
Negotiating Better Development Agreements

Lawrence E. Susskind

Some American cities demand that developers pay "linkage fees" (sometimes called exactions) over-and-above required property taxes. Presumably, these are meant to cover short-term costs and "social impacts" that exceed the development's expected tax payments. The level of linkage payments in each city is determined either through case-by-case negotiations (as in Boston) or by the application of a formula that assumes an average charge per square foot (as in San Francisco). My aim in this column is to review the strengths and weaknesses of these two approaches, then describe still another approach that I think will produce superior negotiated development agreements.

In many situations, particularly those involving real estate or development, the parties assume that there is no overlap between what one is prepared to offer and what the other is likely to accept. Indeed, such an assumption guides many negotiations. Unfortunately, if there is a zone of overlap and not a gap, but the parties adopt a gap-oriented negotiating strategy, they will probably produce unsatisfactory results.

Consider, for instance, the following case:¹

John Ryan represents the Mayor of Middletown. The Mayor has asked John to meet with Anna Rinaldi, one of the city's most successful developers. Rinaldi Construction has indicated to the Middletown Redevelopment Authority that it wants to redevelop almost six vacant acres near the old railroad yard at the edge of the downtown area. Rinaldi proposes an elaborate, mixed-use project the likes of which Middletown has never seen including a new hotel complex, an exhibition hall, high-priced condominiums, and thousands of square feet of shops and offices. For Rinaldi to proceed, the city must rezone the land.

Not only are the residents in the adjacent neighborhood up in arms, but most of the environmental, historic preservation, and social welfare groups in the city oppose the project. The Mayor however, still hopes to proceed. He believes that the city's need for additional tax revenue and new jobs outweighs whatever adverse impacts the project might have. He realizes, though, that he must do something to satisfy the opponents. He wants Rinaldi to make a one-time-only "contribution" to a new city Revitalization Fund. Given the cutbacks in federal and state devel-

Professor of Urban Studies and Planning at the Massachusetts Institute of Technology, **Lawrence E. Susskind** is Associate Director of the Program on Negotiation at Harvard Law School, 500 Pound Hall, Cambridge, Mass. 02138. His latest book, written with Jeffrey Cruickshank, is *Dealing With Differences: Practical Approaches to Resolving Public Disputes*, which will be published later this year by Basic Books, New York. Professor Susskind has served as a mediator in local, state, and national policy disputes.

opment grants, cities all over the country are seeking new sources of revenue similar to the “contribution,” or linkage fee, he proposes.

Middletown has never imposed linkage fees before (a not surprising fact, given the great difficulty the city has had attracting private investment). On the other hand, the city has never seen a developer as anxious as Rinaldi is to build such a substantial project. Since the project cannot proceed without a rezoning (as well as other city commitments), the Mayor believes he can convince the developer to make a contribution to the Revitalization Fund that will be large enough to satisfy opponents of the project and to help the city out financially. A precedent would be set that other developers would be hard-pressed to ignore.

Ryan is about to meet with Rinaldi. Rinaldi knows that the Mayor wants her to make a contribution to the Fund. Each has thought through the situation.

Ryan’s Assessment

Ryan thinks to himself, “The larger the contribution from Rinaldi, the better. While the Mayor hasn’t specified a figure, a quick review of linkage formulas in other cities suggests that something on the order of \$3.00 per square foot would be appropriate. That would yield about \$650,000 if we assume about five acres of buildable space. On the other hand, we don’t have any studies indicating the costs or impacts the project will impose on nearby neighborhoods or the rest of the city. Moreover, we have no formal linkage policy in place.

“Since the point is to set a precedent, I have decided to ask for \$350,000 in the hope of getting \$250,000. While I’m sure the Mayor can live with that, he will undoubtedly want me to secure as large a contribution as possible.”

Rinaldi’s Assessment

Rinaldi thinks to herself, “From my standpoint, the Mayor’s request borders on blackmail, especially since he’s hinted that I might not get the rezoning I need if I don’t agree to make a ‘contribution’. On the other hand, it is probably true that the project will impose certain short-term costs on the city and adjacent neighborhoods that won’t be made up in property taxes. If everything my consultants tell me is correct, I will make a great deal of money on this project—as much as \$20 to \$30 million over ten years. While there are risks involved in being first into a new area, I already have an agreement from a hotel chain that wants to locate in Middletown. If all goes well, I will realize almost a 20 percent return on my investment. Thus, I have a lot to lose. As long as I can describe my contribution as a gift (rather than a fee I was forced to pay), I won’t be setting a bad precedent. I’ll pay \$1 million if I have to; but I’d like to keep the amount as low as possible.”

Possible Scenarios

What will happen when Ryan and Rinaldi meet? Assuming that both adopt positional bargaining strategies, I can see three scenarios:

Scenario 1: Ryan anchors the give-and-take by being the first to suggest a number. He mentions \$300,000. Rinaldi hesitates briefly (not wanting to appear too eager), then agrees to make a one-time-only “gift” at that level. Ryan senses that he asked for too little. He is angry at himself but it’s too late. He decides to let the Mayor know that Rinaldi is likely to make even more money on the project than they had figured. He will suggest to the Mayor that they try to get Rinaldi to cover still other costs that would save the city money. Ryan certainly won’t discourage the neighbor-

hood associations from pressing her for additional commitments.

Scenario II: In an effort to preempt what she expects to be an onerous request, Rinaldi anchors the give-and-take by indicating a willingness to pay \$700,000. Ryan quickly agrees. Rinaldi realizes she overestimated what the city was expecting. She makes up her mind to turn down any further neighborhood requests for assistance. She also tells her attorney to make sure that the city meets every one of its legal obligations and announced timetables. She'll make them wish they had never asked for a contribution.

Scenario III: Rinaldi argues that the unprecedented request for a contribution is illegal. She indicates that she will withdraw the project if the Mayor doesn't drop his request for a contribution. Ryan, while fearful of losing the project, decides she is bluffing. He jacks up his request to \$2 million so that, when he quickly comes down to the number he really wants, she will go along. Outraged, she offers a token payment of \$10,000. He comes down to \$1.5 million. She finally agrees to a gift of \$100,000. They stalemate at this point; neither wants to make further concessions or lose face. They break off negotiations after incorrectly concluding that the gap between them is unbridgeable.

Had my colleagues Roger Fisher and Bill Ury been advising Ryan and Rinaldi, they might have convinced them to adopt a joint problem-solving strategy. It certainly would have been in each party's interest to invent mutually beneficial trades. For example, the city might have helped Rinaldi reduce her overall project costs by clearing the site or building the roads and sewers as part of its regular capital improvements program. In exchange, Rinaldi would have been able to make a large contri-

bution equal to the several million dollars she would save if the city picked up some of her costs. The precedent the Mayor wanted would be set.

Assuming that the funds the Mayor used to help Rinaldi were funds the city would have spent anyway, both the city and the developer would come out ahead. The payment to the Revitalization Fund would give the Mayor the money he needs to compensate the neighborhoods or to undertake social service and environmental improvement projects.

Another option is that the developer could offer in-kind contributions that could be credited toward her gift. These would impose less of a financial burden on her, but also allow the Mayor to show a larger total gift. Finally, the Mayor could allow Rinaldi to make her contribution through a local foundation. He could still argue that a precedent had been set, while she could assert that the gift to the foundation was made voluntarily. Moreover, the Mayor wouldn't have to fight with the City Council about how the fund should be used.

Most public officials want to avoid case-by-case linkage negotiations. They prefer to use a formula. In theory, while it may be possible to invent mutually advantageous solutions in almost every situation, it takes a lot of time and energy. In addition, the public's attitude toward case-by-case deal-making is often quite negative—there is too much room for “under-the-table” deals and other kinds of corruption. The neighborhoods and public interest groups want a guarantee that they will be fully compensated for adverse impacts they must suffer. Moreover, they don't want to be at the mercy of the Mayor. Each neighborhood wants the same level of compensation the others receive. They don't want the developer's contribution to depend on what

the Mayor is able or willing to negotiate in each case. Finally, in addition to predictability, they want control over the allocation of the funds that are contributed. This means that they don't want the Mayor to settle for in-kind contributions that put no cash in their hands.

The formula approach has obvious drawbacks. When projects impose unusual costs, these cannot be compensated if a strict formula must be observed. If, for whatever reason, a developer is willing to make an extra-large contribution, this might be prohibited. In short, a formula approach is likely to produce inefficient agreements. Potential joint gains are likely to be missed since the parties have no incentive to invent "ideal packages" that exploit their special needs and capabilities. While a formula approach ensures evenhandedness and provides predictability, it is likely to leave potential gains unclaimed.

A Better Approach

There is a third approach to negotiating development agreements that can produce efficient agreements while taking account of the concerns of all the parties. The essence of this third approach is joint fact-finding and out-in-the-open negotiation. Representatives of all affected neighborhood and citywide groups should be invited to participate, along with designees of the Mayor and the developer. (N. B., With a very large group, professional facilitation may be needed to manage the dialogue.)

The first task of this group is to prepare a collaborative impact assessment—a forecast of the costs and benefits likely to be associated with the proposed project. Such an assessment should be jointly commissioned by the parties involved, but paid for by the proponent of the project (in the same

way that environmental impact assessments are presently handled). The city should publish guidelines indicating the range of impacts that must be studied so this doesn't have to be debated each time.

With these forecasts in hand, the negotiation should turn to the question of fair compensation. What value should be attached to the short-term disruptions and long-term changes likely to be caused by the project? Is there a shortfall between what the project will generate through taxes and indirect economic benefits and the adverse impacts it is likely to have? If so, what level and type of compensation (and what mitigating measures) should the developer be required to promise? What, if anything, can the city and the neighborhood do to reduce the developer's cost so that more money is available to use for compensation? The results of such negotiation should be informal written agreements that can be incorporated into official permits or zoning changes issued by the city. Since such official actions are subject to formal public scrutiny, the informally negotiated agreement will be reviewed to ensure that no one was left out and no laws were violated.

By moving away from a formula and concentrating on jointly developed estimates of impact, all sides can be assured that the outcome will be based on the merits and not on the political power of the parties. By involving all the stakeholders in face-to-face negotiation, the dangers of behind-closed-door deal-making can be avoided. By ensuring that informally negotiated agreements are subject to formal administrative review, guarantees of due process and equal protection can be preserved along with the statutory obligations of elected and appointed officials. By bringing the parties together to work out specially tailored agreements in

each case, greater efficiency can be achieved. While it may take longer to complete such consensus-building, implementation will be swifter when no one has reason to sue or organize

political opposition.

I think this third approach can produce fairer, wiser, more efficient, and more stable agreements.

NOTE

1. The example used is based on one of the many instructional negotiation simulations, or "games," available through the Clearinghouse of the Program on Negotiation, 500 Pound Hall, Harvard Law School, Cambridge, Mass. 02138.