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Fourth Time's the Charm?

Redeveloping the Former WTC Building

August 26, 2014

In April 2014, the city and the New Orleans Building Corporation (NOBC) terminated lease negotiations with the group selected to redevelop 2 Canal Street, the 33-story vacant office building formerly known as the World Trade Center. The move marked the end of the third unsuccessful attempt to redevelop the building since the late 1990s.

The city and NOBC had pursued the first two attempts in partnership with the building's master tenant at the time (the World Trade Center of New Orleans, Inc.). The first effort lasted eight years, terminating in 2006. A new developer was chosen in 2007, but withdrew in 2008. In 2012, the city and NOBC bought out the master tenant's remaining leasehold interest. The following year, they issued a new Request for Proposals (RFP) and selected a developer, but ultimately could not come to terms.[1]

In all three cases, the city and NOBC sought to negotiate a 99-year lease with the selected developer. They are now planning to issue a fourth RFP.[2] But with three previous attempts having failed – despite the building's prime location – it is time for the city and NOBC to consider taking a different approach: an outright sale of the building.

BGR recommended the sale option in 2009. To simplify the redevelopment process, BGR called for a buy-out of the master tenant's remaining leasehold interest and a clean sale. The city and NOBC took action on the first part, but not the second.

BGR now reiterates its recommendation. The city should set a minimum price that approximates fair market value and sell to the highest bidder willing to accept a redevelopment timeline with penalties, including a recapture provision, for nonperformance.

There are several advantages to a sale.

Greater Transparency. A sale of the building would occur through an open bid process, rather than the RFP process that the city and NOBC used in previous failed lease transactions. A bid process is by its nature more transparent than an RFP process. Its outcome is determined by objective factors, while an RFP process involves some degree of subjectivity and negotiation.

Ultimately, taking bids would minimize the potential for political influence and promote competition among interested developers. The public would have confidence that the market will determine the outcome. The bid process would also address the credibility problem that has arisen from the previous failed development attempts.

Open Competition. Open competition among bidders offers the best opportunity for the city to get full value for the building. According to the administration, the city's most recent appraisal, which should be brought current, put the value at $23.5 million. If that were the minimum in a bid process, it would ensure that the city gets at least that much. Competition among bidders could push the price higher. This contrasts with an RFP process, in which price is ultimately subject to negotiation with the selected developer.

Placing the Building on the Tax Roll. Currently, the publicly owned building is exempt from property taxation. A clean sale to a business would place the entire building on the tax roll through the normal assessment and taxation process.[3] It would also avoid the perils of negotiating a developer's taxes in the context of a lease. Any request for a tax break (such as a restoration tax abatement) would have to go through normal channels and processes.

We note there is a limited risk that a nonprofit or other governmental entity would buy the building and use it for an exempt purpose, keeping it off the tax roll indefinitely. However, the risk seems small given the strategic location of the building in the downtown residential and hotel market.

Receiving the Building's Value Up Front. Another advantage to a sale is that the city gets paid the full value of the building up front. This would avoid the risk of a lessee defaulting on rental payments or seeking renegotiation of rents on more favorable terms. For a lease to have the same effect, all rent would have to be prepaid.

Avoiding Long-Term Monitoring. A sale would eliminate the need for the city to remain actively involved with the site. A lease transaction, by contrast, would require continuous monitoring of the lessee's compliance with the terms of the deal.

There are some potential disadvantages to selling. First, some might argue that the city and NOBC would surrender significant control over the redevelopment of a key downtown site. By awarding the building to the highest bidder, they might miss out on a more catalytic or desirable project. But after more than 15 years of failed development efforts, adhering to the same course of action appears to be a greater risk.

In addition, some might argue that a lease is preferable to a sale because it would provide the cash-strapped city with a recurring source of revenue. However, the city could create a comparable revenue stream by investing the proceeds of a sale. For example, if a developer offered $25 million in present value to lease the building, a 99-year lease would generate an annual payment of $1.1 million. Investing $25 million in sale proceeds would generate approximately $1 million a year.[4]

We note that under the city charter, it is likely that sale proceeds would have to be placed in a trust fund.[5] In that case, a maximum of 80% of annual earnings – or $800,000 a year in our example – could go to the general fund.[6] The rest would accrue to the city's benefit in the trust fund, growing the initial $25 million balance and future earnings.[7] Alternatively, subject to charter requirements, the city could gradually draw down the trust fund for high-priority capital projects, sparing taxpayers the cost of borrowing those funds.

Given all of the advantages of a sale, the city and NOBC should pursue a transparent bid process to jumpstart redevelopment. This approach offers the best chance to receive full value for the property, reduce long-term risk and place the property on the tax roll. After three failed RFP processes spanning a decade and a half, it is time to take a new approach.

ENDNOTES

1 For BGR's past reports on the redevelopment efforts, see www.bgr.org/reports/category/world-trade-center/.
2 Letter to the Editor from Cedric Grant, Deputy Mayor of Facilities, Infrastructure and Community Development, *The Times-Picayune*, May 23, 2014.
3 The city anticipates that the leasehold improvements – the vast majority of the value of the redeveloped building – would also be subject to ad valorem taxation under a lease for commercial use.
4 BGR calculations use a discount rate of 6%. In the 99-year lease scenario, the annual lease payment to produce $25 million present value would be a payment of $1.1 million, adjusted every five years to offset inflation. The inflation adjustment assumes 2% annual growth in the Consumer Price Index (roughly 10% every five years). In the sale scenario, BGR assumed an investment return of 4% per year based on a portfolio of long-term bonds and U.S. Treasury debt.
5 Section 6-307 requires net proceeds from the sale of city-owned real estate with a sale price in excess of $5 million to be placed in the New Orleans Municipal Trust Fund. The charter would allow the City Council to appropriate annually up to 80% of the fund's earnings to the city's General Fund. Alternatively, in any year, the council could, by two-thirds vote, appropriate 50% of the amount contained in the trust fund to the city's capital projects fund.
6 Over 99 years, assuming a 6% discount rate, this payment stream would be worth $16.2 million present value.
7 The residual earnings over 99 years, assuming a 6% discount rate, would have a present value of $4.1 million.