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Future and Present: The 2010 Challenge

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In previous columns we have discussed opportunities after the recession and financing crisis lift. We have recounted the demographic pressures that will (eventually) fuel the next wave of development in Illinois communities and extolled the virtue of looking forward to take the opportunity to plan. We have suggested that the financial constraints on developers offer an opportunity for municipalities to take more control of their future. While still true, the present fiscal crisis is rightfully the main focus of municipal managers today.

Managers know all too well that municipalities face a quintuple whammy: loss of sales tax revenue, lack of fees and transfer taxes from development, pressure on property tax collections from defaults and value reductions, growing pension obligations, and threats of hold backs or delay of State Income Tax share. Some of these problems are not just cyclical.

Sales tax revenue is unlikely to recover broadly unless it is extended to personal services because the spending habits of people over age 65 tend towards more services, fewer goods and less spending overall. The demise of many auto dealers and the continued concentration of retailing into a few large stores like Costco, Wal-Mart and Target creates stark contrasts between municipal sales tax winners and losers – with far more losers. These retailers require large population bases and locations capable of handling substantial traffic volumes. Not every municipality is large enough or has appropriate sites.

Despite theoretically growing demographic pressures, housing transaction volume has not yet recovered. When it does, it is likely to favor rental apartments for the Millenniels and condos or lifestyle communities tailored to empty nesters. The region's stock of rental apartments in interesting environments is concentrated in the City and a few suburbs, and resistance to new rental apartments continues. The empty nesters may want to, but don't have to, move, and may be unwilling to sell their single-family home until the market recovers. Transfer taxes may be slow to recover along with permit and impact fees.

Since municipal revenues are partly paid in arrears (property tax), even if development picks up in late 2010 or early 2011, the next couple of years will be tough. But on the positive side, the stimulus program (ARRA) provides three major financing tools that can help municipalities: Build America Bonds, Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds. Build America Bonds and Recovery Zone Economic Development Bonds are taxable bonds for normal public purposes with the IRS rebating 35% and 45% of the interest respectively. They have siphoned financing away from traditional tax-exempt bonds which has also helped drive down the cost of tax-exempt borrowing. Facility Bonds provide tax-exempt financing for most types of private commercial development. Added to the arsenal of TIF, New Markets Tax Credits (selected Census Tracts), SSAs and SAs, Infrastructure Sales Tax for non-home rule communities now at 1%, and Business Districts, we have more financing tools available.

So what to do to address the current situation and set up for the next economic cycle?

1. Expand Capital Spending/Infrastructure Development. With alternative financing tools available and low tax-exempt rates, this may be an opportune time to refinance debt and to advance more significant, perhaps deferred, capital needs. Communities and their various districts could upgrade sewage treatment plants, consider "regional" storm-water management investments, build recreation centers, expand libraries, build civic campuses as well as repair and replace more mundane infrastructure. Moreover, public buildings can be gathered into downtown areas to help reinforce the fledgling downtown revitalization efforts slowed by the recession. The current weak private development climate may lead to more aggressive pricing from contractors as well.

2. Build Relationships with Banks and Private Developers in Support of Facility Bonds. Recovery Zone Facility Bonds can provide very low interest financing for mixed use and commercial projects (except golf courses, liquor stores, and massage parlors). If there is a "credit tenant" anchor or established business at the core of the deal, it can proceed smoothly. Mixed-use projects with small stores, office or retail buildings, and grocery-anchored projects would likely lack credit tenants and require letters of credit. These could be provided by local banks working with the Federal Home Loan Bank or on their own if they are healthy.

3. Review Retail Structure and Strategy. What are realistic retail potentials in your community and how can you facilitate achieving them? If there are large areas of vacant or weak retail, can those areas be re-used for something else? Are there sites that could be assembled with municipal help to fit current retail development prototypes? What can be done to help existing retailers enhance their market presence and success? How can corridors be re-planned and rezoned for future development?

4. Consider Sales Tax Sharing with Municipal Neighbors. Never an easy dialogue, perhaps the depth of retail change offers an opportunity to consider sales tax sharing. Auto dealer-dependent communities were hit hardest this time, but given trends in spending, the neighbor depending on capturing general merchandise stores may be competing with vacant auto dealer sites. Is this an opportunity to help broaden and stabilize sales tax revenues to municipalities who typically share the market area anyway?

5. Restructure Un-built Subdivisions. We have far too much land zoned and platted for single-family and townhouse development for the next 10 years given the demographic trends. Now is a good time to work with developers, lenders or successor developers to re-plan, re-plat and re-market to the segments likely to present greater opportunity in the next cycle.

The present situation is challenging, but the Chicago region and several mid-sized urban regions around the state are still growing. Once the recovery begins, the future holds many opportunities. The five actions listed above might help to secure that future.