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From Main Street to the Governor's Office

By Ray Watson; Contributor: Christopher Shields

AN ALLIANCE FOR ECONOMIC REDEVELOPMENT

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How does a small suburban municipality that is generating absolutely no interest from developers and losing an average of $100,000 per year in tax revenue because of an abandoned mall and declining business district become home to one of the largest economic development incentive deals in Texas, all within the span of less than 15 months? The answer is perseverance and cooperation.

These were the daunting circumstances that Windcrest, Texas, faced in the spring of 2006. During the next year, extraordinary levels of intergovernmental cooperation and new EDC leadership would lay the groundwork for an economic transformation that previously had been considered almost unthinkable in this San Antonio suburb.

At the center of Windcrest's harsh reality was Windsor Park Mall, an abandoned shopping complex with 1.2 million square feet of space whose steady loss of tenants and eventual closure had precipitated the community's economic decline by the end of the 1990s. For more than two decades, the mall's presence had fueled economic activity along Walzem Road, Windcrest's main thoroughfare that formed the northern border of the mall property.

"As the mall goes, so goes Windcrest" was a truthful refrain that at one time could have been used to celebrate the community's prosperity. In more recent years, these words had become little more than a painful reminder for residents and community leaders that their previously insulated northeast corner of the San Antonio metropolitan area was feeling the encroachment of urban decay and a lack of concern from the other municipalities surrounding Windcrest.

Photo courtesy of Placemakers (Scott Doyon)

Out-of-date signs depicting the former mall's name will soon be replaced with Rackspace branded signage.

This is the uphill struggle that faced the Windcrest Economic Development Corporation (WEDC) (www.ci.windcrest.tx.us) in the spring of 2006. The other obstacle facing the corporation was that it had new staff leadership coming in and did not know if the new executive director would be up to the challenge. The new person had to overcome the fact that Windcrest's image had been severely tarnished. Negative perceptions of the area were being perpetuated by media reports of violence and gang activity in the vicinity.

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AN ALLIANCE FOR ECONOMIC REDEVELOPMENT

Knowing that the vitality of the city of Windcrest, a municipality of 5,300 residents located northeast of San Antonio, was directly linked to the vitality of the neighboring businesses, Windcrest leaders began laying the groundwork for an initiative to revitalize the adjacent corridor. This corridor was once a thriving area that had in the last decade seen a dramatic decline in business activity, appraisal values, and sales tax revenues following the closing of nearby Windsor Park Mall. Through collaborative efforts including city, county, and state representatives, Windcrest was able to spearhead a complex and innovative economic incentive package that allowed technology company Rackspace to relocate to the former mall property.

The new leadership also had to surmount a very tangible obstacle to new business investment: undervalued land. The rest of Bexar County was appreciating at an average rate of 16 percent, while values in the Windcrest area were rising only about 4 to 6 percent annually.

Since the mall had long served as the hub of economic activity for Windcrest, the WEDC, City Administrator Ronnie Cain, Mayor Jack Leonhardt, and County Commissioner Tommy Adkisson knew that finding an effective use for the mall property was essential to restoring Windcrest's economic vigor and they had a vision that just needed to be put into motion. Unfortunately, Windcrest was in no position to bring about any such project on its own. The city didn't own the mall property. It was split among three separate owners. The mall wasn't even within the Windcrest city limits. The site was just across the line in San Antonio.

Restoring vitality to the mall property would have to involve partners in both the public and private sectors. City leaders determined that the only way to begin plotting an effective course was to gain control of the mall by bringing it under single ownership. The city had little to contribute to a purchase, at least not in traditional ways. Aside from declining revenues, Windcrest had always been a fiscally conservative community whose citizens were extremely adverse to debt. Since conventional financing avenues could not be considered, a private funding source would be needed.

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PIECES OF A PUZZLE

Outreach efforts among various private real estate investors / developers led to the first piece of a very complex puzzle falling into place. A multi-state consortium of private investors (one from the San Antonio area and two from Louisiana) who had been looking for an opportunity such as this came together to form a limited liability company, the Windcrest Economic Development Company, L.L.C., and partnered with the Windcrest Economic Development Corporation (WEDC) to buy the mall for $27 million in April 2007 with the intent of offering a lease-to-buy proposal to a future anchor tenant.

The consortium provided all of the capital needed to buy the mall site from the multiple owners, so that the city of Windcrest and the WEDC incurred no financial liability and the only recourse was the mall itself. Their role was to eliminate procedural obstacles to redevelopment and extend incentives to attract investment.

The acquisition of the 68-acre mall property made it possible for the mall to be listed under the WEDC's name on deed records and, therefore, taken off the tax rolls. This strategy was meant to accommodate the consortium and entice potential tenants, since it would allow the mall and all improvements and tangible personal property to be exempt from city, county, and school district property taxes during the term of a lease agreement. The vision for the mall structure was that it would ultimately function as a company headquarters in a corporate campus setting.

Photo courtesy of Placemakers (Scott Doyon)

The former Mervyn's building is the first section of the mall to undergo renovations.

Under Texas' very complex school finance system, it is difficult to secure exemptions from school property taxes. These local property taxes constitute as much as 60 percent of the local property tax burden and are a key consideration for any company planning a major capital investment. WEDC was able to provide the exemption through a unique tax provision that is available only to economic development corporations. With minor exceptions, the school district is not negatively impacted, as the state holds the local school district "harmless" from any change in its level of school funding.

Windcrest and the consortium expanded upon this concept by outlining a plan whereby the consortium through personal financing would purchase 303 additional acres of property in the immediate vicinity of the mall at a cost of more than $40 million. These parcels were intended to provide room for the development opportunities that the reutilization of the mall property was expected to prompt. This land was also intended to help the investors increase the return on their investment and give Windcrest and other local taxing entities greater gains in the future.

The consortium formulated a plan that would integrate the mall property with a mixed-use development on the adjacent acreage. This additional development would include retail, commercial and residential facilities, as well as recreational and lifestyle amenities, that would be designed to complement the corporate culture of any tenant that would occupy the former mall structure.

Despite securing private funding and having a concept for the project, the intricate nature of Windcrest's ultimate objectives required that several political hurdles would have to be cleared before the project could gain momentum. In particular, Windcrest eventually hoped to gain additional tax revenue by bringing the mall and the adjacent properties inside its city limits.

Purchasing the mall site had not been a problem because current state economic development statutes allowed a municipality to purchase land that was outside of its city limits, as long as the land was to be part of a project that involved adjacent land within its city limits. Gaining future tax revenue from the mall site and nearby properties, though, was not a possibility for Windcrest because the land was outside its jurisdiction. Furthermore, even if a mechanism for effecting a boundary change was put into place, San Antonio would have to be persuaded to go along with the proposal.

CONSENSUS BUILDING

Windcrest representatives engaged in an exhaustive series of meetings from the fall of 2006 through the spring of 2007 to help state and local officials understand the merits of their project and gain support. Windcrest's core message was that reinvigorating the mall area and the Walzem Road corridor was not just a Windcrest issue. Windcrest leaders contended that their objective was good for the entire northeastern section of the metro area and Bexar County, since the ancillary growth that would result would spread into these nearby areas.

Persistence paid off. During the 2007 session of the Texas Legislature, State Representative Joe Straus authored a bill, co-sponsored by State Senator Jeff Wentworth, that would allow cities of similar size and demographics to the cities of Windcrest and San Antonio with a similar situation as Windsor Park Mall to negotiate a revision of their boundary lines that separate them. The legislation called for San Antonio to relinquish the mall property and the adjacent tracts of land and for the Windcrest city limits to be extended to include them. The bill, which the legislature eventually passed, combined with Judge Nelson Wolff's (county judge, Bexar County Commissioners Court) influence helped spur talks between the two cities.

San Antonio representatives initially were not convinced of the need to transfer property to Windcrest, in order to help redevelopment move forward. Windcrest officials explained that their collaboration with the investment consortium and the use of the property tax exemption/lease back provision available only to economic development corporations made it imperative that Windcrest acquire the property. The proposed tax abatement structure was worth several tens of millions of dollars to the right tenant. Without this transfer, the project could not progress and the metro area would squander a chance for extraordinary economic expansion.

FILLING A VOID

As the political considerations were being sorted out, Windcrest was simultaneously intensifying its efforts to secure a tenant for the mall site. Initial discussions involved Nationwide Insurance, but a homegrown, San Antonio-based technology company soon entered the picture. Rackspace Managed Hosting, the fastest-growing managed hosting specialist in the world, expressed interest in the location because of its potential to accommodate the company's rapidly expanding workforce. Rackspace, which also has facilities in Dallas, Washington, D.C., and London, projected that its 1,800 employees would more than triple in the next four to five years. When discussions between Windcrest and Rackspace began in the summer of 2006, Rackspace was already exploring options for relocating its headquarters to other cities and states.

Windcrest crafted a package of incentives for Rackspace that necessitated another enormous diplomatic effort for Windcrest to spearhead. The package was largely a mixture of tax abatements and bond money tied to a 30-year lease offer. The lease included a 14-year property tax exemption that had been approved by the affected city and county taxing entities.

Photo courtesy of Rackspace and Sixth Seal

With a focus on green building techniques, Rackspace plans to utilize the facility's 18-foot-high ceilings by positioning offices on raised floors that will house sub-level heating and cooling systems.

Windcrest and Rackspace representatives wanted to ensure that the Northeast Independent School District did not lose any school funding as a result of the mall project, and could even come out ahead. As a result, the agreement called for the tenant to make "payments in lieu of taxes" (PILOT) during the abatement period equal to the amount of interest and sinking fund monies that the company would have paid under normal circumstances. In Texas, these dollars are used to provide school facilities and are separate from the "maintenance and operations" taxes that constitute the majority of school property taxes. Along with PILOT payments, the tenant would be required to pay full sales taxes on local sales made throughout the lease period.

Photo courtesy of Rackspace and Sixth Seal

Remodeling of the former Mervyn's building began in fall 2007 with an expected completion of this section in spring 2008 when the first Rackers move into their new offices.

The initial incentive package also called for Windcrest to issue approximately $100 million in taxable lease revenue bonds to finance the initial renovation of the mall to suit the tenant's needs, as well as pay back the consortium for the purchase of the mall property itself. Additional bond issues for as much as $200 million would be made available for further renovation and expansion projects in the area. The bonds would be payable solely with the lease payments. No general fund, property taxes or sales taxes were to be used and the bonds would solely be based on the company's credit. Additionally, Windcrest was to serve as general contractor for the tenant during the remodeling of the mall to save the 8.25 percent sales tax on the materials used in completing improvements to the mall. At the end of the lease term, the mall property would be conveyed to the tenant for $1 under an agreement between the city and Rackspace.

Finalizing the framework of incentives for Rackspace represented only part of the battle for Windcrest representatives. They also had to address a number of peripheral concerns that involved the city of San Antonio and the state of Texas.

In return for San Antonio's agreement to relinquish the mall site and the adjacent acreage, Windcrest negotiated a revenue-sharing agreement with its neighbor. Windcrest would pay San Antonio the current level of property taxes that it was already receiving from the properties plus 50 percent of all property and sales taxes that would be generated during the course of the 30-year lease period. San Antonio would be guaranteed at least $4.1 million, but could collect as much as $34.5 million.

An opinion by the Texas attorney general, meanwhile, created the need for Windcrest to provide further reassurances to Rackspace of the fundamental soundness of the project. The opinion suggested that combining the tax abatements offered to Rackspace within the framework of the lease-back agreement could be deemed unconstitutional in a court challenge. For example if a taxing district decided that it did not approve of an incentive package that the city or other governmental agency offered to a company, that district could file a suit against the constitutionality of the package, thus forcing the attorney general's office to make a ruling one way or another.

To allay any possible fears on the part of Rackspace, Windcrest entered into an agreement under Section 380 of the Texas Local Government Code, which contains a "make whole" provision. It would obligate Windcrest to compensate Rackspace for any tax liability that it might incur, if the laws that allowed Rackspace's tax exemption were to change in the future. Bexar County (spearheaded by Commissioner Adkisson and David Marquez of the Bexar County Economic Development Department) also gave a Section 381 agreement – a similar government code designed specifically for counties – to guarantee its portion.

Approval of the grant from the Texas Enterprise Fund and the commitment for job training dollars from the Skills Development Fund amounted to the final pieces of a redevelopment puzzle that took more than a year to complete.

Even as Windcrest eliminated obstacles and enhanced the existing proposal for Rackspace, city representatives sought to exhaust all enticement possibilities. They approached the Texas governor's office with the plan for their project and the proposal for Rackspace, in hopes of garnering a grant from the Texas Enterprise Fund (TEF). This fund was a key factor in 2005, 2006, and 2007 when Texas won *Site Selection* magazine's Governor's Cup award, which is presented to the state that secures the most projects in a given year to build or expand corporate facilities.

The case for receiving grant funding was compelling, given Rackspace's projected growth, the prospect that its relocation would spawn related economic activity, and the need for revitalization in the Windcrest area. Despite this compelling case, there were several hurdles to cross to secure funding.

As with most state programs, there is some sense of the need for geographical distribution, and there was a general perception that San Antonio had gotten its fair share from the TEF during the past two years. In addition to that, the legislature helped provide incentives for the Toyota facility, although the TEF had not yet been created; that package included training dollars, infrastructure improvement, land purchase, site preparation work dollars, as well as a facility in which to train Toyota employees. Every other region of the state had certainly taken notice of the San Antonio region's recent success in attracting major new investments.

After a great presentation by the company and some key support from local legislative leadership, the state responded by approving $22 million for the project. This is one of the largest grants awarded from the TEF and represented a significant percentage of the dollars that were available for the balance of the fiscal year.

Representatives of the governor's office projected that the state would receive a return that is far greater in new sales tax revenues alone than the amount of the grant award. They also estimated that keeping Rackspace from moving would generate more than $400 million in capital investment in Texas. There were no stipulations assigned to the money, so Rackspace could use it for any purpose that the company saw fit.

The state was able to provide one additional incentive to urge Rackspace to grow in Texas as it became clear that at least two other states were willing to provide substantial incentives to Rackspace. That additional incentive was in the form of $4 million of job training funds through the state's Skills Development Fund. Working through the region's community college district, these funds will help ensure the quality and availability of the workforce that is critical to Rackspace's success.

Approval of the grant from the Texas Enterprise Fund and the commitment for job training dollars from the Skills Development Fund amounted to the final pieces of a redevelopment puzzle that took more than a year to complete. On August 3, 2007, Windcrest publicly announced that Rackspace had signed an agreement to occupy the former Windsor Park Mall site and take it on as the company's corporate headquarters, with visions of a Google, Apple, and Adobe world headquarters.

LOOKING AHEAD

The outlook for Windcrest and its Walzem Road corridor changed almost overnight with Rackspace's commitment. In all, as many as 6,000 Rackspace employees are expected to be working in the remodeled mall structure within the next five years. Their average salary of $51,000 will result in a payroll in excess of $300 million. Along with Rackspace's relocation, the investment consortium has obtained 111 acres south of the mall site that will be developed into a $225 million mixed-use project that feeds into Rackspace's needs and was part of the consortium's original vision for the area.

These figures are just the hard numbers. The completion of this deal is bringing renewed recognition and interest to Windcrest, which bodes well for future property values and tax revenue. Just since the August announcement, at least nine developers have contacted Windcrest about opportunities associated with the Rackspace agreement, some of whom were not interested in the area prior to Rackspace.

Additionally, in December 2007, the Windcrest Economic Development Company hosted a weeklong, public design planning process, known as a charrette (www.whatsnextforwindsorpark.com), with renowned architect and city planner Andrés Duany of Duany Plater-Zyberk & Company (DPZ). The DPZ team has since finalized a master-plan for a true, mixed-use development south of the mall that will feed into the youthful culture that Rackspace is bringing to the area. Currently, the development company is working with a number of other investors and developers to evaluate their potential fit into this development.

The Windcrest experience is not easily modeled. Public-private partnerships tend to involve two, or maybe, three partners, not the five-member coalition that has launched this redevelopment initiative. What other municipalities and economic development corporations can glean from this case is a lesson in perseverance and a key to forging and maintaining alliances: focusing on the common good. The fundamentals of this project were sound. Moving forward became a matter of educating different audiences about the collective benefits that could be achieved for the area as a whole, if each group could understand and accept its role, and retaining legal counsel that could steer through the complexities of the project.

In this particular case, Windcrest benefited from lawyers who were also economic development special-

Project Timeline

- **October 2005 –** First public meeting held in Windcrest to discuss revitalization needs.
- **January 2006 –** The Walzem Road Area Revitalization organization was formed by citizens concerned about area decline.
- **June 2006 –** Ray Watson hired as executive director of the Windcrest Economic Development Corporation.
- **July 2006 –** Windcrest Economic Development Corporation and city of Windcrest meet with Rackspace to discuss options for the company relocating to the area.
- **September 2006 –** Private real estate developers / investors partner to form the Windcrest Economic Development Company, LLC.
- **April 2007 –** Windcrest announces ownership of former Windsor Park Mall property.
- **May 2007 –** City councils from San Antonio and Windcrest vote to approve a boundary redistribution to place the mall under the jurisdiction of the city of Windcrest.
- **August 2007 –**
  – City councils from San Antonio and Windcrest vote to approve the entire economic incentive package being offered to Rackspace;
  – Rackspace signs a lease to relocate its company headquarters to the former Windsor Park Mall.
- **November 2007 –** Redesign of the mall property begins.
- **December 2007 –** Area developers host public planning meetings to initiate master design plans for the area surrounding the mall.
- **Projected in April 2008 –** Rackspace expects to move several hundred employees to its new headquarters in Windcrest.

ists. In fact, Chris Shields, the attorney who originally helped outline the structure of the incentive package for Rackspace, actually helped draft the legislation more than a decade ago that authorized the property tax abatements that made this deal possible. Shields recommended Jim Plummer, a tax partner at the law firm of Fulbright & Jaworski, to handle the implementation and documentation for the transaction. Together, Shields and Plummer guided all of the multiple parties involved through a very complex transaction.

Economic development is different today than it was in the relatively recent past. Globalization and outsourcing have brought new competitive pressures to bear on the process. Public sector entities typically are not subject to market forces, but the current environment demands that they adopt a more aggressive stance when it comes to attracting new investment and nurturing ongoing economic activity. Existing jobs, and entire companies, can quickly be relocated, given the many incentives that exist for them to do so. Remaining economically viable may involve exploring nontraditional funding sources. It also could require collaboration, not only with the private sector, but with other governmental bodies as well.

Forming strategic alliances to generate economies of scale was once a practice reserved almost exclusively for the private sector. Today, employing such tactics should be a common approach for the public sector as well. Before starting a project like this, participants especially will need creative legal counsel that understands how economic development works.

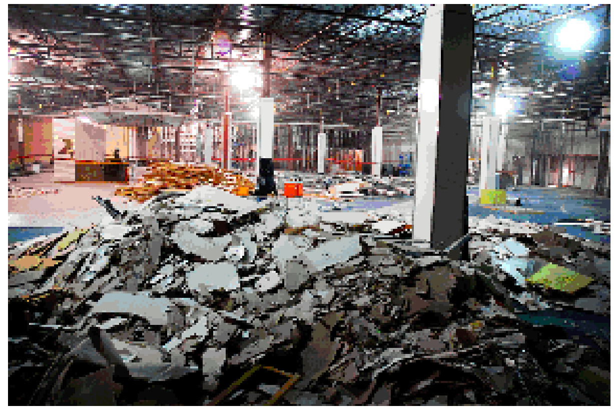

Photo courtesy of Rackspace and Sixth Seal

Demolition of the second floor of the former Mervyn's building began in fall 2007 in preparation for the first several hundred Rackspace employees moving into their new offices in spring 2008.

Special thanks to:

The state of Texas

Rackspace

Bexar County

City of Windcrest

City of San Antonio

Christopher S. Shields, P.C.

Jim Plummer, Fulbright & Jaworski

Walzem Road Area Revitalization Group