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COOL

ECONOMIC DEVELOPMENT

TOOLS

BY KENNEDY SMITH

24

More than One
Perk

26

Main Street at
Work

30

Network
Notes

31

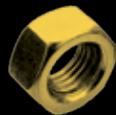
Off the
Shelf



COOL ECONOMIC DEVELOPMENT TOOLS

BY KENNEDY SMITH

Suppose someone knocked on your office door one day and offered your Main Street program \$1 million to encourage business or property development – but only if you could use the \$1 million to stimulate five times that amount in new economic activity for your district. How would you use it? What types of assistance do business owners in your district need most? How about the property owners? What are your program's business and building priorities? Would you create a short-term incentive program, or would you use the money to support economic development on an ongoing basis?





You might not have a white knight or fairy godmother knocking on your door and making you an offer like this – but there are plenty of things your program can do to stimulate economic development. From launching local angel investment groups to organizing business plan competitions, communities are experimenting with new economic development tools for their older commercial districts – and putting a new spin on some old ones – to stimulate and support commercial district business and property development.

Communities in the United States have powers to stimulate economic development that cities and towns in many other nations lack. Amazing powers, really. Unlike many other nations, most planning and land-use policies in the United States are created at the local level. Local governments have considerable latitude in deciding how much and what types of development will take place within

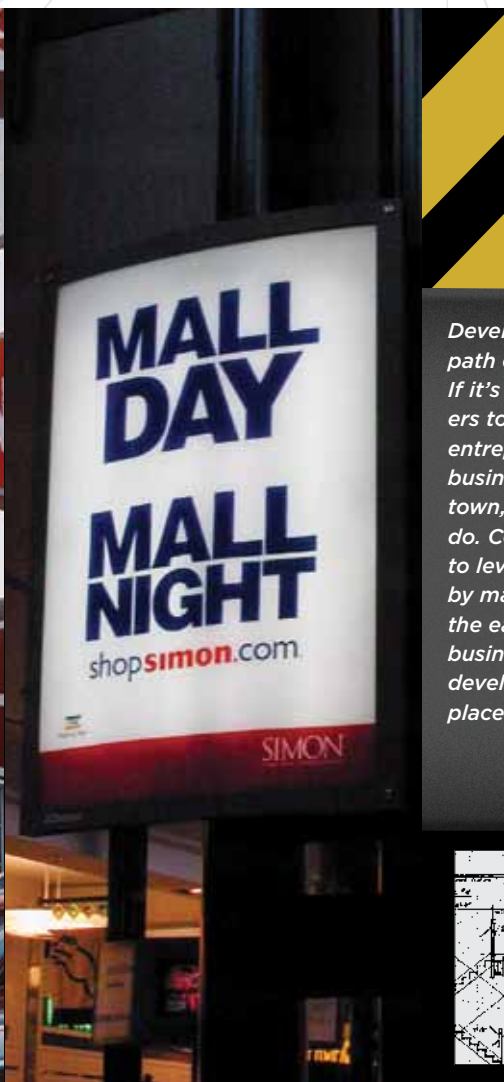
their boundaries. Some land-use policies are made at the state and federal level, of course, and many are influenced by state and federal policy. But, this still gives local governments, and the private-sector entities with which they often partner to stimulate development, lots of room to create new economic development tools and shape existing tools to better meet their needs.

There are lots of reasons why your organization might want to be actively involved in creating new economic development tools and adapting existing tools to better fit your needs:

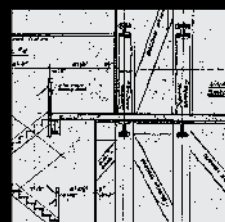
Leveling the playing field. It has always mystified me that we create design review processes for older and historic downtowns and neighborhoods, but we usually don't require equally good design along the highways leading into the community.

Development is like water – it follows the path of least resistance. If it is easier for developers to rehab buildings downtown than to build new ones out on the highway, that's what they'll do. If it is easier for entrepreneurs to open businesses downtown than in a shopping center, that's what they'll do. Unfortunately, it's usually easier – much easier – to develop buildings or businesses outside the central business core. Downtown zoning is often more complicated, financing is frequently more difficult to obtain, and there's often the additional hurdle of design review. But, if you can make Main Street the *easiest* place for business and property development to take place – or at least level the playing field – you'll win half the battle.

Attracting the type of property development you need. Maybe your district needs upper-floor housing. Maybe it needs to find a new use for a historic warehouse. Maybe it needs



Development follows the path of least resistance. If it's easier for developers to build malls and for entrepreneurs to open businesses outside of town, that's what they'll do. Communities need to level the playing field by making Main Street the easiest place for business and property development to take place.





Economic incentives are often needed to stimulate the type of development a downtown needs, such as upper-floor housing (above right) or to pay for necessary amenities, such as a parking garage for new residents (above left).

better office space, or a small hotel. Whatever your district needs, you're more likely to get it if you offer economic development tools that help make that particular project more likely to succeed.

Attracting the types of businesses you need.

As with property development, you can use economic development tools to attract or cultivate the types of business your district needs.

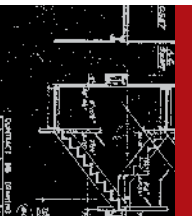
ing construction, new building development sometimes wins out over historic building rehabilitation because of the greater potential risks bankers might believe exist with rehabilitation. In communities where banks – or other potential lenders – aren't willing or able to loan the money needed to rehab buildings or open or expand businesses, the Main Street organization can seek out alternative, or additional, ways to make capital available.

Helping businesses increase sales.

Economic development tools aren't just for start-ups. Practically every existing Main Street business would like to increase sales. But finding capital for expansion is often challenging for small businesses, and options for developing new markets and new distribution channels might seem risky to business owners without some sort of incentive.

Paying for features, amenities, and services required for other development to take place. Some downtown development projects depend on other things happening first or happening

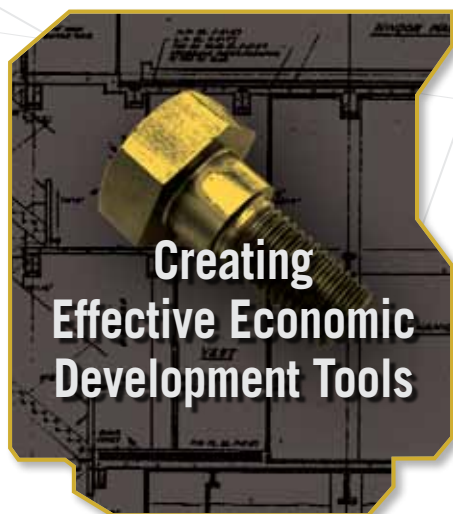
in tandem. For example, creating a sizable number of new housing units in the commercial core might also mean providing parking for some of the new residents. Or, in order to develop and operate successful online commerce to complement sales in their bricks-and-mortar stores, retailers might need high-speed internet service in the district.



COMMUNITIES IN THE UNITED STATES HAVE POWERS TO STIMULATE ECONOMIC DEVELOPMENT THAT CITIES AND TOWNS IN MANY OTHER NATIONS LACK.

Making capital available for business and property development projects. Generally speaking, banks don't like to take risks. They like to make safe investments. This almost always means that, given the choice of loaning money to an entrepreneur interested in opening a new business downtown or loaning money to a national retail chain with a thousand other sites and market capitalization in the millions of dollars, they'll choose the national retail chain. Although the situation isn't quite as depressing when it comes to loaning money for build-

Closing financing gaps in proposed downtown development projects. In many instances, a building rehabilitation project's budget falls just short of what's needed. Sometimes, the rehabilitation is more expensive than anticipated or the rent levels supported by the market are too low to cover the building's mortgage. Some economic development tools are designed specifically to fill financing gaps in projects that are likely to have significant public benefit.



Identifying or creating economic development tools that will achieve your goals requires a good understanding of how the financing for a building rehabilitation or construction project, or a business start-up or expansion project, works. There are two key documents to understand:

- **Sources and Uses Statement:** the document that lists and tallies the sources and uses of financing for the project; and
- **Pro Forma Spreadsheet:** the document that projects revenues and expenses for the first five years or so after the project is put in service.

Together, these two documents (almost always in spreadsheet format) can provide essential insights into the type of economic development tool that could be most effective in making a project work. Let's walk through an example, and I'll explain what I mean.

At right is a simplified "sources and uses" statement for the rehab of a two-floor historic warehouse building that is being adapted for ground-floor retail and restaurant space and second-floor apartments.

The box at the top of the spreadsheet summarizes major project characteristics – in this simplified example, the "assumptions" box contains just the estimated rehabilitation costs per square foot and the building's total square footage.

Below the assumptions box, the spreadsheet lists the sources of financing for the project. In this example, the sources of financing are owner's equity (the amount of cash that the owner is investing in the project) and a mortgage.

The bottom of the spreadsheet lists the ways this money will be used: property

acquisition; architectural, engineering, and other professional fees; permits; construction; landscaping; construction-period financing; and utility costs during construction.

On page 9 is the operating *pro forma* statement for the first five years of operation after the building has been rehabbed.

As in the "sources and uses" statement, the operating *pro forma* begins with a box that summarizes some of the major assumptions about the project – the amount of square feet to be used for retail/restaurant space and for offices; the initial rents anticipated in the project's first year; estimates of annual rent increases and vacancy rates; the property tax rate; and assumptions about the mortgage – interest rate and the term of the mortgage.

Below the assumptions box, the spreadsheet lists the revenues the building earns. In this

example, rent is its sole source of revenue.

The bottom of the operating *pro forma* lists the building's operating expenses: real estate taxes; insurance; management fees; utilities; repairs and maintenance; water and sewer; trash removal; janitorial services; marketing costs; and reserves for replacement (basically, money to be set aside each year to pay for replacement of building components like roofing, floor coverings, and mechanical equipment).

The project's income, minus its expenses, equals its net operating income. The mortgage payment – the project's "debt service" – is then paid from its net operating income. If there's any money left over, the owner makes a profit. But if the cash flow is negative, there's a problem.

$$\text{Gross income} - \text{gross expenses} = \text{net operating income}$$

$$\text{Net operating income} - \text{debt service} = \text{cash flow}$$

SOURCES + USES OF FINANCING

Assumptions

Rehabilitation costs/SF	\$125
Square feet (total)	10,000
Maximum loan (% of project cost)	70%

Sources of financing

Owners equity	\$100,000
Mortgage	\$1,400,000
Total sources of financing.....	\$1,500,000

Uses of financing

Property acquisition	\$120,000
Architect, engineer, other professional fees	\$100,000
Permits.....	\$1,500
Construction	\$1,250,000
Site preparation, landscaping.....	\$20,000
Construction-period financing	\$5,000
Construction-period utilities.....	\$3,500
Total uses of financing.....	\$1,500,000

OPERATING PRO FORMA

Assumptions

SF retail + restaurant	5,000
SF offices	5,000
Initial rent/SF (retail + restaurant)	\$16.00
Initial rent/SF (offices)	\$15.00
Annual rent increase	1.5%
Allowance for vacancy	5%
Property tax rate	0.65%
Mortgage interest rate	6%
Mortgage term (years)	30

Income	Year 1	Year 2	Year 3	Year 4	Year 5
Gross scheduled rents	\$155,000	\$157,325	\$159,685	\$162,080	\$164,511
Minus: allowance for vacancy	\$7,750	\$7,866	\$7,984	\$8,104	\$8,226
Plus: other income	—	—	—	—	—
Effective gross income (EGI)	\$147,250	\$149,459	\$151,701	\$153,976	\$156,286
Expenses	Year 1	Year 2	Year 3	Year 4	Year 5
Fixed expenses					
Real estate taxes	\$9,750	\$9,750	\$9,750	\$9,750	\$9,750
Insurance	\$15,000	\$15,000	\$15,000	\$15,000	\$15,000
Other					
Variable expenses					
Management	\$9,300	\$9,440	\$9,581	\$9,725	\$9,871
Utilities	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
Repairs + maintenance	\$2,000	\$2,000	\$2,000	\$2,000	\$2,000
Water + sewer	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500
Trash disposal	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500
Supplies	\$250	\$250	\$250	\$250	\$250
Other					
Reserve for replacement					
Roof (25 yrs)	\$2,400	\$2,400	\$2,400	\$2,400	\$2,400
Mechanical equipment (15 yrs)	\$8,000	\$8,000	\$8,000	\$8,000	\$8,000
Floor coverings (10 yrs)	\$4,500	\$4,500	\$4,500	\$4,500	\$4,500
Other					
Total expenses	\$66,200	\$66,340	\$66,481	\$66,625	\$66,771
Net operating income (NOI)	\$81,050	\$83,119	\$85,220	\$87,351	\$89,515
Minus: Debt service	\$101,708	\$101,708	\$101,708	\$101,708	\$101,708
Equals: Cash flow	\$(20,658)	\$(18,589)	\$(16,489)	\$(14,357)	\$(12,193)



To encourage building rehabilitation projects, Main Street programs and their public and private-sector partners can create economic incentives, such as loan guarantee or interest buy-down programs.

One component connects these two spreadsheets: the mortgage payment (“debt service”) on the operating *pro forma* is calculated based on the mortgage amount listed in the “sources” section of the “sources and uses” statement. *But*, if you’ll look closely at these two spreadsheets, you’ll see that the project’s financing has a few problems.

For example, the *pro forma* shows that the project will have a negative cash flow for its first five years. So, unless the property owner can afford to pump money into the project until it begins generating positive cash flow, the project isn’t likely to happen.

Also, the assumptions box on the “sources and uses” statement says that the mortgage issuer will finance a maximum of 70 percent of the total project cost. This is a \$1.5 million project, which means the maximum mortgage the owner can get (at least from this mortgage issuer) is \$1,050,000. But, the “sources” section of the “sources and uses” statement lists only \$100,000 in additional financing – so the owner will need to find some other sources of financing. Without some sort of assistance, this building rehabilitation project will almost certainly not take place.

So, let’s take a close look at the “sources and uses” and operating *pro forma* statements. What could make this project feasible?

More equity. If the bank will only finance 70 percent of the project’s value, and the owner can only invest \$100,000, the project needs an additional \$350,000. Where might that \$350,000 come from? It could come from historic rehabilitation tax credits (if they are converted to cash), for example, or perhaps through a grant from the local or state government or from a foundation. Or perhaps the property owner could find someone to share ownership of the building.

More loans. It looks like the property owner has only explored the possibility of obtaining a mortgage loan from one bank. Because this bank is only willing to finance 70 percent of the project’s value, perhaps another lender could provide a smaller loan for another 10-20 percent of the project’s value.

A lower interest rate. If the bank lowered the interest rate from 6 to 4.5 percent, the project would begin generating a profit in Year 4.

Lower rehabilitation costs. Some of the rehabilitation costs aren’t likely to change, but some could potentially be lowered. For example, the city might consider waiving the permit fees it

would ordinarily charge. The owner and/or a nonprofit organization could provide some of the labor, lowering the construction costs. The current owner of the building might consider donating it to a nonprofit organization to obtain a sizable tax deduction. The nonprofit could, in turn, give the building to the new owner or developer, thereby reducing or eliminating acquisition costs.

Lower operating expenses. If it costs less to operate the building, the net operating income will increase. So, for example, if the city were willing to waive the building's post-rehab real estate taxes for 10 years, the project would save almost \$10,000 a year. This would cut its negative cash flow almost in half during the first year of operation and make the project profitable by its seventh year.

More operating income. Generating more income could help close the project's cash-flow gap. It is unlikely that the property owner will be able to charge a higher rent per square foot for this building than other owners are charging for comparable space in their buildings, but there might be building uses that could generate higher rents than the uses the owner assumed in the operating *pro forma*. Or there could be additional sources of rental income that the owner has not yet considered – renting on-site parking spaces, for example.

In each of these instances, there are potential opportunities for a Main Street program and its public- and private-sector partners to create economic development tools that could increase this project's feasibility. For example:

- The Main Street program could identify or create a second loan source. The Downtown Housing Assistance Fund in Louisville, Kentucky, for instance, stimulates development of market-rate downtown housing by offering below-market-rate loans of 10 to 20 percent of a project's total debt to augment loans made by a primary lender.

- The Main Street program might create a loan guarantee program, using funds from a foundation, from a Community Development Block Grant, or from another source to “guarantee” all or a portion of the loan. This would assure a project's primary lender (in this case, the bank) that if the project fails and the owner defaults on the loan, the loan guarantee capital will be used to repay the bank's loan.
- The Main Street program could “buy down” interest rates with cash from another source, lowering mortgage payments for people who borrow money to rehabilitate downtown buildings. For example, in Kansas, the Downtown Hays Development Corporation and the City of Hays have created an interest buy-down program for façade improvements. The program, funded with a \$15,000 appropriation from the city government, will effectively reduce façade improvement loans of up to \$20,000 by several basis points. (A basis point is one percent of the amount of the loan.)
- The local government might waive permit fees. For example, Shreveport, Louisiana, waives construction permit fees for rehabs of downtown buildings built before 1960.
- The local government might abate property taxes for a certain period of time. Seguin, Texas, provides a five-year abatement of property taxes on improvements made to historic downtown buildings.
- The local government could offer additional incentives, either by designating the district an Enterprise Zone, by creating a special overlay zone to encourage certain types of investment, or simply by passing an ordinance that offers targeted incentives. Downtown South Boston, Virginia, for instance, lies within the town's Enterprise Zone, which offers a rich package of incentives that includes waivers of business license fees and utility tax payments, below-market-rate loans for buying or improving downtown buildings, and access to a revolving loan fund that supplies capital for small business development. All of these local incentives are on top of the Enterprise Zone incentives offered by the Commonwealth of Virginia. The state's incentives include a grant of 30 percent of the cost of qualified building improvements within the Enterprise Zone, with a maximum grant of \$125,000 for projects that cost less than \$2 million and \$250,000 for projects above \$2 million.

Incentive grant programs can benefit Main Street districts in a variety of ways. In Dubuque, Iowa, the Downtown Housing Incentive program provides incentive grants to encourage downtown property owners to create market-rate housing downtown.





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One of the first projects to win a federal HOPE VI Main Street grant, Stillwater Mills, a historic woolen mill complex in Burrillville, Rhode Island, was converted to offices and apartments, using a combination of federal, state, and local grants and tax credits.



© City of Burrillville, R.I.

- The Main Street program could create an incentive grant program for façade improvements, energy upgrades, or other improvements that benefit the district and the community. There are literally hundreds of examples of downtown incentive grant programs throughout the United States. In LaGrange, Georgia, for instance, the Downtown LaGrange Development Authority offers grants of up to \$1,000 for façade improvements, with grants covering no more than 50 percent of the improvement. In Dubuque, Iowa, the Downtown Housing Incentive Program provides incentive grants of up to \$10,000 per unit to encourage downtown property owners to create market-rate housing units downtown.

The \$2.5 million program (which, with maximum grants of \$10,000, can help support development of 250 new market-rate housing units) was funded by savings from and reductions in several capital improvements projects.

- The Main Street program could provide technical assistance and guidance to introduce and explain funding options the building owner might not know about. This might include assistance on how to use historic rehabilitation tax credits to help finance the building's rehabilitation, on using the façade improvement option, on building code requirements, or on environmentally friendly upgrades.

Why Should the Public Sector Participate?

In most of these instances, local government plays an important role by providing funding, either directly or as a pass-through from a state or federal government source; by waiving fees; or by offering tax or other incentives. Sometimes local governments are reluctant to play an active role in encouraging and supporting development – but there are many good reasons why local and state governments should be actively involved:

Property tax revenue. The local government will earn more property tax revenue once a building is rehabilitated and occupied, so it is in the city's best fiscal interest to help ensure that all commercial buildings within its jurisdiction are performing well financially. In this example, the building is worth about \$100,000 before rehabilitation. After being rehabbed, it will be worth about \$1.5 million. At the city's current property tax rate of 0.65 percent, the city will earn \$9,100 more annually on the building after rehabilitation.¹

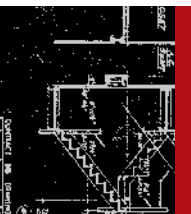
Sales tax revenue. State governments – and, in many states, local governments – will earn more retail sales tax revenue after a building has been rehabbed and new businesses are operating within it. In this case, half of the building (5,000 square feet) will be used for retail shops and restaurants. If these businesses generate \$200 per square foot in gross sales (about average for downtown retail

shops and restaurants) and the state sales tax rate is 5 percent (about average for most states), the state will collect \$50,000 in sales tax annually from the building's ground-floor tenants.² Many states return one percentage point or more of the sales tax to the community in which the sales were generated; in this example, that could mean \$10,000 in revenue for the city.

in new property and sales tax revenue for the city government each year, \$40,000 in sales tax revenue and more than \$43,750 in income tax revenue for the state government, and \$875,000 in wages. Each of these new revenue streams is multiplied as the businesses located in the building buy supplies and inventory from other businesses, as the businesses' workers spend their wages on goods and services, and as the local and state governments

- The Woonsocket Neighborhood Development Corporation, a local organization, and NeighborWorks America, a national organization that focuses on affordable housing development, provided grants of \$50,000 and \$185,000, respectively.

This left a gap of only \$475,000. I don't know what the term and interest rate were for



THE LOCAL GOVERNMENT WILL EARN MORE PROPERTY TAX REVENUE ONCE A BUILDING IS REHABBED AND OCCUPIED, SO IT IS IN THE CITY'S BEST INTEREST TO HELP ENSURE THAT ALL COMMERCIAL BUILDINGS... ARE PERFORMING WELL FINANCIALLY.

Jobs. New businesses create new jobs, which bring new expenditures to the community for rents, utilities, groceries, clothing, home furnishings, and many other goods and services. In this instance, the rehabilitated building would provide jobs for approximately 35 people. If these 35 people earned an average of \$25,000 annually, the rehabbed building would generate \$875,000 in annual wages.

Income tax revenue. New businesses mean a new source of corporate and personal income tax revenue for the state and federal governments. In this example, if the state's average personal income tax rate is approximately five percent, the \$875,000 in wages earned by the building's workers would translate into approximately \$43,750 in new income tax revenue for the state. And the state would earn business income tax from both the businesses operating within the building and from the building owner.

There are many other benefits, as well. For example, the more activity that takes place downtown from residents, workers, visitors, and businesses, the safer the district will be, and the more appealing it will be to others. But, as important as some of these less quantifiable benefits might be, nothing attracts the attention of government officials quite as quickly as the opportunity to generate new revenues.

In the examples listed above, public investment in this project could generate \$19,100

use the revenues earned to support education, public safety, infrastructure, and other essential community services.

One of my favorite examples is the rehabilitation of Stillwater Mills in Burrillville, Rhode Island. One of the first projects to win a federal HOPE VI Main Street grant, it involved rehabilitating a historic woolen mill complex and converting it to offices and apartments.

The project's rehabilitation cost was estimated to be around \$14.2 million. But the development team ultimately had to borrow only \$475,000. Here's how the financing worked:

- The developers partnered with private-sector investors to convert federal and state historic rehabilitation tax credits and federal low-income housing tax credits into cash, which covered more than \$9.5 million of the project's cost.
- They obtained several federal grants from the U.S. Department of Housing and Urban Development: a HOPE VI Main Street grant (\$500,000) and a HOME grant (\$500,000) for development of affordable housing; a Community Development Block Grant (\$603,065); and a Brownfields Economic Development Initiative grant (\$910,000) to remove environmental hazards from the site.
- The State of Rhode Island gave the project an outright grant of \$1,450,000.

the mortgage loan – but, if the term was 30 years and the interest rate was 6 percent, the annual mortgage payment would be around \$34,500, or less than \$3,000 per month – much less than the rental income the project will likely earn, and almost certainly generating enough positive cash flow to more than cover the project's operating expenses.

\$500,000	HOPE VI Main Street grant
\$500,000	HOME grant
\$603,065	Community Development Block Grant
\$910,000	Brownfields Economic Dev. Initiative grant
\$1,450,000	Grant from State of Rhode Island
\$5,115,342	Low income housing tax credit equity
\$4,406,815	Historic rehabilitation tax credit equity
\$50,000	Woonsocket Neighborhood Development Corporation grant
\$185,000	NeighborWorks America grant
\$475,000	First mortgage

¹ $(\$1,500,000 - \$100,000) \times 0.65\% \text{ property tax rate} = \$9,100$

² $2,000 \text{ SF} \times \$200/\text{SF} \times 5\% \text{ tax rate} = \$50,000$



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Making Things Happen: How Cool Economic Development Tools Work

They leverage other resources. The Stillwater Mill project illustrates one of the key characteristics of cool economic development tools: great leverage. With the exception of the tax credit equity, no one funding source contributed more than seven percent of the project's financing; yet each of these economic develop-

ment tools was instrumental in making the project happen (we'll talk more about tax credit equity later). So, for a relatively small percentage of the project's total cost, each funder and investor can claim an important role in turning a derelict property into a profitable project – and a source of community pride.

They're designed for specific needs. Some economic development tools provide one-size-fits-all development assistance – for example, a revolving loan fund for downtown building rehabilitation projects. Tools like this can benefit just about every commercial district. But the really cool economic development tools are designed for specific needs or opportunities. They make things happen that probably wouldn't otherwise.

For example, Winston-Salem, North Carolina, designed an economic development tool specifically to recruit a cluster of new restaurants to a concentrated area on the edge of its central business district. The program – called

Restaurant Row – made it possible for restaurateurs willing to open a new establishment within this concentrated area to borrow most of the financing they needed from one of two local banks. The city used Community Development Block Grant funds to pay the debt service on loans made through the program, making it possible for restaurateurs to defer loan repayments for the first two years of their restaurants' operation. It's usually very costly to launch a new restaurant – fixtures and furnishings are expensive. It also takes a while for restaurants to build a customer base, so it's particularly important that new restaurants be able to cover start-up costs while gradually increasing sales. Winston-Salem's Restaurant Row program tackled this problem head-on by relieving debt repayment during the critical start-up period. The program successfully attracted 10 new restaurants.

Another example: several years ago, a college community in suburban Detroit was concerned about keeping recent grad school students in the area, rather than watch-

Buildings that are re-habbed and occupied by successful businesses will produce more property and sales tax revenue for state and local governments.



People usually think of economic development tools as *finance* tools to help business and property owners close financial gaps or to provide capital for projects that might otherwise have a hard time getting financing, and some communities have created very cool tools to help fund projects. But non-financial tools can often be equally or even more effective in meeting certain needs or stimulating certain types of development activity.

Technical assistance. Some of the most effective economic development tools don't involve loans or equity investments at all. Instead, they focus on helping business or property owners make their businesses more profitable by providing training, encouragement, ideas, and access to resources that they might not otherwise have. For instance, production kitchens – professional kitchens in which entrepreneurs (and even established restaurateurs) can prepare and package food for resale somewhere else – have popped up in several older and historic commercial districts in recent years.

Entrepreneurs typically rent access to the production kitchen for a day or two at a time; this gives them access to lots of work space and professional equipment that is too expensive for them to buy or rent on their own, particularly if they only produce small quantities for resale. Some production kitchens focus on particular types of food or on particular types of producers. For example, La Cocina, a production kitchen in San Francisco, focuses on helping low-income people – particularly women – develop and market food products. In addition to renting its production kitchen space to entrepreneurs, La Cocina offers training programs, workshops, and one-on-one assistance.

They have significant impact. When an economic development tool is designed to meet a specific need, such as keeping young adults in the community, or to encourage a certain type of development, such as developing a concentrated cluster of new restaurants, it is likely to have a greater impact than if it is designed to meet routine, ongoing downtown development needs, such as making loan money available for historic building rehabilitation.

A business plan competition is another (usually) great technical assistance tool that helps business owners focus intensively on improving their operations. Business plan competitions typically give entrepreneurs several months to develop a business plan, often with hands-on guidance from business management experts. A panel of judges reviews the business plans submitted and selects a winner. The winner usually receives a cash prize, publicity, and guidance in implementing the plan. But all of the business owners who enter the competition are winners in the long run because the process of developing a business plan helps them think deeply about ways to make their businesses more successful. Business plan competitions can be general (e.g., a business plan for a new downtown business) or specific (e.g., a business plan for adding a new product line or creating a new sales distribution channel), with a cash prize to help defray or cover the costs of implementing the plan.

When it comes to the bottom line, two different approaches can accomplish essentially the same goal of increasing the success and profitability of a business: reducing costs or increasing revenue. Financial incentive programs typically address the former; technical assistance programs usually address the latter. Ideally, Main Street programs should offer both.

Facilitation. The simple act of bringing people together so that they can pool their resources or gain better economies of scale can serve as a powerful economic development tool. For example, it might not be financially feasible for a single downtown property owner to convert historic rehabilitation tax credits into cash to rehab a building because the accounting and legal costs might offset most or all of the value of the tax credits. But, by banding together, a group of several property owners could share accounting and legal costs and could more effectively attract a tax credit investor. By promoting an idea (in this case, grouping property owners together) and providing some guidance (in this case, explaining how grouping properties together might make it possible for all participating property owners to convert tax credits to cash), the Main Street program can stimulate a form of development and reinvestment that might not otherwise occur.



So, here are some of my favorite cool economic development tools – some financial, some technical assistance, some facilitation. Some of these tools aren't particularly new, but they are woefully underused and should, in my opinion, be a larger part of most Main Street programs' toolkits.

Tax credits. The federal historic rehabilitation tax credit program provides great tax benefits to owners of historic commercial buildings. There are two federal historic rehabilitation tax credits: a credit equal to 10 percent of qualified rehabilitation costs for non-historic

buildings built before 1936 and a credit equal to 20 percent of qualified rehab costs for historic buildings. The 20 percent credit is obviously the more lucrative of the two, and more than half of the states offer a state income tax credit that roughly parallels the 20 percent federal credit. When you combine the federal and state credits, you've got an amazing incentive.

BUT, tax credits aren't always a good fit for property owners. For example:

- There are some income restrictions. For many Main Street property owners, owning and managing their buildings isn't their main profession. The IRS considers income from activities that aren't someone's main profession to be "passive" income, and it limits the amount of tax benefits an individual can use if those benefits are generated by passive income.
- Sometimes property owners need cash up front to make improvements, rather than credits to use afterwards. Property owners can convert federal historic rehabilitation tax credits to cash by partnering with an investor who isn't subject

to passive income restrictions (like a corporation) and letting that investor use the credits in exchange for a cash investment in the project. However, because of the amount of accounting and legal work involved in setting up this sort of transaction, investors are usually only interested in projects that have rehabilitation costs substantial enough to earn them a hefty amount of tax credits. That means they aren't likely to be interested in rehabilitation projects involving single storefront buildings.

But Main Street programs can play a key role in making tax credits a more practical and appealing option for downtown property owners. For example, the Main Street program can help bring together a group of property owners interested in rehabilitating their buildings; as a group, they might be able to attract the attention of a tax credit investor. Or, the Main Street director might talk with corporations in the community and region about becoming tax credit investors for downtown projects. In Oskaloosa, Iowa, for instance, a local lighting company with a global market, Musco Lighting, became the tax credit inves-

TWO DIFFERENT APPROACHES CAN ACCOMPLISH ESSENTIALLY THE SAME GOAL OF INCREASING THE SUCCESS AND PROFITABILITY OF A BUSINESS: REDUCING COSTS OR INCREASING REVENUE.



tor for the rehabilitation of several downtown commercial buildings – a project that would probably not have attracted the attention of an out-of-town corporation. Musco's investment was motivated not only by the ability to offset taxable income with tax credits but also by a civic-minded desire to support downtown revitalization in its hometown.

Tax-increment financing. Undeveloped land and vacant buildings generate significantly less property tax revenue for local governments than developed land and occupied, rehabilitated buildings. But sometimes property can't be developed, or buildings rehabbed, or districts revitalized, without some infusion of cash. Tax-increment financing (TIF) helps provide some of the cash that's needed by using the new property taxes generated by the redeveloped land and rehabbed buildings for the redevelopment and revitalization process. The amount of tax revenue that results from redevelopment, above and beyond what the municipality is already collecting on the undeveloped (or pre-rehabbed) property is the tax "increment." This isn't a new tax, or a higher tax rate; it's simply that because the property's value

has increased due to the improvements, the prevailing property tax rate generates more revenue.

There are two types of tax increment financing: pay-as-you-go and bonded. With a pay-as-you-go TIF, property tax revenue accumulates as the district's property values increase. When the accumulated revenue reaches a certain level, it can be tapped for things the district needs, from business development plans to new benches and trash cans. With a bonded TIF, the city estimates how much new property tax revenue will be generated by a specific rehabilitation or development project, then sells bonds to raise that amount of revenue, paying off the bonds as the new property tax revenue comes in. Here are a couple of examples.

- The historic Hippodrome Theatre, in Baltimore, was rehabbed about 10 years ago. It needed a large number of on-site parking spaces, however; and the developer could not afford to build a parking garage in conjunction with the theatre redevelopment. To solve the problem, the city used TIF to generate funds for construction of a parking garage. It issued

municipal bonds to raise the money up front and is paying off the bonds with the incremental tax revenue it collects annually from the rehabbed, reopened theatre.

- Carlsbad, California, created a redevelopment district in the 1980s to help revitalize its downtown, Carlsbad Village. Unlike the TIF enacted for the Hippodrome Theatre, which issued bonds to raise money up front, the TIF in Carlsbad Village is "pay as you go." It pools the new, incremental property tax revenue that is collected each year into a special fund that can be used for revitalization and redevelopment projects approved by the city council and the city's redevelopment authority.

Community capital. I've seen communities wait for years for the right business or the perfect entrepreneur to come along ... and most are still waiting for someone to walk through the door and say he wants to open a cool new restaurant, buy a block of buildings and create some great upper-floor housing, or rehab the downtown's historic movie theatre. So, it's not too surprising that a growing

A business plan competition can be a great technical assistance tool that helps new entrepreneurs develop feasible operating plans and existing business owners focus on ways to improve their operations (left).

The downtown program in Mobile, Alabama, offers forgivable loans for business start-ups and expansions in targeted downtown blocks. If the business remains in operation for five years, the loan repayments are refunded to the borrower (right).



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number of communities are taking the bull by the horns and raising money themselves to pay for building rehabilitations and business start-ups and expansions. Community equity can be particularly useful in helping launch businesses the community really wants – and can realistically support – but for which it has been unable to find an interested or available business owner or entrepreneur.

- **Private investment groups:** A small group of community residents pools its money and creates or buys a business as a group.
- **Community stock ownership:** A business, or group of businesses, sells shares of stock in its operation to members of the community. More than 20 community-owned downtown department stores have been created this way, with residents buying stock and, when the business is

profitable, receiving periodic dividends. In the United Kingdom, three charitable foundations have given this model of community ownership a boost by offering to match up to £40,000 in locally raised funds for the launch of community-owned department stores.

Shared building ownership. When commercial property values increase more rapidly than retail sales, businesses may be at risk of failure as rents escalate. The best defense against this form of commercial gentrification is for merchants to own the buildings in which they operate. In some circumstances, it might be possible for a nonprofit organization, a private foundation, or a civic-minded local corporation to buy commercial buildings in partnership with business owners. Instead of having to cover the entire purchase price, a business owner might only need to cover half of the cost, with the remainder being paid by the civic-minded investment partner.

The business owner and the investment partner would create a limited liability company or other corporation to own the building, with ownership shares allocated according to the percentage of the purchase price each partner covers. If the business fails, or the owner retires or decides to sell his or her share of the building for some other reason, he or she would simply sell it to another business owner. The civic-minded investment partner would continue to own its share of the building. This would probably be a good investment for the investment partner, as it is likely that the district's buildings will continue to appreciate in value as time goes by.

Tax incentives for downtown investment. In many European nations, it is common for governments to charge higher taxes on businesses and commercial buildings located outside town centers than on those that locate or built downtown. Why? Because they



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Carlsbad, California (left, above, and right) created a redevelopment district in the 1980s to help revitalize its downtown. The tax increment finance district pools new, incremental property tax revenue each year into a special fund that finances revitalization projects approved by the city.

recognize that it will cost more to provide municipal services and to extend and maintain infrastructure in outlying areas. No such system exists in the United States because land-use decisions in this country are made at the local, not the federal, level. But local governments can choose to guide development patterns through property tax policy, encouraging businesses to locate downtown and encouraging developers to improve downtown buildings – and some communities have done so.

Nearly 20 years ago, Collierville, Tennessee, passed an ordinance charging a fee for commercial development larger than a certain size outside the downtown area. The fee acts as a deterrent to development outside the downtown, and the fees help support Collierville's downtown revitalization initiative.

Coworking space. Collective work space – or coworking space, as it is usually called – provides shared office or production space to small businesses (usually with solo practitioners) at a fraction of what it would otherwise cost the business owner to rent space independently. For a relatively modest monthly fee, the business owner has a small work space in a large office that houses a dozen or more similar tenants. The tenants share use of a conference room, office equipment, high-speed internet service, a kitchen, and other amenities, such as a reference library or a receptionist. Coworking spaces not only help the business owners who work there – by providing them with relatively low rent and with the synergy of working with other small business owners; they also benefit the

overall district, which now has more daytime workers.

Incubating new retail businesses inside established retail businesses. Successful, established retailers have already done the hard work of building a customer base (not that that process ever ends, of course), while start-up businesses desperately need exposure to potential customers. So, successful, established stores make great incubators for new businesses. In some instances, the start-up business might place its products in the host business, with the host retailer essentially folding the start-up's products into its own merchandise mix in exchange for a flat monthly fee or a percentage of sales. If the host business has room to create a physical space for the start-up business, that's also an option – just try to avoid a “mini-mall” appearance, which turns lots of shoppers off.



A restaurant located in a historic former hardware store in downtown Charlottesville, Virginia – called The Hardware Store Restaurant – was perfectly designed for this set up. Several small bays in the restaurant's entryway made ideal homes for start-up businesses. The

InQBox, a Singapore-based business, manufactures stackable display cubes approximately 3-feet-by-3-feet, stacks the cubes from floor to ceiling and wall to wall, and rents the cubicles for a nominal amount to artisans and small manufacturers that can't yet afford an

than 500 employees – but, of course, most small businesses are much smaller than that. In the late 1970s, the term “microenterprise” popped up to define a business that has no more than five workers and that could benefit from loans of \$35,000 or less. The SBA

COMMUNITY EQUITY CAN HELP LAUNCH BUSINESSES THE COMMUNITY REALLY WANTS – AND CAN SUPPORT – BUT HASN'T BEEN ABLE TO FIND AN INTERESTED OR AVAILABLE ENTREPRENEUR.

restaurant owner provided storage and work space for his start-up tenants on the building's top floor. More than 500 people patronized the restaurant on an average day, and all of them walked past the small bays of the start-ups, giving them great exposure. Over the 30 years the restaurant was in operation before the owners retired, more than 20 small businesses were born there and successfully moved into their own storefronts.

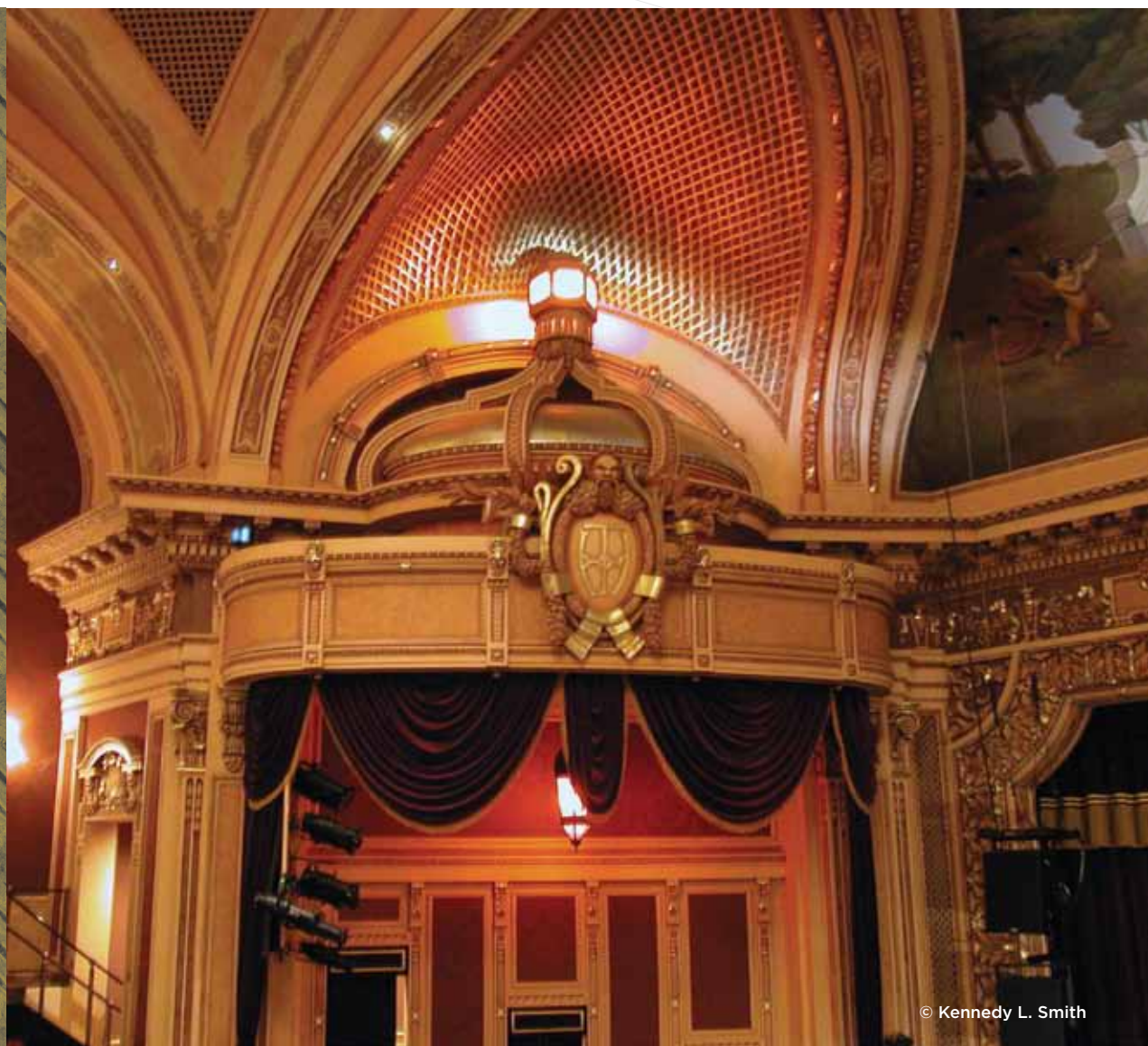
independent storefront space. InQBox provides a staff person who fulfills sales and distributes proceeds to the cube renters.

Microfinance programs. Microfinance programs provide small, but crucial, amounts of funding to small businesses. What's a small business, really, you might ask? According to the U.S. Small Business Administration, a small business is *technically* one with fewer

adopted that definition in 1991, designating microenterprises as a subset of small businesses. And, there are lots of them. In 2005, more than 60 percent of all businesses in the United States were microenterprises. And, consistently, microenterprises create the largest share of the nation's new jobs, in almost every industry.

According to ACCION USA, a leading microfinance organization, most microen-

When Baltimore's historic Hippodrome Theatre was rehabbed a decade ago, it needed a large number of on-site parking spaces, which the developer could not afford to provide. The city solved the problem by using tax increment financing to generate funds for a parking garage.



terprises have never procured bank loans for their businesses. They finance their establishments with their own savings, with loans or investments from family and friends, and with their personal credit cards. Of those that have applied for bank loans, many are turned down because they lack collateral.

As a result, many microenterprises are undercapitalized; they don't have the cash needed to add new product lines, to expand into new markets, to upgrade fixtures and equipment, to buy the buildings in which they operate, or to finance other desirable improvements. According to a survey conducted by a research firm on behalf of ACTION USA, only 18 percent of the nation's microenterprises have received bank loans. Of those that have *not* received bank loans, 46 percent have never considered getting one, 42 percent would like a bank loan but haven't applied because they think the process would be too difficult or that their applications would be rejected, and 13 percent have applied but were rejected.

Microfinance programs help make small loans available to small businesses for things like creating an online storefront, adding a new product line, or increasing store hours. Microloans are technically loans of less than \$35,000 – but the maximum loan amount of many microloan programs is \$10,000, and some are even smaller. These loan programs are often administered by a nonprofit community development organization working in conjunction with local banks.

Forgivable loans. The downtown management organizations in Mobile, Alabama; Lincoln, Nebraska; and Louisville, Kentucky, all offer, or have recently offered, forgivable loans for business start-ups and expansions in targeted downtown blocks. The programs vary slightly from one another, but their basic characteristics are similar. In Mobile, loans have an upper limit of \$20,000, and business owners must match the loan amount 1:1 with their own funds. The loan term is five years, at zero percent interest. Borrowers

must make monthly principal payments, but if the business remains in operation for five years, the loan repayments are refunded to the borrower. Businesses must have ground-floor street access, must be open a minimum of 48 hours per week, and must be a business recommended in the community's downtown retail development plan.

Charitably minded venture capital funds. Venture capital funds are usually created to make profits for their investors, but sometimes they have charitable goals. The Boston Community Venture Fund and Pacific Community Ventures, for example, invest their equity in businesses that provide needed goods and services, like grocery stores, to underserved neighborhoods.

Shared building equity. In downtowns and neighborhood commercial districts in which commercial rents are accelerating quickly and threatening to force out locally owned businesses, some community organizations

A growing number of communities are taking matters into their own hands and raising the money to rehab buildings and finance new businesses. Bonaparte, Iowa, (below left) raised more than \$100,000 to create Township Grocery, a community-owned grocery and hardware store that has remained strong for more than 20 years. In Hardwicke, Vermont (below right), a downtown bookstore owner mobilized residents to raise operating capital to create Claire's, a fine dining establishment.



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have bought commercial buildings, then sold a share of the buildings to the business owners operating there. This reduces the cost of the building since the business owner is only buying a percentage of the property.

Use your resources to leverage additional resources. Potential funders are often more willing to support a project if other funders are also supporting it.



Find funding sources that fit your priorities, rather than shaping your priorities to fit funding sources. Remember urban renewal? The

Main Street programs can play a key role in making tax credits a more practical and appealing option for downtown property owners. In Oskaloosa, Iowa, a local lighting company, Musco Lighting, became the tax credit investor for the rehabilitation of several downtown buildings.

federal government offered communities lots of money to “eliminate slum and blight.” As a result, scores of communities demolished blocks of older and historic downtown buildings – believing, somewhat weirdly, that demolishing vacant buildings would somehow eliminate the reasons they were vacant. I have never yet met a civic leader from a community that used urban renewal money to demolish downtown buildings who doesn’t now regret it.

Similar regrets are popping up around grants and financing for low-income housing. While it is certainly a good thing for commercial districts to pursue, it should be a component of a comprehensive housing program for the district, a program that also includes market-rate housing, transportation, and other popular federal programs of the past couple of decades. It’s awfully tempting to grab a grant when it’s dangling in front of you – but, is the activity it supports really one that fits your district’s overall, long-term agenda?

Provide capital and incentives. Often, there isn’t enough capital to finance the building rehabilitation and business development that would make the commercial core healthy. The money is almost certainly there *somewhere*, but banks may prefer to loan money to national retail chains rather than to independently owned businesses, property owners may not understand how to tap historic rehabilitation tax credits, or, for a variety of other reasons, capital may be hard to come by. Consequently, downtown revitalization programs must often play a central role in ensuring that adequate capital is available. But simply making capital available isn’t always enough to convince entrepreneurs and property owners to invest in new businesses and downtown building development projects. For that, your program will probably need incentives – either financial, technical assistance, or facilitation, or some combination of these.



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Successful retailers make great incubators for new businesses. For more than 30 years, the Hardware Store Restaurant in Charlottesville, Virginia, displayed the wares of startup businesses in small bays in the restaurant's entryway. More than 20 small businesses were born there and eventually moved into their own shops.

Start small. If your program doesn't have a track record of creating economic development tools, start with some small tools and gradually build the capacity of your organization and your partners to manage larger and/or more complicated tools.

Think big. Always keep your organization's goals for your district's long-term future in mind as you're designing economic development tools. What are the major transformations that need to occur over the next 10 or 20 years, and what sorts of economic development tools are most likely to help you get there?

Kennedy Smith is a principal with the Community Land Use and Economics (CLUE) Group and a former director of the National Trust Main Street Center. She is an Allied Member of the National Main Street Network. To learn more about CLUE group, visit <http://allieddirectory.mainstreet.org/listing/cluegroup.html>. Kennedy can be reached at kennedy@cluegroup.com.

Join the Conversation Online

You have just been hired to be the executive director of the Bigsville Main Street Program. For the program's first five years of activity, its board and previous executive director worked very hard to make more capital available for building rehabilitation and business development projects, and they have created a revolving loan fund for building rehabilitation and a loan guarantee program for business development and expansion. But, in spite of the fact that adequate capital is now available, not much is happening. The organization's long-range goals include creating upper-floor market-rate housing, bringing more restaurants downtown, and expanding the number of small (e.g., five workers or less) working arts studios and manufacturing businesses.

What economic development tools would you recommend to encourage business and property owners to take action towards one or more of these goals, and why?

To give us your opinion, go to <http://bit.ly/e8Z9FH>.