CRESTPOINTE - My Economic Perspective

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3/19/2007

Many of you are writing to me and asking questions about the GBT proposal to develop *Crestpointe of Oak Ridge* on Pine Ridge as a new shopping complex containing a Target Store, with public financial assistance. During the last month I have stated that the commercial retail developments produce the greatest revenue return available to any municipality. Retail sales produce a greater return than industrial development or residential complexes. There are also severe future implications of doing nothing.

We have been waiting years for the free market to work its magic on our decrepit downtown mall. For the last five years we have expected to see a new "City Center" rise from the ashes like the Phoenix. It has not happened. It is not likely to happen for a multitude of reasons.

Three very clear choices are before us today:

1. **Do nothing and watch our sales tax revenues and shopping complex decay.**

2. **Defeat the currently proposed $6 million dollar bond effort designated to assist development of a regional retail shopping complex to be developed by GBT. Defeat of this borrowing effort will also guarantee no short-term change in our sales and revenue decay.**

3. **Approve the bond issue and work to develop a regional shopping complex, recognizing the risk related to repayment of the related debt service.**

The third choice has the potential for significant future Oak Ridge sales tax revenue growth, while the first and second choices hold only the promise of much higher property taxes, and the erosion of Oak Ridge's revenues and its hard-fought competitive tax rate position.

I am publishing this economic perspective to provide you with my insight into the related effectiveness of our past and present assistance efforts. I will not address the social/emotional/ psychological or other issues that many people inexorably link to public-funding based economic assistance, the Pine Ridge location, or the present Mall area. I will, however, address the comparative economics of Crestpointe and the two previous projects which have left such a bad taste in many people's mouths; specifically, Parcel A, and the delayed/failed Arnsdorff City Center proposal of July 2002. Regardless of which of the listed three options is selected, we will all either reap the benefits or pay the price of the decision. We must generate new municipal revenues.

The history of retail development in Oak Ridge is a long and complex one with many twists and turns, but it behooves all to understand the last eight years or so. It was as early as 1999 when Mr. Arnsdorff began looking into the purchase of the then already badly declining Oak Ridge Mall from Crown America. He purchased the Mall in June 2003 following further decline. During the period of 1999 – 2005, Mr. Arnsdorff proposed a series of "mall revitalization designs," with the last proposal coming in October 2005. All had one characteristic in common; that is, the proposals all incorporated at least some form of government financial assistance. In my view, the most potentially damaging to the citizens of Oak Ridge was a July 2002 proposal to utilize $22.3 million of borrowed City funds with virtually no City controls.

My major Crestpointe questions are:

1. Is it worth investing $10.5 million (i.e., will it produce a return sufficient to pay its debt service)?

Attached you will find two figures. Figure 1 describes most of the financial relationships of cost and returns to the General Fund from the City's perspective as it relates to cash flow. Any evaluation requires one to estimate many factors from the City's perspective. These include total sales, realized new sales, investment, the cost of borrowing, property tax returns, sales tax returns, other tax returns and the duration of the loans and the project. I have simplified all of these into one easily understandable graph (Figure 1).

Figure 1. Annual Oak Ridge General Fund Impacts of Realized New Sales, 2011

First, what it says and how to read it. The simple answer is that green is GOOD, and red is BAD! You begin by finding the intersection of the start (the black dot on the left-center). The graph has a horizontal axis that is labeled "Realized New Sales," depicted in millions of dollars, and the vertical primary scale is labeled "General Fund Revenue," and is depicted in thousands of dollars. Additionally, there are two more vertical scales that relate other important elements to the General Fund revenue, such as the borrowed funds in millions of dollars and the expected tax rate change in cents. All of these are important. The Crestpointe proposal is depicted by two lines – one dashed and one solid black. Both lines rise from left to right. The lower, dashed line depicts the situation should Oak Ridge assume the full debt of $10.5 million. The upper solid black line depicts the Oak Ridge General Fund financial situation with Anderson County project participation in the amount of $3 million.

Second, let's make a relative comparison of actual and potential past assistance projects on Figure 1. These are Parcel A and the never-consummated Arnsdorff City Center proposal. My analysis indicates that neither of these past projects would have paid for their annual debt service cost during their advertised lifetimes. They both were either too expensive or they could not achieve the expected unrealistic rate of development. Both are shown solidly within the red portion of Figure 1.

Now let's talk about Figure 1 as it relates to the Crestpointe investment and my expectations. The red star on the left side marks the initial Oak Ridge investment of $7.5 million dollars, assuming County participation in this project, and the solid black line rising to the right the General Fund revenue return expected for any realized new sales. The return ratio is slightly less than 2% for retail sales. The solid line crosses the horizontal axis at about $35 million dollars. In other words, with new realized sales of about $35 million, all City debt service would be returned. When sales grow above this level, cash would annually flow into the City for other uses. The green star marks the $60 million sales level which would return about $325,000 excess annually to Oak Ridge, or the equivalent of about 5 cents on the tax rate. Now you can pick any realized new sales that you can justify and compute the expected return. Also on the chart is a very faint green dotted oval that encompasses what I believe to be the most probable sales-to-yield relationships. Nearly the entire green oval is within the "green" portion of this figure! This is the only one of the three projects plotted that shows a solid return for our investment.

As you can see, Crestpointe is different! Yes, we should pursue Crestpointe if Anderson County participates with us as it should because we both profit! In other words, this project should be able to pay for itself if Anderson County participates by contributing $3 million, which will reduce City costs to a bearable $7.5 million level. The project pays for itself; it provides a viable shopping complex; and it has the potential to grow into a much larger revenue-producing entity.

2. What are the risks that we take in either selecting or rejecting this endeavor and what are the potential long-term costs?

The biggest single risk Oak Ridgers face is **the failure to develop growing General Fund revenue sources.** Regardless of how this failure occurs, the impact is the same. Just to do nothing will guarantee that we fall into this trap. The failure of the proposed $6 million dollar bond issue will have an even worse effect as it will most likely "brand" Oak Ridge for many years to come, impacting industrial recruitment as well as retail development. Today sales tax revenues are declining. They have been declining in real terms for more than 10 years and no trend reversal is anticipated. Oak Ridge has assumed the burden of a new $65 million dollar high school whose debt repayment is dependant upon future sales tax revenues; i.e., 0.5% of all future sales taxes have been committed to the high school project. Any shortfall of the sales tax revenues committed to the satisfaction of the high school debt service will result in an Oak Ridge property tax increase.

The Crestpointe proposal will include a number of guarantees and controls to protect all public investments, particularly those initial investments. The complex is guaranteed to contain a Target Super Store or it will not be built. In addition to the Target, it will most likely contain another anchor store. It is proposed to contain an expected total of 450,000 square feet of new, non-Anderson county retail stores, including a total of 17 new non-Anderson County retailers. GBT is a developer with a proven track record and they are willing to work with Oak Ridge to develop a binding contract with the needed city controls. There would be NO City-related finances transferred up-front; i.e., no money would be paid before the deliverables are achieved and certified at the start of the project and the Target contract has been finalized. The developer would also be required to make a minimum investment of $50 million in this project.

If contract agreements are consummated that contain the proposed controls, I expect the risks to the City to be both minimized and acceptable. There is discounting built into the sales estimates of all newly realized sales. For instance, it is estimated that Target would yield new sales taxes on about $24 million of taxable new sales, but it is expected to produce $50-62 million of total annual revenues for Target. Part of the difference between these numbers is the transfer of already existing sales taking place within Oak Ridge. About 40% of all expected City General Fund revenues would come from property taxes or property tax equivalents received through a PILOT (payment in lieu of taxes) agreement. The other 60% would come from newly realized sales taxes. The potential long-term risks would be primarily related to future patterns in buying and future loss of sales.

Figure 2. <u>Income/Property Tax Relationships</u>

Oak Ridge has enjoyed a flat or decreasing property tax rate for the last five years. City Council has done a magnificent job of both controlling expenditures and assisting real

> growth to increase revenues, even with declining sales tax revenues. But the opportunities to further increase non-property tax revenues are becoming limited. The impact of decreasing sales tax revenues in the face of increasing expenses is devastating. This is because property tax increases or services cuts are the only avenues for correction of the shortfall. Figure 2 depicts the critical decreasing sales tax revenues versus the increasing property tax burden that is evolving in Oak Ridge today. It is easy to see that property tax increases in the range of 10- 20% are possible with only 5% annual expenditure increases and our anticipated sales tax shortfall. We could soon see recurring double digit property tax rate increases annually if we do not attempt to halt the sales tax revenue decline.

Yes, there is a small risk of increasing property taxes through Crestpointe's failure to meet the minimum realized sales expectations. As you can see in Figure 1, that risk is minimal because with Anderson County's participation the green dotted football figure is mostly in the green region, indicating a very favorable impact on General Fund revenues. The maximum possible short-term tax rate impact is about a 12-cent burden if no new realized sales occurred. That is very unlikely. Long-term, there is always the potential for a shift in buying patterns that could be damaging and which cannot be risk-estimated today.

3. Will Crestpointe provide any new needed municipal revenues?

Even though Crestpointe's impact will be positive, I expect the usable General Fund cash yields to be small, but anything is better than nothing at all! I expect that it will produce between nothing to $250,000 annually. At best, this is approximately one-half of last year's additional "School Board" request of $500,000 dollars, which was denied by City Council because of insufficient revenues without an unacceptable property tax increase. There is significant future potential for new sales growth with the creation of a nice regional shopping complex which would achieve the sales needed by attracting additional people to the desired, national chain stores. It is also likely to improve the quality of surrounding shopping options by attracting higher quality stores.

Today, the Crestpointe proposal appears to be an economic wash with respect to the potential for increasing major new usable General Fund revenues, but there is no question that future increased retail sales will offer our best option for increasing City revenues. On Figure 1, the steepest, ascending lines are the retail sales alternatives.

4. With what is known today, what is my bottom line – Yes, No, or "Let's talk"?

Yes, we should pursue Crestpointe if Anderson County participates with us inasmuch as we both profit!

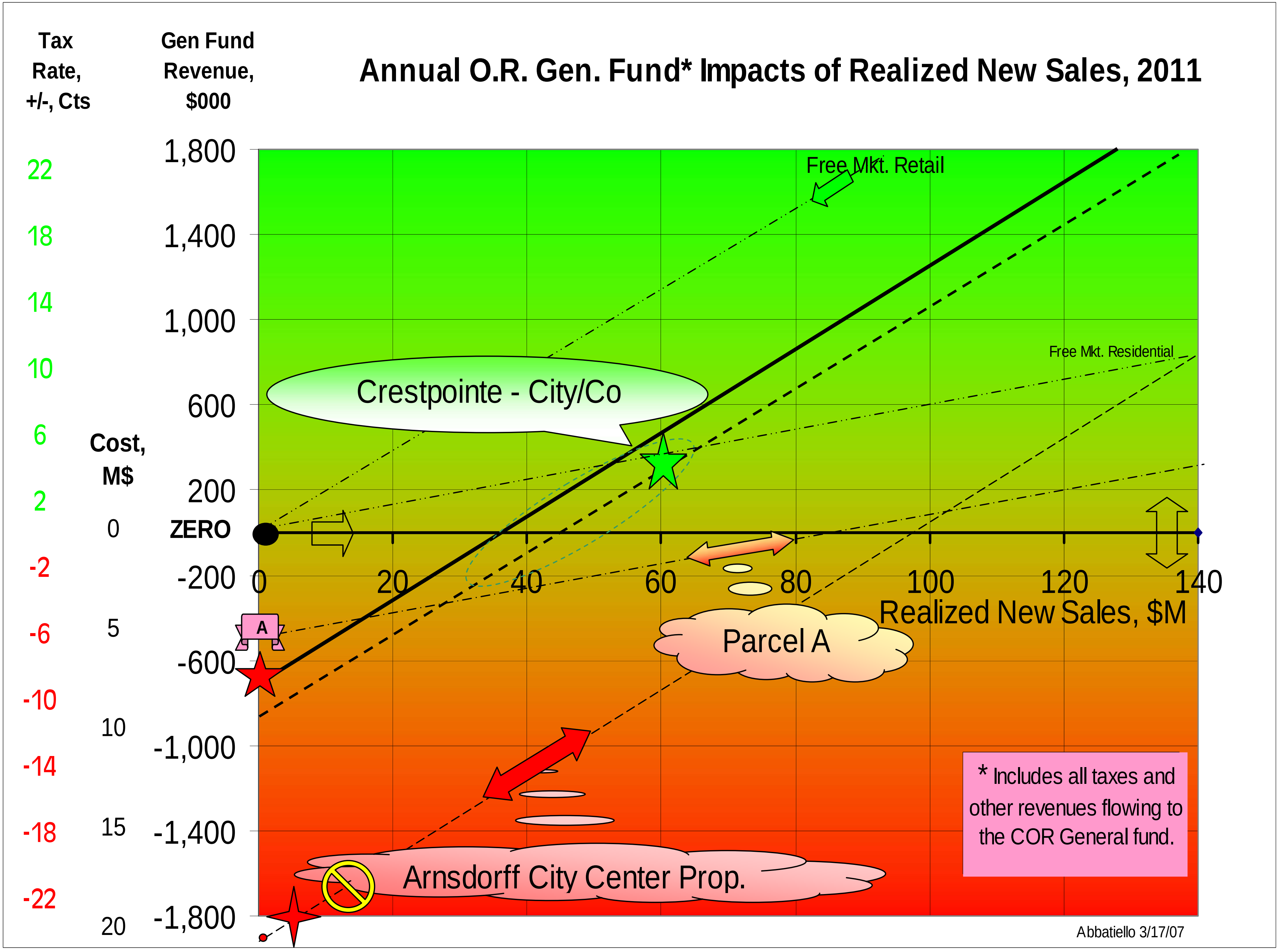
In summary, this project should be able to pay for itself if Anderson County participates by contributing $3 million, which reduces City costs to a bearable $7.5 million level. The project can pay for itself and provides a viable shopping complex, and it has the potential to grow into a much larger revenue-producing entity.

In any case, we need to continue the dialogue to develop and incorporate meaningful protection and controls into any retail development. Figure 1 clearly shows that Oak Ridge can afford to invest a maximum of about $7-8 million dollars if any retail complex project is to be affordable and profitable. Failure to develop new, sales-tax based City revenues will have a devastating impact on tomorrow's goals, such as the new high school staffing and the increased police protection, because Oak Ridge will not be able to maintain a competitive property tax environment in which we can sustain growth and the needed revenues. It is not possible to sustain our level of municipal services and support for the schools while remaining just a bedroom community. Without either new sales-tax based revenues or major new taxable industrial businesses, General Fund revenues will not keep pace with known expenditures. The result will be rapidly rising property tax rates.

If the City has to carry all of the $10.5 million dollar debt burden, then we should not invest in Crestpointe.

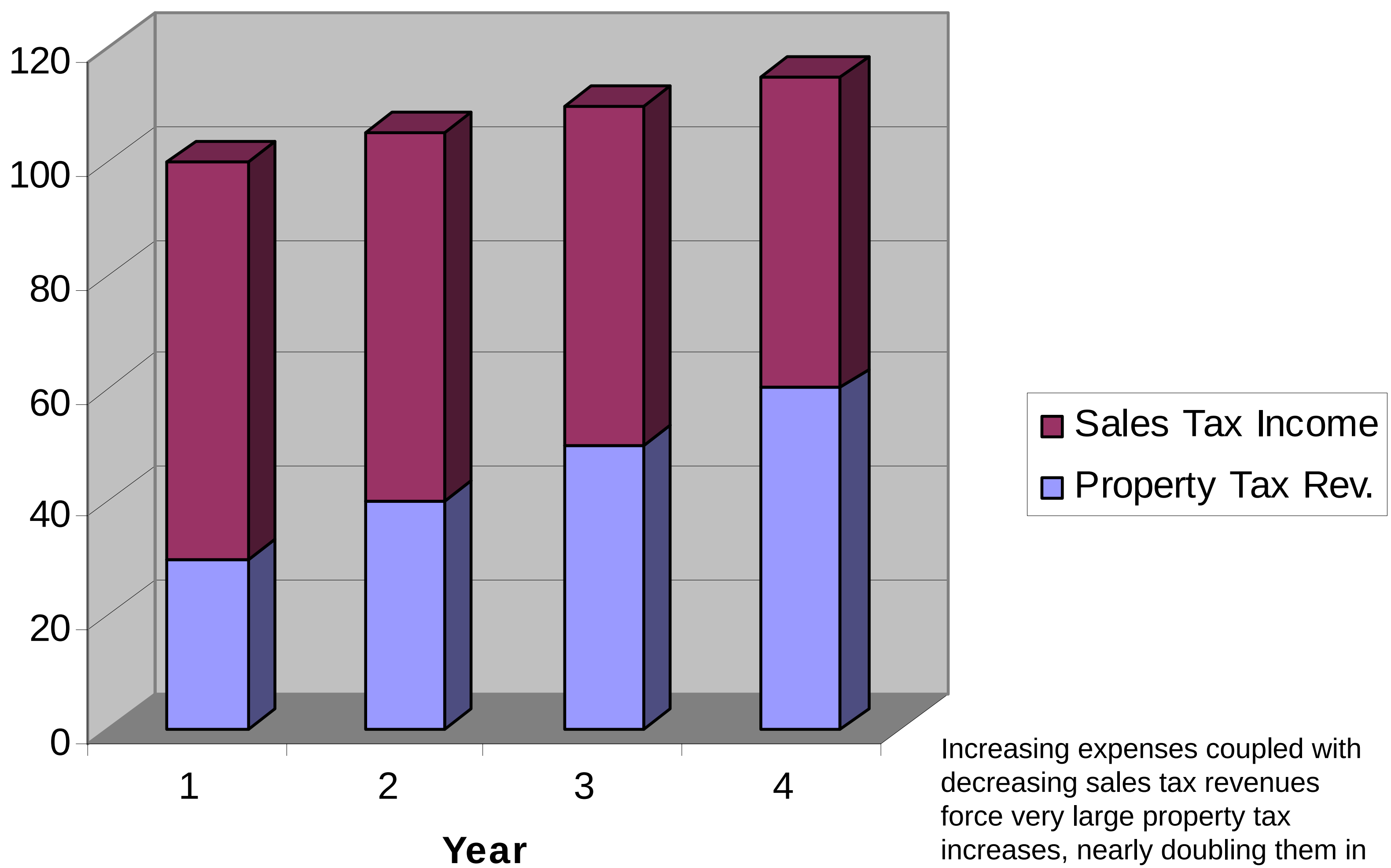
The biggest single risk every Oak Ridge citizen faces today is our failure to develop the required General Fund revenue sources. Regardless of what may cause this failure, the impact will be traumatic. Just to do nothing will guarantee failure. Failure to pass the proposed $6 million dollar bond issue supporting an affordable retail project will have an even worse effect as it will most likely cause Oak Ridge to be “branded” for many years to come, impacting both future industrial and retail development. Today sales tax revenues are declining. They have been declining in real terms for more than 10 years and no trend reversal is anticipated. We must be proactive to achieve a functional, affordable shopping complex that will yield new City revenues.

In my opinion, to do nothing is NOT an option! We must increase our non-property tax revenues within the very near future. Unless you have a better idea which can produce a higher General Fund return, you should support Crestpointe.



Annual O.R. Gen. Fund* Impacts of Realized New Sales, 2011
Tax Rate, +/-, Cts
Gen Fund Revenue, $000
Cost, M$
22
18
14
10
6
2
-2
-6
-10
-14
-18
-22
0
5
10
15
20
1,800
1,400
1,000
600
200
ZERO
-200
-600
-1,000
-1,400
-1,800
0
20
40
60
80
100
120
140
Realized New Sales, $M
Free Mkt. Retail
Free Mkt. Residential
Crestpointe - City/Co
Parcel A
A
Arnsdorff City Center Prop.
* Includes all taxes and other revenues flowing to the COR General fund.
Abbatiello 3/17/07

Income / Property Tax Relationships, Fig. 2



Increasing expenses coupled with decreasing sales tax revenues force very large property tax increases, nearly doubling them in this simple example.

Abbatiello, 3/17/07