be measured in increased home values, increased home ownership, or increased improvements by existing owners to their properties.¹² In this case, it is likely the strategy, more than any single project, that is transformative. Any investment policy or program must be flexible enough to address different forms of transformative redevelopment while requiring, as discussed below, a minimum level of private sector investment for every state dollar invested.

At the same time, many projects, including some large and expensive ones, are not truly transformative in this sense, or may leverage little additional change relative to the amount of public sector funding needed to make the project happen. Arenas and stadiums are often cited as examples of such projects.¹³ State support for transformative redevelopment should incorporate a screen to ensure that any proj-

ect's claim to be transformative is based on a solid argument that it will leverage change and a credible projection of the change likely to result.¹⁴

What are the obstacles to transformative redevelopment?

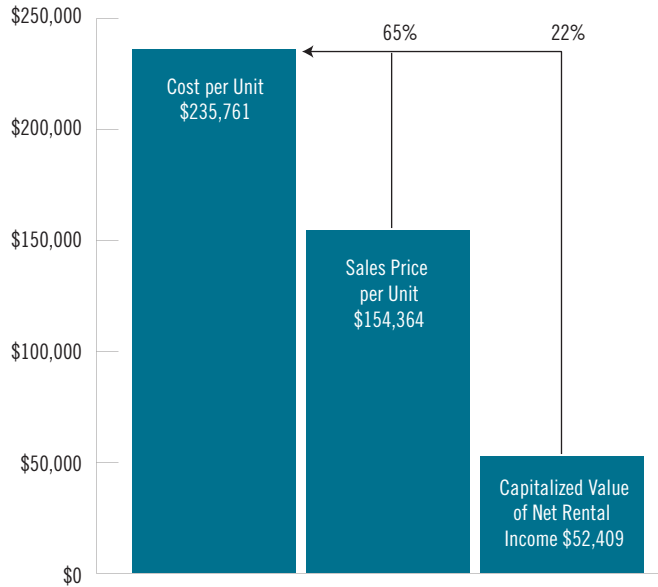
The central barrier standing in the way of transformative redevelopment — which is also the reason it is so badly needed — is the weak condition of Gateway City real estate markets. Weak markets mean that even the most well thought out projects are simply not financially feasible; that is, they will not generate enough rental or sales income once completed to cover the costs of property acquisition, improvement, and construction. This disparity between cost and return is known as the “market gap,” and all else flows from this point. Unless the market gap can be closed, everything else is academic.

Recent data show that the average residential unit costs over \$235,000 to produce in Gateway Cities, but housing units in Gateway Cities sell for less than \$155,000 on average — just two-thirds of development costs. Low rents in Gateway Cities relative to the cost of constructing, financing, and operating apartment buildings leads to a much larger market gap for rental housing. On a per-unit basis, capitalized rents support less than one-quarter of total cost (Figure 1).

Estimates of costs versus cash flow for commercial property (Figure 2) also demonstrate a large market gap. With rents for office space typically hovering around \$15 per square foot, net operating income capitalized (\$88 per square foot) would cover only about one-third of new construction costs (\$266 per square foot). Even space fetching a much healthier \$25 per square foot would struggle with a market gap equal to one-fifth the cost of new construction.

Figure 1:

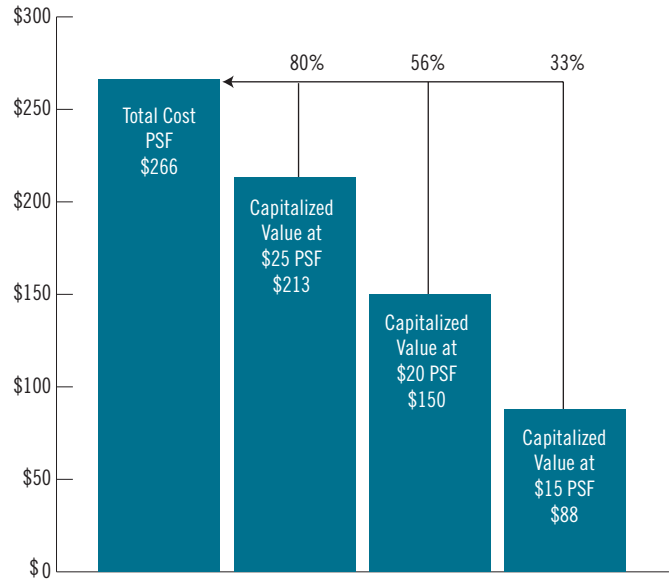
The Average Gap in Gateway City Residential Real Estate Markets



Note: Authors' estimates. See Appendix A for sources and methods.

Figure 2:

The Average Gap in Gateway City Commercial Real Estate Markets



Note: Authors' estimates. See Appendix A for sources and methods.

Four common constraints produce the market gap in weak markets:

1. High front-end costs associated with large-scale urban redevelopment. These include a number of different costs, beginning with the initial planning process and continuing up to construction:

Planning activities

- Planning funds (conceptual plans, development of redevelopment plans, preparation of RFPs, etc.)
- Site condition and environmental contamination assessments, MEPA process
- Feasibility and impact analyses
- Community engagement activities

Pre-development activities

- Acquisition
- Environmental remediation
- Infrastructure improvements
- Site preparation

With large-scale multi-phase projects, these costs are not only substantial, but also must be incurred, for the most part, long before any return is realized from the project. Where the activity is a long-term strategy such as a neighborhood revitalization effort (rather than a single project), ongoing management costs over many years may also have to be covered.

2. High development costs. The actual cost of devel-

opment itself is often greater in Gateway Cities and other urban areas, partly because of the higher costs associated with site assembly, environmental remediation, vertical construction, and, often, historic rehabilitation; and also because many developments in high-density urban areas need to incorporate costly features such as infrastructure improvements, structured parking, and other public amenities. Neighborhood-scale strategies similarly may need to include improved sidewalks, tree plantings, upgrades to parks and open spaces, and steps to address non-physical issues such as improvements to public safety or other services in order to enhance the area's quality of life and “curb

appeal.” There may also be a need for “soft” strategies, such as community building and areawide marketing efforts.

3. Difficulty obtaining affordable, stable long-term financing. In the current financial climate, many sound projects have difficulty obtaining the long-term financing needed once construction is complete, or can only obtain financing subject to conditions such as high interest rates, short repayment terms, or excessive equity requirements that make the project infeasible.

4. Non-financial obstacles. A number of obstacles combine to create a significant non-financial barrier to transformative investment.

HAMILTON CANAL, LOWELL

Lowell's Hamilton Canal is the epitome of the challenges even the most well-conceived transformative projects face. The city has expertly managed the process, attracting real investment from the private sector as well as from state and federal governments. Yet despite significant public leadership at all levels, and in a market at the strong end of the Gateway City spectrum, the project is hobbled by financial uncertainty.

On a conceptual level, the \$800 million in investment envisioned for Hamilton Canal is Urban Redevelopment 101. It takes outmoded infrastructure — canals designed to serve industry that existed a century ago — and converts it to an amenity. With a revised street grid, the canals will frame stunning views of a waterfall that forms where the district's three canals meet. Redevelopment along these

waterways will transform 15 acres of vacant and underutilized land in the heart of the city into a mixed-use gateway, doubling the size of the city's downtown and vastly improving the connection to the city's MBTA commuter rail station.

For Lowell, Hamilton Canal is much more than just urban placemaking, it's the right economic development strategy. The city is located in a region teeming with New Economy growth. But positioning the community to compete successfully for these new businesses requires public intervention. In the 1990s, Lowell experienced the downside of the alternative (courting a large employer with the resources to take on complex redevelopment) when Wang Laboratories filed for bankruptcy and abandoned the city, shortly after building 1 million square feet of office space to house its 4,500 workers.

Hamilton Canal aims to strengthen and diversify the city's economy by providing attractive office space for the region's many small to midsize employers. If it succeeds, the project would accommodate up to 1,800 new permanent full-time workers. The city would benefit from an additional \$4 million in annual property tax revenue.

To help ensure that the project would conform to market realities and the needs of prospective employers, Lowell designed a process that put the private sector in the lead. The city issued an RFP for a master developer charged with designing, rezoning, marketing, and redeveloping the Hamilton Canal District.

After a competitive process, the city selected Trinity Financial as master developer in 2007. Trinity and the city led a 12-month public planning process (at Trin-

In many communities, limited capacity is the most significant non-financial roadblock. Cities lack the staff and organizational structures to plan and design well-conceived redevelopment projects; to evaluate the qualifications of developers and the quality and feasibility of their proposals; to revise local ordinances to facilitate complex, multi-use projects; and to build effective, ongoing partnerships with developers and CDCs to ensure that transformative projects succeed. Without this capacity, it is difficult for the city to be an effective partner in the redevelopment process.

Lack of information is another major non-financial barrier. Lenders and investors need a solid understanding of

real estate trends. In these small markets, where office and higher-end residential products have not been introduced in many years, it is very difficult to gauge how the market will respond with the certainty required for underwriting.

Other common non-financial barriers include regulations and inconsistencies and conflicts between programs administered by different government agencies.

The sum effect of these four obstacles is that much-needed private investment, which could potentially transform the economic conditions and quality of life in Gateway Cities, is not taking place.

city's expense), which produced a district master plan. The city's planning department then translated this plan into a form-based code regulating the scale and character of development in the district in accordance with the community's vision. The planning department presented these new codes to the city council for approval. This expedited permitting process successfully achieved its goal of minimizing risk and delay.

To date, Trinity Financial has completed the rehabilitation of the Appleton Mills, a brick complex on Jackson Street. The stylish apartment complex, which provides 130 units of rental housing for artists, opened last May and is now fully occupied. Appleton Mills was financed with \$42 million in state and federal housing and historic tax credit equity from its investor, Met Life. The project also received a \$1.6 million permanent mort-

gage and a \$34 million construction loan from MassHousing, as well as a \$13 million state Growth District Initiative grant from the Executive Office of Housing and Economic Development and additional grants from the Department of Housing and Community Development.

The second major piece of Phase 1 is the \$14 million renovation of the former Freudenberg Nonwovens building, newly branded by Trinity as 110 Canal Street. While the structure's historic character make it a signature piece of the district revitalization plan, the 55,000 square feet of commercial space envisioned is difficult to finance. In contrast to the many state resources that exist to fill the gap for housing, funding for commercial development is more limited. With an anchor tenant, the project could qualify for a mortgage, but identifying an employer

large enough to lease a significant amount of space is difficult given the approximately 12-month lead time required to close the deal and compete the rehabilitation. Additionally, the building in its current condition looks awful, and tenant prospects have a hard time reconciling the vision for the building with the eyesore that it is today.

The Freudenberg's success is critical to the project's long-term prospects. The renovated building would redefine the area, demonstrate the strength of the commercial market, and give the private sector confidence that this bold effort is real. Hamilton Canal is struggling to maintain the master plan's ambitious 10-year vision. Achieving the plan would make Lowell a stronger engine in the Merrimack Valley economy and demonstrate a model for investing in transformative change.

III. PUBLIC INVESTMENT STRATEGIES TO OVERCOME THE OBSTACLES TO TRANSFORMATIVE REDEVELOPMENT

Transformative redevelopment projects and strategies are occurring in Massachusetts's Gateway Cities, and they will undoubtedly continue to take place under current ground rules. Sophisticated developers, nonprofits, and economic development officials identify opportunities that are workable with existing tools, and, after years of effort, they assemble multilayered financing, leveraging private funds with federal, state, and local public sector programs to overcome the obstacles.

However, to truly realize the opportunity in Gateway Cities, Massachusetts needs a comprehensive transformative development policy so that these projects and change strategies are no longer the hard-fought exception. This section establishes basic principles for this transformative redevelopment framework, outlines its contours, and assesses the state's current urban revitalization tools relative to this model.

A. Transformative Redevelopment Principles

To clearly establish the character of the interventions required to achieve the goal of transformative redevelopment, it is critical to delineate five fundamental principles at the outset:

1. **Filling market gaps will require forms of public investment that do not have an immediate, assured source of return.** In Gateway Cities the market gap cannot be filled solely by increasing access to conventional financial instruments. Closing the gap requires financial resources that do not demand an immediate financial return from project cash flow or sales revenues. This can take the form of equity

investments, either by the state (or private parties who are compensated through state tax credits) or by subordinated deferred-payment debt. In either case, they are likely to require the state to put public funds at risk, incur costs, and forego revenues to which it might otherwise be entitled, or defer repayment of public funds until revenue streams emerge.

While the Commonwealth is affected by very real resource constraints, the revival of these cities is paramount to the state's future economic strength and sustainability, and it justifies a large commitment to transformative redevelopment, as long as it is kept within fiscally responsible bounds.

2. **Where public funds are put at risk by the state, a potential source of full or partial downstream repayment should be identified wherever possible.** While these projects are subject to a market gap under today's economic conditions, a central premise underlying the concept of transformative redevelopment is that such activities are likely to lead to changes in market conditions in the cities where they take place, so that the market gap will be progressively reduced and, in time, eliminated (as depicted in Figure 3).¹⁵ As a result, the rents that developers will be able to get should rise, and the value of properties should increase on resale.

These increases represent the principal means by which cash flow can be generated to repay market gap financing vehicles, either by creating tax increment financing (or similar repayment structures) or by designing subordinated debt instruments whose repayment is triggered by cash flow increases or the recapture of increased value on resale or refinancing. Some part of all of these potential revenue sources should be made avail-

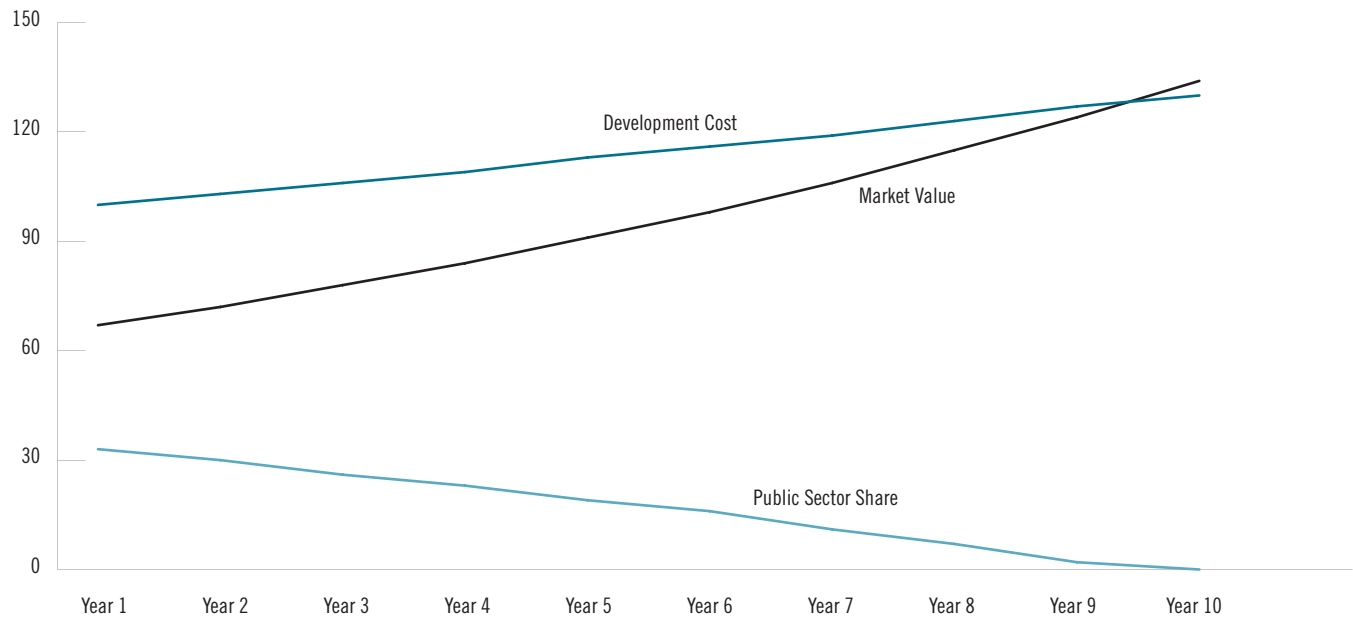
able for repayment of state resources placed at risk.

The state should not necessarily have access to the entire upside potential, however, nor should it necessarily require that local government or developers guarantee its investment.¹⁶ It is unreasonable for the state to place the full repayment burden on the Gateway Cities, whose resources are far more constrained than those of the state and are already inadequate to provide their residents and workers with the services they have a right to expect.

3. **Transformative redevelopment must respond to the needs of the people of Gateway Cities, not only the places. The state's Gateway Cities are people, not just places.** Transformative redevelopment cannot be considered successful unless it improves the living conditions and increases opportunities for the residents of the cities in which it takes place. Strategies to further transformative redevelopment must be designed to ensure that the projects and activities supported by the public sector do indeed lead to better conditions and greater opportunities for the residents of the cities benefiting from that investment.

Figure 3:

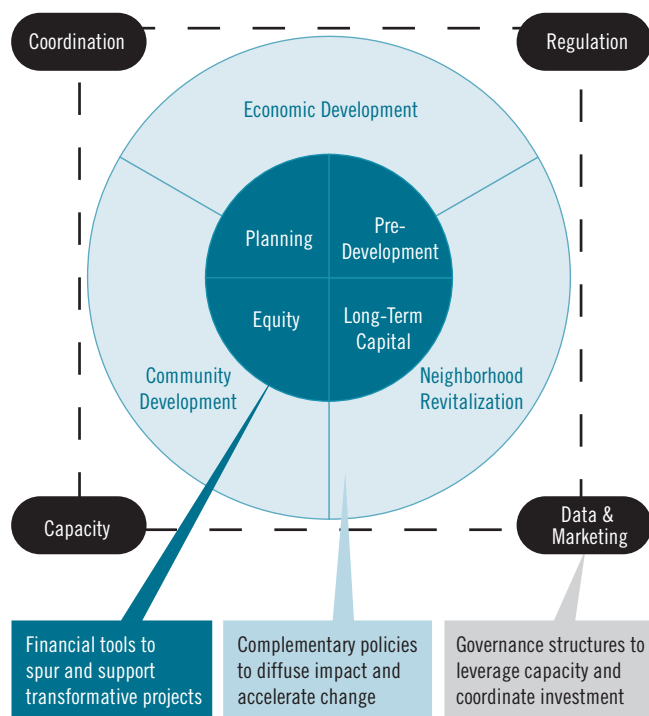
Closing the Market Gap with Transformative Redevelopment



A key objective of transformative development is to catalyze new economic activity that creates value and closes these gaps over time. In this theoretical example, public subsidy is required to close a market gap equal to one-third of the total cost of development. The project generates an increase in values, closing the market gap within a decade so that public funds are no longer required to support new investment.

4. **Transformative investment must be a unique response to a local market opportunity.** Successful transformative development is opportunistic by nature; it takes advantage of particular opportunities, such as buildings, business activities, economic moments, housing market demand, and energized communities, that emerge at particular times and in particular places. No single strategy or model is likely to be effective in all of the state’s Gateway Cities, and policymakers cannot anticipate what form transformative redevelopment might take. However, as stewards of public resources, they have an obligation to ensure that transformative investments respond to actual market opportunities to catalyze reinvestment, as opposed to the simple need for revitalization.
5. **Local governments should demonstrate a strong commitment to transformative redevelopment.** To succeed, Gateway Cities must be full partners in transformative redevelopment. While local resources are severely constrained, local governments must show they are prepared and committed to maximize return on the state’s investment. The transformative development policy should provide communities with incentives and support to position themselves for transformative redevelopment projects, but ultimately, the state should devote resources only to those places that demonstrate their ability to enter into an effective partnership.

Figure 4:
Elements of a Transformative Redevelopment Policy



B. A Comprehensive Transformative Redevelopment Framework

Massachusetts can make transformative investments in Gateway Cities by developing a comprehensive framework that puts in place three elements critical for success: financial tools to spur and support transformative projects; complementary policies to diffuse impact and accelerate change; and governance structures to leverage capacity and coordinate investment.

Financial Tools to Spur and Support Transformative Projects

Financial tools to spur and support transformative projects are the core of a transformative redevelopment policy. As detailed below, in designing financial support, the objective is to overcome the financial obstacles that arise at each phase of the project as efficiently as possible, while providing flexibility to serve a wide variety of projects, incentivizing market-driven redevelopment, and positioning the state to recapture its investment when possible.

Financial assistance in the planning process. Given the long timeframe associated with large-scale redevelopment, planning costs are particularly difficult for both public and private entities to carry. Providing grants or loans for planning, site assessment, and related costs incurred before other financing becomes available will encourage local governments and developers to put forward bold strategies informed by strong planning and analysis. At the same time, however, the state wants to avoid subsidizing planning work that is disconnected from market realities. The right balance can be established by structuring these grants or loans so that they are recoverable if the project moves forward; if not, the municipality and/or the developer should bear partial responsibility for repayment.

Financial assistance for pre-development costs. Site remediation and infrastructure work that must occur before the construction of buildings represent the differential between greenfield projects and urban reinvestment. As such, the state has a real incentive to offer grants, loans, and tax credits to help level the playing field. While the large market gap in Gateway Cities will make it difficult for projects to support these costs, the state can share pre-development expenses with municipalities through tax increment financing structures.

Market gap equity. Providing resources to close market gaps associated with the construction of buildings is an essential component of transformative redevelopment. Current practice in most states, including Massachusetts, is to restrict public assistance largely to public infrastructure. This makes it difficult to create transformative change when a key market driver is the form and function of the buildings. (A notable exception is New Jersey's Urban Transit Hub Tax Credit, a \$1.5 billion state investment in large projects near transit stations in nine targeted cities).¹⁷

A variety of potential mechanisms can be used to close these market gaps, including tax credits and direct public investment. The most cost-effective approach is likely to be a long-term bond commitment.¹⁸ While the state is not expected to recoup its investment directly from the transformative project, cash flow from the development and appreciation on resale or refinancing represent potential repayment streams for the state's equity that should be tapped in the event the project outperforms expectations.

Financial assistance to obtain private capital. A transformative redevelopment project should seek to draw as much private capital to the project as possible without distorting the long-term goal of catalyzing transformative change. The state can pursue this objective by offering guarantees either to support private sector borrowing or to back up bonds

secured by tax increment financing structures. In the event these loan guarantees are triggered by default, the state could take an equity position in the development and attempt to recapture funds from future appreciation or cash flow.

Complementary Policies to Diffuse Impact and Accelerate Change

The financial tools described above are the heart of the strategy, but without the complementary tools detailed below, the outcome of what would be a major commitment on the part of the state toward transformative change in Gateway Cities could fall significantly short of its potential. A transformative redevelopment strategy must integrate policies across three dimensions to increase return on the state's investment:

Economic development tools. Transformative redevelopment that draws employers to an area and builds urban markets will have a particularly strong catalytic impact. The state can support these efforts by offering tax incentives to appropriate anchor tenants. Targeting appropriate long-term state leases to transformative redevelopment projects could have a similar market-building impact. The key consideration is to strategically identify business and agencies that are most likely to complement an urban economic development strategy. For longer-term strategies, sustained programming that supports the growth and development of innovation districts, cultural districts, or other urban markets could help absorb space created by new development and increase the job creation impact of the state's transformative investment.

Neighborhood revitalization tools. Transformative redevelopment will have a larger geographic impact if incentives are strategically targeted to promote residential reinvestment in surrounding neighborhoods. First-time homebuyer tax credits, rehabilitation tax credits, and home equity protection

insurance represent very modest investments but potentially important accelerants. The role of local government is particularly critical in promoting neighborhood revitalization. CDBG funds can be used to provide loans to area property owners to improve their properties to leverage the effects of a neighborhood revitalization strategy. Cities can also work to coordinate investments, like schools, community centers, and libraries, in ways that create attractive neighborhood amenities.

Community development tools. Large-scale redevelopment projects typically seek to provide community benefits through local procurement provisions and through the training and hiring of local construction workers. These tactics are more difficult in smaller, Gateway City-scale communities, and when they can be applied, they are likely to provide short-lived benefit to only a small number of residents. In developing a comprehensive transformative redevelopment strategy, Massachusetts should pursue innovative approaches to augment community development impact. For example, instead of asking communities to shoulder costs through tax increment financing, the state could allow cities to capture property value increases catalyzed by the project and direct these resources toward job training, public education, local transportation services, and other investments that contribute directly to the economic success of residents.

Governance Structures to Leverage Capacity and Coordinate Investment

Efforts to leverage capacity and coordinate investment make up the third element of a comprehensive transformative redevelopment policy. These actions are critical to demonstrating the state's commitment to transformative redevelopment and providing public assurance that these resources will be invested wisely:

Establishing criteria, evaluating proposals, and designating projects. The most essential governance component is establishing criteria (see Figure 6), evaluating proposals to ensure that state funds are only used to support credible projects. To demonstrate a commitment to transformative development and stimulate bold concepts, the program should put significant resources on the table. But these resources should be allocated only if and when there are highly compelling proposals and the projects withstand rigorous and transparent scrutiny.

Streamlining and coordinating. A transformative redevelopment policy can reduce complexity and uncertainty by integrating the tools in a single decision-making and delivery process administered by a single state agency with input from other relevant state agencies.¹⁹

Supporting capacity. Transformative development will not occur at scale without efforts to increase or augment local capacity. Viable strategies include “embedding” highly skilled personnel in city government for fixed periods, providing training opportunities for existing local government personnel, providing specialized technical assistance, fostering peer-to-peer learning partnerships, and building the capacity at the state level to provide ongoing support to local governments undertaking transformative redevelopment projects.²⁰

Removing regulatory barriers. The promise of a major transformative redevelopment effort creates an opportunity to review regulations and standards in state law, as well as local regulations affecting projects that could reasonably be modified or waived in order to further the state’s transformative investment.

Providing data and marketing. A transformative redevelopment policy can take advantage of recent advances in data-gathering technology to provide investors with better

information on values and trends and to rigorously evaluate and quantify the impact of state spending. Making this information available is another way to widely market state tools to facilitate transformative redevelopment and attract compelling project proposals.

C. Transformative Redevelopment in Massachusetts

Massachusetts is fortunate to have talented real estate professionals serving public agencies and a number of existing programs effectively supporting redevelopment. As highlighted in the summary below, there are clear strengths that the state can draw from in building a transformative redevelopment policy, but there are also major gaps in the state’s current urban revitalization portfolio:

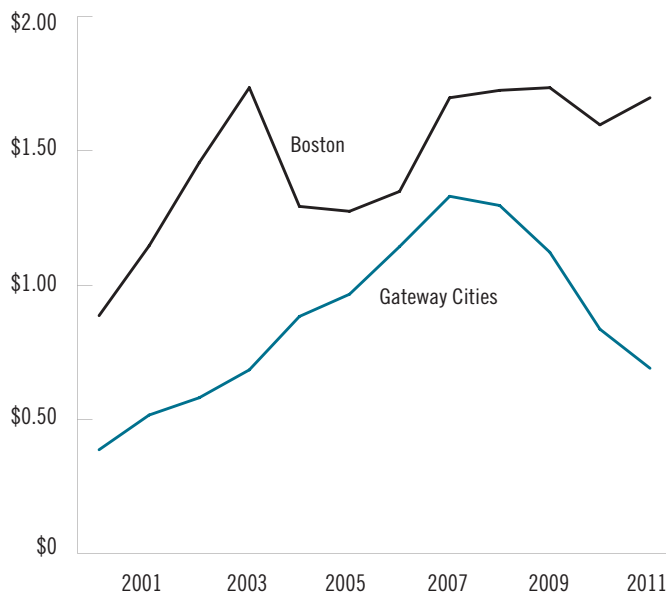
Clear Strengths

- *Financial assistance for planning and pre-development.* MassDevelopment offers a planning grant, which was recently increased from \$50,000 to \$100,000 per project. MassDevelopment also provides grants and loans for environmental site assessment and remediation.
- *Streamlining and coordination.* The state has taken significant steps to streamline programs by consolidating a number of individual programs into the MassWorks Infrastructure Grant. Making the Secretary of Housing and Economic Development the chair of all of the major state quasi-public economic development agencies has also facilitated the coordination of state resources.
- *Removing regulatory barriers.* Massachusetts has in place Chapter 43D expedited permitting; more than 170 sites across the state have already been pre-permitted for development.

MASSACHUSETT'S BROWNFIELDS SUPPORT TEAM

The Brownfields Support Team led by Lieutenant Governor Murray provides a model for how the state can support transformative redevelopment projects. Since its inception in 2008, the team has coordinated 24 state, local, and federal agencies overseeing more than \$18 million in funding. By helping projects overcome challenges, the team has fast-tracked the cleanup of more than 300 acres. Local officials give high marks to the effort and point to the strategy as an example of how state government can leverage its capacity to facilitate transformative redevelopment in Gateway Cities.

Figure 5:
Value of New Development: Boston vs. 11 Gateway Cities (billions of current dollars)



Source: Massachusetts Department of Revenue

Major Gaps

- *Market gap equity.* The state currently provides \$50 million annually through the State Historic Tax Credit. However, the cap on these resources provides real uncertainty around the timing of rewards, which reduces their value in difficult-to-finance projects. Moreover, these dollars are limited to historic properties. Transformative redevelopment often calls for new construction.

Massachusetts also has an Urban Renewal Grant that provides flexible funding. This program has been critical in supporting major reinvestment initiatives, such as Medical City in Worcester, scattered site redevelopment of Lowell's Acre neighborhood, and downtown revitalization in Fitchburg. However, since FY 2000 there has been no line item in the budget to support the Urban Renewal Grant. It has been over a decade since a new Urban Renewal project received funding.

In 2010, the state created the Housing Development Incentive Program (HDIP), which provides equity to market rate projects in Gateway Cities. However, this refundable tax credit program is capped at just \$5 million annually and can only be applied to existing structures with no more than 50 market rate units.

- *Financial assistance to obtain private capital.* MassDevelopment makes mortgage insurance loan guarantees available to businesses investing in facilities and MassHousing provides a similar guarantee program for affordable housing development, but there is no equivalent for developers building retail, commercial, and market-rate housing. MassDevelopment and MassHousing both offer taxable and tax-exempt financing, but these lending programs are not structured specifically to support large-scale mixed-use redevelopment projects.

- *Complementary policies to diffuse impact and accelerate change.* While there are some bright spots, overall this entire element is underdeveloped. The state recently revamped and retargeted the Economic Development Incentive Program (EDIP), but this program is heavily oriented to manufacturing in Gateway Cities; as such, these dollars are largely helping to retain and expand existing businesses as opposed to drawing new anchor tenants to redevelopment projects. The Massachusetts Cultural Council has an impressive track record supporting arts-based economic development in Gateway Cities across the state via its Adams Grant. However, this resource has been cut in half over the last few years. And on the neighborhood revitalization front, the Department of Housing and Community Development has in the recent past used Employer Assisted Housing incentives to encourage investment in targeted neighborhoods, but this program has been put on hold due to budgetary constraints.

A look at the disparities between investment in Boston and the state's other major cities (Figure 5) provides perhaps the strongest indicator that Massachusetts must consider new strategies to facilitate transformative redevelopment in weaker markets. Between 2000 and 2011, the city of Boston saw more than \$17.5 billion in new development. In comparison, the 11 Gateway Cities combined received only \$10.5 billion in development over this period — less than 60 percent of Boston's growth despite containing nearly 40 percent more population.

The contrast between the sharp drop in development activity in Gateway Cities since 2007, relative to Boston's stable investment trend through the downturn, demonstrates the need to develop a state policy framework that responds to the unique needs of weak markets.

TEACHERS VILLAGE, NEWARK, NEW JERSEY

An exciting and potentially transformative project in Newark, New Jersey, for which the groundbreaking took place in February 2012 offers a good example of transformative redevelopment. Known as Teachers Village and designed by renowned architect and Newark native Richard Meier, it will include three charter schools, over 200 housing units, and 70,000 square feet of retail and restaurant space, anchoring a larger redevelopment area ultimately planned to contain 15 million square feet of development. Notably, nearly three-quarters of the total \$150 million cost of the project comes from public funds, including \$60 million in federal New Market Tax Credits, \$40 million in New Jersey Urban Transit Hub tax credits, and smaller contributions from the city of Newark and the state Casino Reinvestment Development Authority, while much of the private contribution is being subsidized under the federal Qualified School Construction Bond program, an element of the 2009 economic stimulus program. The private sector portion of the project involves four separate financial institutions. Market conditions in Newark are not markedly different from those in the stronger of Massachusetts's Gateway Cities, and the complexity (and heavily public-sector-dependent) nature of this financing package reflects the difficulty of making such projects work.

Figure 6:

Model Criteria for Evaluating Transformative Redevelopment Proposals

CATEGORY	CRITERIA
Scale	Project should demonstrate that it will – either in itself or through the cumulative effect of a long-term strategy or indirect impacts – act on a scale large enough to have a significant impact.
Project Leveraging	Project should credibly show likely indirect impacts in terms of dollars invested, square feet built/rehabilitated, and jobs created as appropriate multiples of direct project impacts.
State Funds Leveraging	Project should demonstrate that state funds will be leveraged by two-to-one with respect to the project itself, and by a multiple of four-to-one with respect to the sum of the project and its indirect impacts. ²¹
Local Economic Benefit	Project should show either/both (1) fiscal benefit (increased tax revenues, increased property values, etc.) and (2) economic benefit (new businesses and jobs).
Local Action and Governance	<p>Communities must demonstrate a commitment to managing and supporting the project in a fashion that maximizes its potential transformative impact. Criteria should include:</p> <ul style="list-style-type: none"> • Local commitment to a meaningful and participatory planning process for the site and project • Commitment to streamlining or eliminating discretionary permit review processes • Contribution of resources or tools to assist with land assembly and/or provision of municipally owned land for the project • Contribution of in-kind or financial resources through staff assistance, direct project funding, or tax abatements and other long-range benefits • Demonstration of a clear public/private partnership approach to the project, with a clear definition of the municipal role in support of project implementation and with private partners that have established track records and the capacity to successfully complete the project
Low-Moderate Income Benefit	Project should demonstrate appropriate level of benefit to low- and moderate-income households and individuals in terms of housing or neighborhood improvement, job opportunities, service delivery, etc.

DOWNTOWN OWENSBORO, KENTUCKY

In the small city of Owensboro in western Kentucky, the city and county decided to become the investors in their vision of the future. By roughly doubling the local insurance tax, a levy paid on premiums for auto, homeowners, boat, and casualty insurance, they have raised \$80 million to support the project. The centerpiece of their transformative investment is a reconfigured riverfront park that will open to the public this summer; it will be an active destination space that spans five city blocks and will draw visitors into downtown. The second major element of the downtown strategy is an iconic glass-and-steel riverfront convention center, supported with \$48 million in public funds. Additional public funds will be used for streetscape work along the waterfront to transform it into a pedestrian-friendly environment. These public projects are already catalyzing private investment. A \$20 million hotel connected to the convention center is slated for construction next spring while other private developers have come forward with proposals for a mix of commercial, retail, and housing projects on vacant and underutilized downtown parcels. Thoughtful planning has been a part of Owensboro's strategy; in addition to a 2001 riverfront master plan, the city invested \$400,000 in a downtown "placemaking" initiative, resulting in a form-based zoning overlay for the entire downtown introduced in 2009.

ALLENTOWN'S NEIGHBORHOOD IMPROVEMENT ZONE

Pennsylvania made a unique commitment to transformative redevelopment in 2009 when it passed legislation creating the Allentown Neighborhood Improvement Zone. For 30 years, all state taxes collected by businesses moving into this 130 acre district will be used to service construction bonds for physical improvements in the area. This includes taxes on gross receipts, cigarettes, malt beverages, personal income taxes, and state income taxes withheld by companies with employees working in the zone. According to *The Express-Times*, this commitment has catalyzed several major reinvestment projects, including a \$275 million mixed-use development along the Leigh River spearheaded by the private Waterfront Redevelopment Partners, and a \$200 million mixed-use project led by, City Center Investment Corp, also a private venture.

NINTH SQUARE REDEVELOPMENT, NEW HAVEN, CONNECTICUT

The area known as the Ninth Square, the southwest part of downtown New Haven, was a heavily disinvested area in the 1980s, despite its proximity to downtown businesses and Yale University. A public-private strategy to create a critical mass of 335 units of mixed-income housing with substantial retail space in the area, through a combination of rehabilitation and new construction, was furthered by the involvement of Yale University, which provided seed capital for the \$86 million project and bought \$10 million in taxable bonds from the state housing finance agency. In addition to investments by the state and by Yale, the project included Low Income Tax Credits (for one-third of the units), city support, and a tax increment financing district. The Residences at Ninth Square, which were completed in 1995, were highly successful despite earlier public misgivings by state officials. They have since leveraged substantial additional investment in the area, including retail, services, and more than 500 additional upscale housing units.

IV. TOWARD A COMPREHENSIVE TRANSFORMATIVE REDEVELOPMENT STRATEGY

Massachusetts needs a transformative redevelopment policy that creates new markets for commercial activity, expands opportunities for desirable residential living, responds to energy and environmental challenges, and creates more economic opportunity for disadvantaged residents. A strong transformative investment program can accomplish these goals, capitalizing on Gateway Cities as a unique economic asset for the Commonwealth and increasing the state's overall competitive advantage.

A transformative redevelopment policy should enhance and coordinate the current state investment in Gateway Cities, and also fill gaps in the state's existing tool chest with new programs. With a strategic and comprehensive approach to transformative redevelopment, Massachusetts can dramatically increase the number of compelling project proposals and facilitate transformative development at a scale that produces real change.

As a starting point, MassINC offers the following recommendations for leaders working to build an effective transformative redevelopment strategy. Combined, this effort would require total new state investment of \$1.7 billion over 10 years, approximately 8 percent of the Commonwealth's bond cap over the period.²² With this commitment, Massachusetts would stimulate at least \$3.4 billion in new development and reuse, providing funds to make possible at least 7 major transformative redevelopment projects and generating a total level of reinvestment in Gateway Cities approaching \$7 billion. Economic impact analysis suggests this level of reinvestment activity would support approximately 80,000 jobs.²³

1. Commit \$125 million per year for the next 10 years to build a transformative redevelopment fund.

The Massachusetts Transformative Redevelopment Fund would be a vehicle through which the state would invest directly in transformative redevelopment projects that meet the established criteria. State investments could take the form of pre-development loans, equity investment, subordinated debt, or loan guarantees for residential or non-residential developments, and would be secured by potential down-the-road revenues through cash flow or appreciation on resale. The repayment stream would go into the Investment Fund, and would enable it to become a perpetual fund dedicated to this purpose.

The state should allocate \$125 million each year for the next 10 years to this initiative from the economic development capital budget.

2. Create a loan guarantee program to facilitate private lending for transformative redevelopment projects.

These loan guarantees, designed to be capable of supporting up to \$1 billion in private lending, would be backed by money in the transformative redevelopment fund.

The state should work with lenders, including commercial banks, community banks, and Community Development Financial Institutions (CDFIs), to develop the program. The size of the back-end guarantee should be variable so that higher-risk projects that meet the criteria would be eligible for a higher guarantee percentage than others.

3. Create a transformative redevelopment revolving loan fund.

An interest-free or low-interest revolving loan fund would be a flexible, quick-turnaround resource to support construction, upgrading, and fit-out of commercial spaces for marketing and speedy delivery to tenants. As space is leased, the developer would be expected within a short period to secure a first mortgage, in order to return the loan to the revolving fund. This program should be capitalized at \$100 million. If state dollars are used to build a significant loan-loss reserve, a significant share of this pool could come from private lenders.

4. Commit \$20 million per year over the next 10 years to the MassWorks grant program.

Implementing a transformative redevelopment program will create significant new demand for state funds for infrastructure investment. Local economic development officials already voice concern that the current program's funding constraints, combined with the need to ensure that all regions of the state benefit from it, results in smaller scale grants that offer insufficient leverage to catalyze private reinvestment.

To provide resources for roads, transit improvement, streetscaping, parking structures, and other infrastructure upgrades associated with transformative redevelopment projects, the state should add \$20 million annually in increased funding for the MassWorks grant program.

5. Provide targeted incentives for homebuyers to significantly increase the catalytic neighborhood revitalization impact of transformative redevelopment.

While there are a number of models for targeted neighborhood revitalization incentives that cities (e.g., New Haven, Richmond, and Washington, DC) have used effectively, two stand out as particularly appropriate as a complement to

transformative investment:

- **State income tax credits for households who buy and rehabilitate substandard houses in targeted neighborhoods for owner occupancy.** A state tax credit would be an incentive for households to buy and rehabilitate houses in designated neighborhoods for owner occupancy. The credit would be offered only in neighborhoods that were the focus of a transformative revitalization strategy. Although the dollar amount of the credit would not be formally capped, the state's exposure would be limited by capping the number of neighborhoods and/or the total number of houses (one- to three-unit residential structures) that would be eligible for the credit at any time.²⁴ Assuming that the cap were set at 20,000 residential structures, the state's maximum exposure would equal approximately \$5 million per year.²⁵
- **Home equity protection insurance for households who buy houses for owner occupancy in designated neighborhoods in distressed cities.** A state-chartered home equity protection insurance program would be established as an incentive for households to buy and occupy houses in designated neighborhoods. In contrast to the narrowly targeted tax credit program proposed above, this program could operate in a wider range of neighborhoods. Qualifying neighborhoods would be those that meet reasonable criteria of neighborhood vitality, but which nonetheless exhibit weak market conditions and a market gap.²⁶ While this program should be designed to be self-supporting through the premiums that it would charge for the insurance, it may need either a source of initial capitalization or a designated source of funds that can be tapped in the event of a shortfall.²⁷

6. Design and coordinate economic development programs that catalyze Gateway City markets.

Transformative redevelopment must be based in a credible market opportunity, but state investment will be required to strategically nurture industries appropriate for growth in urban settings. Resources should be allocated as follows to build upon models that have been successful in the past:

- \$75 million for the development of three UMass satellite campuses to be designed and constructed in concert with a transformative redevelopment strategy.
- \$2 million annually for the expansion of the Massachusetts Cultural Council’s Adams Grant in designated Cultural Districts that overlap with transformative redevelopment districts.
- Appropriate long-term state leases to help finance redevelopment and increase foot traffic in areas targeted for redevelopment.
- Existing Economic Development Incentives Program (EDIP) tax credits targeted to attract new anchor tenants to transformative redevelopment projects.

7. Build Gateway City capacity.

To provide capacity for early-stage efforts, Massachusetts can build “community assistance teams” using existing state economic development personnel. Former governor Ed Rendell employed this approach effectively in Pennsylvania, bringing together highly skilled staff in the state’s Department of Community and Economic Development to work with local governments to help design major projects, and then to navigate those projects through the various state resources as well as regulatory requirements.

As projects move toward implementation and more intense support is needed, the state should assist by allocating \$2.5 million to select, train, and place five mid-career

professionals to serve four-year terms in Gateway City economic development agencies implementing transformative redevelopment plans. The US Department of Housing and Urban Development’s Strong Cities Strong Communities (SC2) program provides a model for this approach. The program will select, train, and place early to mid-career professionals to serve multi-year terms in cities, assisting them in their economic revitalization efforts.

Notably, this federal model relies heavily on philanthropic support. Efforts to develop the long-term capacity of Gateway Cities is an area where the state should pursue foundation partnerships.

8. Make changes to existing state programs and regulations to enhance their ability to support transformative redevelopment.

The state’s current Business Improvement District statute, which makes it difficult to draw ongoing private revenue to support strategic initiatives that benefit property owners, provides an example of the kind of reform that could complement that state’s significant investment in transformative redevelopment.

The state should use the establishment of a comprehensive transformative redevelopment policy as an opening to develop a commission to identify other laws that create burdensome and unnecessary barriers to large-scale revitalization initiatives.

9. Create a strong governance structure.

Structures at the state level are needed to provide a transparent and competitive process guided by rigorous yet flexible selection criteria. Parallel structures must be built at the local level to ensure that projects will have capable and sustainable long-term stewardship. The Living Cities Integration

Initiative has invested considerable attention to governance models for large-scale redevelopment projects and may offer important insights for Massachusetts.

10. Assemble data to identify market opportunities and evaluate progress.

Developing systems to track Gateway City real estate data is critical to the success of the initiative. The state should allocate \$250,000 annually to collect, analyze, and make public resale and other market data in areas targeted for transformative development so that developers, financiers, and policymakers can develop a better understanding of Gateway City markets and the impact of state investments.

The Reinvestment Fund in Philadelphia and RW Ventures in Chicago have significant expertise in this area to guide the development of this strategy. The New England Federal Reserve Bank and local universities could provide capacity to implement this component.

THE LOWELL PLAN

The Lowell Plan, Inc. is a strong case study in a governance structure that can help midsize cities steward transformative redevelopment over the many years these efforts require to come to fruition. Established in 1979, the Lowell Plan is a nonprofit economic development organization with 80 members representing businesses, organizations, and individuals. Working together, Lowell Plan members have invested over \$7 million to encourage commercial, industrial and housing development, infrastructure improvements, historic preservation, educational, cultural and recreational initiatives and cooperative marketing efforts. To ensure that the organization's efforts are aligned with community priorities, the Lowell Plan's board includes the City Manager, the Mayor, the Assistant City Manager and Director of the Lowell's Division of Planning and Development, the Chancellor of UMass Lowell, the President of Middlesex Community College, the Superintendent of Schools, and the Superintendent of Lowell National Historical Park.

APPENDIX A

Table 1: Estimating the Residential Market Capital Gap

City	Acquisition Per Unit	Hard Cost PSF	Soft Cost PSF	Total Cost Per Unit	Sales Price PSF	Sales Price Per Unit	Capital Gap For Sale	HUD FMR	Annual NOI	Capitalized Value	Capital Gap Rental
	1	2	3	4	5	6	7	8	9	10	11
Brockton	\$10,000	\$145	\$48	\$241,420	\$210	\$252,000	\$10,580	\$1,148	\$6,776	\$84,700	(\$156,720)
Fall River	\$10,000	\$144	\$48	\$239,824	\$124	\$148,800	(\$91,024)	\$910	\$3,920	\$49,000	(\$190,824)
Fitchburg	\$10,000	\$143	\$47	\$238,228	\$110	\$132,000	(\$106,228)	\$839	\$3,068	\$38,350	(\$199,878)
Haverhill	\$10,000	\$146	\$48	\$243,016	\$143	\$171,600	(\$71,416)	\$1,097	\$6,164	\$77,050	(\$165,966)
Holyoke	\$10,000	\$133	\$44	\$222,268	\$117	\$140,400	(\$81,868)	\$1,107	\$6,284	\$78,550	(\$143,718)
Lawrence	\$10,000	\$147	\$49	\$244,612	\$112	\$134,400	(\$110,212)	\$820	\$2,840	\$35,500	(\$209,112)
Lowell	\$10,000	\$145	\$48	\$241,420	\$126	\$151,200	(\$90,220)	\$835	\$3,020	\$37,750	(\$203,670)
New Bedford	\$10,000	\$144	\$48	\$239,824	\$128	\$153,600	(\$86,224)	\$855	\$3,260	\$40,750	(\$199,074)
Pittsfield	\$10,000	\$132	\$44	\$220,672	\$120	\$144,000	(\$76,672)	\$897	\$3,764	\$47,050	(\$173,622)
Springfield	\$10,000	\$133	\$44	\$222,268	\$99	\$118,800	(\$103,468)	\$855	\$3,260	\$40,750	(\$181,518)
Worcester	\$10,000	\$144	\$48	\$239,824	\$126	\$151,200	(\$88,624)	\$897	\$3,764	\$47,050	(\$192,774)
Average	\$10,000	\$141	\$47	\$235,761	\$129	\$154,364	(\$81,398)	\$933	\$4,193	\$52,409	(\$183,352)

Notes and Assumptions:

General note: Unit size by square footage for both for-sale and rental housing is: 1200

1. Cost per unit (unimproved, unpermitted land): \$10,000
2. Construction cost data from 21012 from RS Means (1,200 single family home with unfinished basement and 1.5 baths)
3. Soft costs - architectural, engineering, legal, insurance and financing fees are estimated at 1/3 of hard costs
4. Total costs is equal to the sum of column 1 plus unit size (1200 sf) times columns 2 + 3
5. Sales price data from Zillow.com (36 month average, Feb 2009 - Jan 2012)
6. Column 5 times 1200 sf
7. Sales price per unit minus cost per unit (column 6 minus column 4)
8. HUD 2012 2-bedroom Fair Market Rents
9. Annual cash flow after subtracting annual operating expenses (estimated at \$7,000 per unit per year) from annual rental income
10. Dividing column 9 by a market capitalization rate of 8%
11. Capitalized value per unit minus cost per unit (column 10 minus column 4)

Table 2: Estimating the Commercial Market Capital Gap (Per Square Foot)

City	Acquisition Cost	Hard Cost	Soft Cost	Total Cost	Value at \$15	Capital Gap \$15	Value at \$20	Capital Gap \$20	Value at \$25	Capital Gap \$25
	1	2	3	4	5	6	7	8	9	10
Brockton	\$10	\$195	\$64	\$269	\$88	(\$182)	\$150	(\$119)	\$213	(\$57)
Fall River	\$10	\$195	\$64	\$269	\$88	(\$182)	\$150	(\$119)	\$213	(\$57)
Fitchburg	\$10	\$188	\$62	\$260	\$88	(\$173)	\$150	(\$110)	\$213	(\$48)
Haverhill	\$10	\$200	\$66	\$276	\$88	(\$189)	\$150	(\$126)	\$213	(\$64)
Holyoke	\$10	\$184	\$61	\$255	\$88	(\$167)	\$150	(\$105)	\$213	(\$42)
Lawrence	\$10	\$201	\$66	\$277	\$88	(\$190)	\$150	(\$127)	\$213	(\$65)
Lowell	\$10	\$198	\$65	\$273	\$88	(\$186)	\$150	(\$123)	\$213	(\$61)
New Bedford	\$10	\$195	\$64	\$269	\$88	(\$182)	\$150	(\$119)	\$213	(\$57)
Pittsfield	\$10	\$182	\$60	\$252	\$88	(\$165)	\$150	(\$102)	\$213	(\$40)
Springfield	\$10	\$184	\$61	\$255	\$88	(\$167)	\$150	(\$105)	\$213	(\$42)
Worcester	\$10	\$192	\$63	\$265	\$88	(\$178)	\$150	(\$115)	\$213	(\$53)
Gateway Average	\$10	\$192	\$63	\$266	\$88	(\$178)	\$150	(\$116)	\$213	(\$53)

Notes and Assumptions:

1. Cost per square foot of unimproved, unpermitted land: \$10
2. Construction cost data from 2012 RS Means (5-10 story steel frame office building)
3. Soft costs — architectural, engineering, legal, insurance and financing fees are estimated at 1/3 of hard costs
4. Total costs is equal to the sum of columns 1, 2 + 3
5. Value equals gross rent/psf minus \$8 psf in CAM charges, divided by capitalization rate of: 8.0%
6. Capital Gap @15/psf equals value/psf - cost/psf (Column 5 minus column 4)
7. Value equals gross rent/psf minus \$8psf in CAM charges, divided by capitalization rate of: 8.0%
8. Capital Gap @20/psf equals value/psf - cost/psf (Column 7 minus column 4)
9. Value equals gross rent/psf minus \$8psf in CAM charges, divided by capitalization rate of: 8.0%
10. Capital Gap @30/psf equals value/psf - cost/psf (Column 7 minus column 4)

APPENDIX B

Inventory of Current Massachusetts Redevelopment Policies

FINANCIAL TOOLS	PREDEVELOPMENT & PLANNING (INCLUDING INFRASTRUCTURE AND OPEN SPACE)	MassDevelopment Planning Assistance	Technical assistance only
		MassDevelopment Predevelopment Loans	Up to \$100,000 per project
		Massachusetts Preservation Projects Fund	Approximately \$5M per year
		Brownfields Site Assessment	Up to \$100,000 per project
		Brownfields Remediation Loans	Up to \$500,000 per project
		Brownfields Tax Credit	25% of net remediation costs for limited use; 50% for unrestricted use
		MassWorks Grants	~\$50M annually
		District Improvement Financing (DIF)	Local option
		I-Cubed	Not to exceed \$400M
		MA Land and Water Conservation Fund	Approximately \$4.5M per year for open space acquisition
		Gateway City Parks Program	Approximately \$2M per year
		Parkland Acquisition and Renovation for Communities (PARC)	Approximately \$7.5M per year
		MARKET GAP	Housing Development Incentive Program (HDIP)
Urban Renewal Grant	Subject to appropriation		
State Historic Preservation Tax Credit	\$50m per year		
LONG-TERM CAPITAL	Tax Exempt Bonds	Limited to public infrastructure and facilities	
	Taxable Bonds	Limited to manufacturers or business expansion	
COMPLEMENTARY POLICIES	ECONOMIC DEVELOPMENT	Business Improvement District	Creates potential capital financing stream at local option
		Economic Development Incentive Program	\$20M per year; max. 10% nonrefundable, nontransferable credit for non-manufacturing
		MA Cultural Council Adams Grant	~ \$320,000 per year
GOVERNANCE	CAPACITY	Community Development Partnership Tax Credit	\$2M per year in 2013 increasing to \$6 Million by 2015
		DHCD Training	
		Brownfields Support Team	
	REGULATION	Chapter 403D, Expedited Permitting	

ENDNOTES

- 1 The administration recently made increasing the supply of multifamily housing in walkable urban neighborhoods served by existing infrastructure a high-level public policy priority, setting an annual production goal of 10,000 units through 2020. See the text box on page 7.
- 2 This estimate assumes average project size of \$500 million leveraging state funds two-to-one, with the projects, over time, generating a catalytic impact in the surrounding neighborhood of four times greater than the public-private investment in the initial projects.
- 3 This estimate was produced for MassINC by BW Research Partnership using EMSI's input-output model and the following assumptions: \$6.8 billion in expenditures split evenly between multifamily residential construction and commercial and institutional construction. Accounting for the direct, indirect, and induced impact, this spending yields a 2.27 employment multiplier. About half of the jobs generated are in construction industries.
- 4 The 11 Gateway Cities identified in the report, produced in partnership with the Brookings Institution, were Brockton, Fall River, Fitchburg, Haverhill, Holyoke, Lawrence, Lowell, New Bedford, Pittsfield, Springfield, and Worcester. They were cities outside the Greater Boston area selected on the basis of a number of criteria, including a minimum population of 35,000, high poverty and low education attainment levels, and a strong historic manufacturing heritage. Subsequently, the state of Massachusetts defined Gateway Cities for purposes of certain state programs as cities with a population between 35,000 and 250,000, with an average household income below the state average and an average educational attainment rate below the state average, under which a total of 24 communities qualify as Gateway Cities.
- 5 For example, see Gerald Carlino and others, "Urban density and the rate of invention" *Journal of Urban Economics* 61(3) (2007); and Antonio Ciccone and Robert Hall, "Productivity and the Density of Economic Activity," NBER Working Paper W4313 (1996).
- 6 See for example, Katharine Bradbury, "Long-Term Inequality and Mobility," Public Policy Brief 12-1 (Boston, MA: Federal Reserve Bank of Boston, 2012).
- 7 Andrew Sum and others, "Recapturing the American Dream: Meeting the Challenges of the Bay State's Lost Decade" (Boston, MA: MassINC, 2011).
- 8 Barry Bluestone and others, "The Greater Boston Housing Report Card 2012: A New Paradigm for Housing in Greater Boston" (Boston, MA: Northeastern University, 2012).
- 9 See Iain Begg, "Investability: The Key to Competitive Regions and Cities?" *Regional Studies* 36(2) 2002.
- 10 Bluestone and others (2012). Jenifer McKim. "Governor Patrick details multifamily housing plan" *Boston Globe* November 14, 2013.
- 11 The concept of transformative investment, or transformative redevelopment, as a strategy for revival of distressed older cities is not new; in many respects, it was the principle that drove much of the thinking that led to the creation of the federal urban renewal program in the 1949 Housing Act. In retrospect, however, the rationale behind the urban renewal program, particularly the focus on land assembly to the relative exclusion of other factors, was fatally flawed. The Urban Development Action Grant (UDAG) program of the 1970s, a flexible investment vehicle for large-scale development, was a better model, particularly in its focus on an entrepreneurial model and on the downstream recapture of public funds. More recently, the Brookings Institution, which has partnered with MassINC on its Gateway Cities initiative, has focused public attention on transformative investment, which Bruce Katz, director of the Metropolitan Policy Program, has defined as "multi-dimensional efforts that remake the urban physical landscape to stimulate economic growth, improve fiscal vitality, and advance social equity." In Katz's 2006 presentation, he pointed out that profound demographic, economic, cultural, and social forces are reshaping the nation. These broad forces give cities the best chance to compete in decades.
- 12 A number of CDC-led initiatives have received attention, including the revitalization of the Detroit-Shoreway neighborhood in Cleveland and the Patterson Park neighborhood of Baltimore. The latter is discussed in a 1998 book by Ed Rutkowski, then-executive director of Patterson Park CDC, and Marcus Pollack, *The Urban Transition Zone: A Place Worth A Fight*.
- 13 There is an extensive economic literature on arenas and stadiums. The case for a significant positive economic impact from arenas and sports facilities is weak, as documented by Andrew Zimbalist and Roger Noll in "Sports, Jobs & Taxes: Are New Stadiums Worth the Cost?" (1997), and Dennis Coates and Brad Humphreys, "Professional Sports Facilities, Franchises and Urban Economic Development" (2003).
- 14 An important consideration in developing such projections is experience with similar investments elsewhere. If a particular type of project has a weak historical track record in leveraging other investment, someone seeking public investment in support of a similar project would have a heavy burden to justify why their project was different from projects elsewhere. At the same time, the state should not be too conservative or risk-averse in its assessment, else it may choke off potentially high-return (though uncertain) ventures.
- 15 This is not guaranteed, however; the extent to which market change will actually take place is far from being within local control, as it depends as well on the trajectories of the regional, national, and even global economies.

- 16 Similarly, for the state to demand guarantees from developers is likely to discourage projects that carry more than very modest risk – that is, the projects that are most needed and have the greatest potential to be transformative. Moreover, it limits the pool of developers who are likely to be realistically eligible for the state assistance, since only the strongest, largest firms are likely to be able to credibly provide such guarantees.
- 17 The Transit Hub Tax Credit, enacted in 2008, provides a transferable 100 percent credit against capital investment in commercial projects, and 35 percent of credit for investment in residential projects.
- 18 Bonds are likely the better approach for at least two reasons. First, interest rates are unusually low at present, making borrowing costs highly affordable; and second, since repayment revenue streams will become available over time, those revenue streams can either cover the state's debt service costs at that point or make additional funds available to revolve into other projects. Tax credits are less fiscally efficient than appropriations, since they tend to be discounted from their full value by the market, but may be more easily pursued than appropriations, since they do not represent a direct, overt budgetary outlay by state government. Moreover, once a tax credit has been enacted, it remains in effect unless explicitly repealed by the legislature, in contrast to annual appropriations, which require that funds be explicitly re-appropriated each year. Thus, they offer far greater predictability, a critical concern when dealing with projects that are almost always multi-year efforts.
- 19 In order to facilitate this process, the state may want to create a “project manager” approach, under which each project, once approved as a transformative project, is assigned to a highly trained, senior staff person who has the responsibility to monitor the project over time, identify its needs and how they can be addressed through the state program, and work to build a seamless system of state support for the project.
- 20 An interesting model for such an approach is being pursued by the US Department of Housing & Urban Development in their Strong Cities Strong Communities (SC2) program; the program will select, train, and place up to 30 early- to mid-career professionals to serve multi-year terms in six cities and assist them in their economic revitalization efforts. Notably, the cost of the program is largely being borne by the Rockefeller Foundation, not by the federal government. Another model for such an effort was the CATS (Community Assistance Teams) program created by former governor Ed Rendell in Pennsylvania, which consisted of highly skilled staff in the state's Department of Community & Economic Development who worked with local governments to help design major projects and then navigate those projects through the various state resources as well as regulatory requirements. The program no longer exists. A similar program of the Michigan State Housing Development Agency (MSHDA), which (notwithstanding its name) focuses as much on downtown revitalization as housing, called CATeam, still operates.
- 21 As noted earlier, projects of particularly great value in difficult locations could justify a lower leveraging ratio, but not less than one-to-one.
- 22 The Governor's Five Year Capital Investment Plan calls for \$2 billion in bond cap allocation in FY 2014. Increasing this figure by 2.5 percent annually over a 10-year period, the proposed 1.7 billion transformative investment program would represent less than 8 percent of the cap.
- 23 This feature, which appears to go against the fiscal responsibility grain, is critically important to the success of the program, which is designed to overcome market gaps and build homebuyer confidence. For the credit to be effective, and for homebuyers to build it into their decisions, they must be able to operate with absolute certainty that it will be available to them. If the program has a dollar cap, that condition leads to the possibility (even likelihood) that it will run out during the course of the year; no homebuyer, therefore, will be able to know with certainty that it will be available. As a result, homebuyers will not factor it into their financial calculus (at most, will treat it as an add-on, like winning the lottery) and its market-transforming effect will be minimal.
- 24 See end note 3.
- 25 This is based on the following assumptions: (1) 4,000 or 20% of the structures in the target areas will be eligible for the credit, based on their need for major rehabilitation; (2) 5% to 8% of those structures will be purchased each year, or 200 to 320 properties; (3) households will spend an average of \$40,000 to \$60,000 in eligible rehabilitation costs; and (4) the tax credit will be equal to 30% of the eligible rehabilitation costs, taken over the three years following completion of rehabilitation. Households who cease to be owner occupants of the house during the three-year period would lose their eligibility for credits not yet taken, thus reducing the state's ultimate financial exposure.
- 26 The insurance program would not guarantee any seller a specific price, or even, necessarily, the price that they paid for the house. The actual price that a seller gets for a house can be affected by many factors, including the level of maintenance, beyond the program's control. What the program would do is, if a market sales index for the neighborhood or subarea used for the purpose moves downward from the time the household bought the house, they would be compensated for the decline. For example, if a family buys a house for \$100,000, and from the time of purchase to the time of resale the market index declines by 4%, they would receive \$4000 when they sold the house – whatever the actual sales price.
- 27 Without a much more in-depth analysis, it is impossible to put even a ballpark figure on this item, but it should be very small compared to the larger public investments discussed above. It is possible that initial capitalization could come from the transformative redevelopment investment fund, which could be reimbursed as premium income grew.

NOTES

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ABOUT MASSINC

Massachusetts Institute for a New Commonwealth (MassINC) is a non-partisan think tank and civic organization focused on putting the American Dream within the reach of everyone in Massachusetts. MassINC uses three distinct tools – research, journalism, and civic engagement – to fulfill its mission, each characterized by accurate data, careful analysis, and unbiased conclusions. MassINC sees its role not as an advocacy organization, but as a new kind of think tank, rigorously non-partisan, whose outcomes are measured by the influence of its products in helping to guide advocates and civic and policy leaders toward decisions consistent with MassINC’s mission, and in helping to engage citizens in understanding and seeking to influence policies that affect their lives.

ABOUT GATEWAY CITIES INNOVATION INSTITUTE

The Gateway Cities Innovation Institute is new platform at MassINC designed to build and sustain collaborative cross-city, cross-sector efforts to advance a common agenda for Gateway City growth and renewal. The Institute provides independent analysis and a neutral table to help communities coalesce around shared priorities and cooperatively implement bold policy innovation.

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