

**Testimony
Of
Mayor J. Richard Gray,
City of Lancaster**

And

**Randy S. Patterson
Director of Economic Development & Neighborhood Revitalization
for the City of Lancaster**

**Joint Hearing of the House Commerce and Urban Affairs Committees
on the
City Revitalization and Improvement Zone Program**

Thursday, April 7, 2016

Testimony of Randy S. Patterson, Director of Economic Development &
Neighborhood Revitalization, City of Lancaster:

Thank you for the opportunity to present testimony regarding our experience with the CRIZ Program over the past two and a half years and recommendations we wish to present that will permit the program to become an effective economic development tool for eligible third class cities in the Commonwealth. You just heard from Mayor Gray about the very limited opportunities that third class cities have today to incentivize developers and businesses to consider moving back into the City to increase our tax base and provide employment opportunities for its residents. We worked closely with Senator Smucker, Representative Sturla and the General Assembly in crafting the CRIZ Program in 2012 and 2013. Now that we have had the opportunity to work with this new economic development tool over the past two and a half years, we believe essential amendments are needed to craft the Program in such a way that it strengthens the Program as an effective economic development tool and to achieve the goal of assisting the Commonwealth's eligible third class cities revitalize their economies, which in turn will strengthen the Commonwealth's economy.

The primary goal of the CRIZ Program is to assist economic development at the local level by using the new/additional incremental increase in revenues generated by new development or redevelopment of existing properties. Gaining support of the enabling legislation was not without challenges. Compromises had to be made to get establish the Program. Now, after working with the CRIZ, we have the experience to understand the challenges of the CRIZ program as structured and interpreted primarily by the Department of Revenue. Therefore, we

are grateful for this opportunity to present our recommendations to General Assembly and work together to make the CRIZ program the effective economic development tool that it can be.

The City of Lancaster and the CRIZ Authority have developed a program designed to address urban infill development and the redevelopment of vacant and/or underutilized buildings within the downtown business district and key commercial corridors of the City. Lancaster has a single large tract of undeveloped land in the northwest sector of the City where Lancaster General Health and Franklin & Marshall College, with the assistance of the Commonwealth, relocated and remediated the Norfolk Southern Switching Yard and demolished and remediated the former and vacated Armstrong plant where new development can occur similar to developing in surrounding townships on greenfield sites. With this exception, the key economic development need of the City is to drive development to underutilized and vacant properties that can grow the City's economy, and to redevelop those properties that have sat vacant and are having a negative impact on the City's economy.

The CRIZ Authority has established a CRIZ Program that steers developers and businesses to consider repurposing these sites. The key is to assist them in "making the numbers work." The issue in Lancaster, as in other small cities in the Commonwealth, is that we cannot command adequate market rate lease rates that enable a developer or business to renovate these properties, or demolish and build new structures, with any reasonable rate of return. We need to provide incentives to not only encourage the redevelopment of these properties but to also give certainty to financial institutions underwriting these projects that the "numbers work" and the loans can be expected to be repaid with reasonable risk.

With the exception of two projects in Lancaster, a neighborhood economic development project being undertaken by SACA Development Company, a non-profit development company, and assistance to the Lancaster County Convention Center for future FF&E expenditures to maintain the quality of the facility, projects to which the CRIZ Authority will commit CRIZ revenue it receives from the Commonwealth are required to obtain their own private financing to undertake a project. This insures that there is no additional public debt associated with the CRIZ financial assistance. A project must stand on its own from a financial underwriting perspective. If changes we are seeking are enacted, the CRIZ Authority will “pass through” to the developer or business only that CRIZ revenue which the project generates to assist in paying a portion of their debt service. The CRIZ Authority is not taking on the risk of providing direct financing to a project. It is, therefore, important that financial institutions are able to consider the CRIZ incremental revenue generated by the project as available for debt service.

The current method used by the Department of Revenue to calculate the annual CRIZ incremental increase in revenue generated over the baseline year (which for Lancaster is 2013) does not provide that level of certainty to financial institutions. It has, therefore, been difficult for potential development projects and/or businesses to raise the private financing required to undertake a project.

I would like to focus the majority of the remainder of my time on getting into the weeds of this issue, if you will bear with me. It is important that you have a clear understanding of the negative impact the current increment calculation being used by the Department of Revenue, based on its interpretation of the

legislative language, is having on a developer's or business's ability to obtain private financing for a project.

The critical issue is how the Department of Revenue is calculating the annual increment that is to be transferred into a City's CRIZ fund. The premise of revenue neutrality for the CRIZ Program is at the essence of the calculation. When developing the CRIZ Program it was agreed that the State would not receive any less revenue from **a business than that business had generated and paid to the State in the baseline year**. The Department of Revenue is interpreting the current legislative language to mean that the State would not receive any revenue below **the total amount of revenue received by all businesses located in the CRIZ**. The Department is taking a **total net revenue number generated by all businesses in the CRIZ and subtracting that number from the baseline year revenue number reported for all businesses in the CRIZ District**.

It is our position that this approach goes beyond the premise of the State not receiving less revenue in any subsequent year following the baseline year than **each business** generated in the baseline year. The current method used by the Department actually requires businesses that have generated increased CRIZ revenue in a subsequent year to offset losses of CRIZ revenue experienced by other businesses in the CRIZ. For example, if we had a business that generated a seven figure CRIZ revenue stream in the baseline year but in the subsequent year generated only a five figure revenue stream, the increases in incremental CRIZ revenue being generated by other businesses in the CRIZ are being used to offset that significant loss.

While we agree on the premise of revenue neutrality, we expected that the current language should be interpreted to undertake the annual calculation on a **business by business basis, not a net basis for the entire CRIZ**. The fact that any one business could have a loss of revenue below their baseline amount in a subsequent year should not penalize the actual increment available to the CRIZ Program. The State would have only received the actual revenue generated by that business in any subsequent year, with or without the CRIZ Program. The CRIZ Program was not generating the loss, it was the business that generated a lower revenue from the baseline year. We expected that as long as a business did not generate more revenue than it reported in the baseline year, that business would contribute \$0.00 to the annual increment. Only those businesses that did generate CRIZ revenue above the baseline would be added together to determine the actual annual CRIZ increment transferred to the Authority's account. **This still presents a revenue neutral position to the State on a business by business basis.**

The difference in methodologies is apparent when examining the City of Lancaster's 2014 CRIZ revenue. Under the Department's net calculation, the City actually had a deficit of revenue between the baseline amount in 2013 and the revenue reported in 2014. Therefore, the City received only \$2,870 last year from the State. This amount included no revenue from the 732 existing businesses currently located within the City's CRIZ District. The amount received was based only on a few new businesses locating in the CRIZ and contractor revenue.

Using the methodology the City expected the Department to use, the City should have received approximately \$1.5 million based on the reporting population. Looking into the details of the reporting even further, if we only looked at three businesses that had not opened in the City until late in 2013, those

three businesses alone created new incremental CRIZ revenue of more than \$300,000 in 2014. However, the Department's methodology required that this incremental revenue offset the lower revenue generated by other businesses in the CRIZ against their baseline revenue amount. The Department also bases its calculation against the entire CRIZ business population reporting in the baseline year, not just the reporting population in the subsequent year.

Why is this so critical? Developers and businesses are unable to obtain private financing to undertake their projects. For a financial institution to underwrite these projects, which are often already challenged using normal underwriting criteria, they must be able to depend on the project receiving the CRIZ incremental revenue the project is expected to generate from year to year. At this point in time developers have been unable to obtain financing for CRIZ projects because financial institutions understand that incremental increases in CRIZ revenue generated by a project may be used to offset CRIZ revenue losses experienced in any year by other businesses in the CRIZ. Financial institutions cannot view the CRIZ revenue expected to be generated by a project as available to pay debt service.

When the CRIZ Authority was negotiating with a local financial institution to issue a bank qualified tax revenue bond to finance the two projects I mentioned earlier, we were projecting that we would annually receive between \$750,000 and \$1.5 million a year in new incremental CRIZ revenue (sufficient revenue to cover the debt service). We were negotiating with the bank to issue this bond without any other required collateral. On the day we were finalizing the negotiations the State released the \$2,870 CRIZ revenue amount for 2014. The bank, recognizing how the Department of Revenue was calculating the CRIZ revenue increment,

determined that they would not proceed to provide the bond without a full guarantee by the City of Lancaster.

I should add that the City calculated its local CRIZ increment based on the reporting population for 2014 and the City determined the local contribution to the CRIZ fund would be \$126,000. This is based on only two revenue streams, the \$52.00 Local Services Tax and the City's share of the local Earned Income Tax, and only for those who work in the CRIZ and live in the City. While the CRIZ revenue stream is based on seven different State taxes.

The amendments we have been seeking to the CRIZ legislation are necessary to insure that the methodology we had anticipated the Department of Revenue would use to calculate the annual increment be based on a **business by business approach** rather than a **net calculation**. We have attempted to reach agreement through negotiation that the current legislative language does not prevent the Department from calculating the increment as we had anticipated. The Department, however, has indicated that without legislative changes it remains steadfast in its position that it is unable to calculate the annual CRIZ increment on any basis other than a net calculation. We believe that without the legislative changes proposed the City cannot expect to see any useful CRIZ incremental revenue in the next several years, if ever, to assist in financing economic development projects within the CRIZ.

In addition to this priority amendment, there are several other legislative amendments that we would request and those are outlined in the written testimony. In the interests of time I would simply like to mention them for the record but allow the additional written testimony to outline the details.

1. Permit CRIZ Authorities to use CRIZ Revenue it receives from the State and the City to offset costs of annual business reporting, compliance related issues and certification of the local increment, and accounting, as well as auditing which is already a permitted use. These costs can be extensive based on the number of businesses within the CRIZ District.
2. Permit CRIZ Authorities to use a small percentage of CRIZ revenue to cover the costs of general administration of the program. We have suggested no more than 5% of the annual increment generated.
3. Clearly identify the State Hotel Occupancy Tax as a CRIZ attributable tax. The original DCED Official Guidelines issued in November of 2014 lists the Hotel Occupancy Tax as a CRIZ attributable tax but the Department has since determined that the Hotel Occupancy Tax was not intended to be included. You will hear next from Mr. Meeder (the first project financed under the CRIZ Program) that he had expected the Hotel Occupancy Tax to be included when he prepared the financial projections. The loss of that anticipated revenue has created new financial challenges for the project. We are requesting that the Hotel Occupancy Tax be specifically identified in the legislation as a CRIZ attributable tax.
4. Allow CRIZ incremental revenue to be used to finance additional infrastructure costs related to a facility that may be located outside of the CRIZ District, but is an essential upgrade to enable a business to locate within the CRIZ. Costs related to electrical infrastructure, sewer and water infrastructure or technology upgrades should be permitted to be financed

with CRIZ revenues if those improvements are directly linked to the location of a business within the CRIZ. For example, a high tech company locating a data center in the CRIZ could require upgrades to a fiber optic network serving the building, or require an upgrade to an electrical substation located outside of the CRIZ to provide adequate service to the data center. The legislation is currently unclear on this issue and DCED has interpreted the current legislative language as prohibiting the use of CRIZ revenue for any infrastructure project located outside of the CRIZ.

5. Allow for the creation of a CRIZ District less than 130 acres at the outset of the Program rather than establishing that whatever acreage is included in the original CRIZ District in the application will be the size of the CRIZ for the full term of the Program. This current interpretation requires a City to include acreage at the outset when submitting the application to preserve the 130 acres size of the district going forward. Allowing the District to expand over time, up to 130 acres, as new projects come on line will reduce the administrative costs to both the City and the State, primarily through a reduced number of businesses reporting and certification of CRIZ revenue

Conclusion:

In summary, we believe the legislative amendments we have presented today are essential to making the CRIZ Program a successful economic development and job creation program for eligible third class cities like Lancaster and Bethlehem and for the State. The structure of the program today, as shown by the 2014 \$2,870 increment certified by the State for Lancaster's CRIZ Program, places roadblocks and unnecessary administrative burdens on both the local community

and the State that severely limits the program's effectiveness and ability to achieve its intended purpose.

Thank you for your time today and we look forward to a continuing dialogue on the CRIZ Program.

My contact information is as follows:

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