



Real estate developers Brandon Champeau, David Menke and Mark Nordland

Minnesota's incentives not competitive with those of other states

A Civic Caucus Focus on Competitiveness Interview

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Present

Dave Broden (vice chair), Brandon Champeau, Pat Davies, Paul Gilje (coordinator), Sallie Kemper, Dan Loritz (chair), David Menke, Mark Nordland, Kaye Rakow, Dana Schroeder, Clarence Shallbetter. By phone: Janis Clay.

Summary

Minnesota needs better economic incentives to be able to compete with other states in attracting and maintaining businesses, according to commercial real estate developers Brandon Champeau, David Menke and Mark Nordland. They give an example of how United Natural Foods, Inc., decided to build a large distribution center in Prescott, Wisc., rather than in Lakeville, a competing location. Wisconsin and Prescott were able to offer the company over \$7 million more in incentives than the incentives offered by Minnesota and Lakeville. The developers believe economic incentives can pay off by attracting new businesses that will cycle money from new jobs through the community and the state economy.

Champeau, Menke and Nordland all believe transportation is extremely important in competing with other cities and that the Twin Cities area is making progress in developing transit. Nordland says the area needs to complete the transit system, but cannot neglect its degrading road system. He also believes Minnesota must be careful not to tax itself out of competitiveness in businesses property taxes and income taxes.

The developers say the benefit of the large increases in land values that occur when the state invests in public infrastructure, like a new highway interchange, generally goes to farmers or to land speculators who own the land nearby, not to developers, who tend not to buy land far in advance of

development. Nordland believes government can recoup part of this type of infrastructure investment through the increased property taxes paid on the developed land and the income taxes paid by employees working in newly created jobs.

Background

NAIOP Minnesota is the Minnesota chapter of the Commercial Real Estate Development Association. The Civic Caucus interviewed four NAIOP Minnesota leaders: Brandon Champeau, David Menke, Mark Nordland and Kaye Rakow.

Brandon Champeau is assistant vice president, United Properties, a commercial real estate developer and investor working in office, industrial, retail, healthcare and senior housing. Headquartered in Minneapolis, the firm serves clients in Minnesota, Wisconsin and Colorado. Champeau has been with United Properties since 2004. He serves as 2014-15 chair of the NAIOP Minnesota Public Policy Committee, 2014 chair of the Real Estate Diversity Collaborative and executive committee member of the Urban Land Institute Young Leaders. He has a B.A. degree in entrepreneurial studies and finance from the University of Minnesota's Carlson School of Management.

David Menke is executive vice president of Opus Development Company, a commercial real estate company headquartered in Minneapolis, with projects across the country. The firm is involved in construction, development and architecture and works in the office, industrial, retail, institutional, residential and government sectors. Menke joined Opus in 1995 and oversees all development for the company's Midwest region, which currently has projects in eight different cities. He is a member of NAIOP Minnesota's board of directors. He has 27 years of real estate development and brokerage experience. Prior to joining Opus, he was a senior sales associate for eight years at Towle Real Estate Company, working as an office sales and leasing specialist, representing both owners and renters. He has a B.S. degree in business finance from the University of Minnesota.

Mark Nordland is principal at Roseville, Minn.-based Launch Properties, a developer and investor in healthcare, retail, industrial and office real estate in the Twin Cities. Prior to cofounding Launch Properties in 2011, Nordland was vice president of development for Ryan Companies, Inc., from 2006 to 2010. He was director of industrial development for CSM Corp. from 1999 to 2006 and industrial broker for Welsh Companies from 1996 to 1999. He is NAIOP Minnesota's 2014 president. He has a B.A. in economics and government from Lafayette College in Easton, Penn.

Kaye Rakow retired on Dec. 31, 2013, as director of public policy for NAIOP Minnesota. She was the first person to fill that position in 1996. She then left for three years to serve as president of the Twin West Chamber of Commerce. Rakow returned to the NAIOP post in 2000. At NAIOP, Rakow has worked with commercial real estate developers and property owners as they advocate at the Legislature for issues like lower business property taxes and greater transparency of local government spending. She has a B.A. in political science and history from the University of Minnesota.

Issues to address:

Prior to the meeting, Champeau, Menke, Nordland and Rakow were asked to be prepared to discuss the following issues: the role of commercial-industrial development in Minnesota's economic

competitiveness; the state's economic climate today and in five, 10 or 20 years; the importance of economic incentives to businesses; the importance of transportation corridors, such as Hwy. 169, workforce location, and economic incentives in determining where companies locate; development in the metro area vs. other parts of the state; and how Minnesota is faring in commercial development compared with other states.

Discussion

Commercial developers work closely with commercial real estate brokers. All four speakers have a background in commercial real estate brokerage, which Mark Nordland called the most direct way to learn about development. According to David Menke, the "lion's share" of development contacts, about 90 percent, comes through brokerage firms. "Very rarely do we hear straight from the companies," he said, noting that there are a number of strong commercial brokerage firms in the metro area. Also, some contacts come through Greater MSP, the Minneapolis Saint Paul Regional Economic Development Partnership.

Nordland added that Greater MSP is a facilitator. If there's an out-of-town company, Greater MSP facilitates the initial contact with a brokerage firm. "Almost everybody is represented by somebody," he said.

Wisconsin attracted a company away from Minnesota with a large package of economic incentives. Nordland noted the recent example of United Natural Foods, Inc., the leading distributor of natural, organic and specialty food in North America, deciding to build a \$37.8 million, 300,000 square-foot distribution center with over 300 jobs in Prescott, Wisc. The company currently has a facility in Burnsville, but it needed room to expand and was looking in the Twin Cities market. Nordland's firm proposed selling the company a large piece of land in an industrial park in Lakeville. United used the services of a broker and site selectors, he said.

The company ended up going to Prescott, Nordland said, because it received \$9.5 million in incentives from the state of Wisconsin and the city of Prescott. At the Lakeville location, the combination of state and local incentives amounted to about \$2.5 million to \$3 million, primarily through tax-increment financing (TIF), a process through which a city can capture all the increased property taxes in a development area over a period of years to help pay for infrastructure and other costs of development. "The state of Minnesota really didn't have a lot to offer," he said.

Minnesota needs better incentives to get distribution and manufacturing companies here. An interviewer asked what things would need to be in place to make more companies want to come to or expand in Minnesota. "We've got 19 Fortune 500 companies here," Nordland said. "People like to have their headquarters here. They like the quality of life. But that only goes so far when you break it down to the working-class jobs." When companies want to hire for blue-collar jobs in distribution and manufacturing, he said, they start looking at lower-cost places, such as Kentucky, Arkansas, Louisiana, or Wisconsin, North Dakota or Iowa. He said Minnesota needs better incentives to get those companies

to locate here. "We need the same tools the other states have," he said.

Wisconsin offers lower taxes and better incentives. Champeau offered the example of a piece of land he is working on in Hudson, Wisc. "The state of Wisconsin loves to compare itself to Minnesota," he said. He noted the following comparisons:

- Corporate income tax (2012): Minnesota, 9.8 percent; Wisconsin, 7.9 percent.
- Top personal income tax bracket (2011): Minnesota, \$74,000; Wisconsin, \$295,000.
- Property taxes on a building valued at \$8,000,000, with 99 employees (payable in 2009): Minnesota, \$128,975; Wisconsin, \$59,545. Wisconsin property tax savings over 10 years: \$694,300.
- State sales tax and use tax (2011): Minnesota, 6.875 percent; Wisconsin, five percent.

There are other exemptions and incentives offered in Wisconsin that are not offered in Minnesota.

Champeau said developers wish Minnesota would be on "a more level playing field with some of the states around us." "It's taxes and incentives," Nordland added. "Incentives have become a necessary evil, because all other states are doing them," Champeau said. "You have to play in that game. It's easy to make a case against relocating or moving to Minnesota when states around us can show a company our tax and incentive comparisons."

Incentives are especially important to companies with larger space requirements. An interviewer asked how much development activity from Twin Cities firms that are expanding or from firms that are locating here is driven by the marketplace vs. being affected significantly by incentives from cities, counties or the state. Nordland replied that the larger space-requirement projects are much more affected by the incentives. "They're going to figure out the most cost-effective place to be," he said.

Minnesota needs to have incentives to compete. "If I had my way, nobody would have incentives," Nordland said. "Then we'd be a market economy. That's just fundamentally what I believe. Then states could compete on their own. We'd have to deal with the tax issue here, but that's easier to overcome than the incentives, because we have a good quality of life and good employees. The reality is that incentives do exist both nationally and regionally and we need to have them to compete."

The quality of the workforce in the Twin Cities is more important for high-tech companies. An interviewer asked how much the quality of the workforce is a driver in location decisions. Champeau replied that high-tech companies might choose the Twin Cities, because they would place more importance on their employees' educational background. But, he said, manufacturers or distributors who don't need highly skilled employees and are offered \$6 million or \$8 million in tax savings or subsidy over 10 years will say, 'We'll train 40 new people and locate somewhere else.'

Minnesota needs to be able to compete regionally. "Some of the southern states that don't have much going on are going to throw the book at companies they're trying to attract," Nordland said. "They're going to win the day on some of these things. But if we can compete with the Midwest region, that would do a lot. I would like us to be more competitive regionally."

Menke noted that currently a company requiring 300,000 square feet, with lots of high-paying jobs, is looking at locating in Texas, San Diego, Denver or Minnesota.

He said the incentive package put together by Texas is six or seven times the size of the Minnesota package. "It's real," he said.

The Twin Cities is competing with Portland, Seattle and Denver for intellectual kinds of jobs.

An interviewer commented that the Twin Cities area is always being told it must compete with Portland, Seattle and Denver. "Different types of jobs," Nordland said. Those communities and the Twin Cities all have a highly educated workforce for what he called the "intellectual kinds of jobs." But, he argued, that doesn't provide a balanced economy. "You can't just have the intellectual class here and not have a working class," he said. "It just doesn't work. It doesn't support the overall health of the community and the economy."

Economic incentives can pay off. An interviewer asked why a state like Wisconsin would offer \$9 million in economic incentives to attract a business to Prescott, rather than using that money for K-12 education. Nordland replied, "Because it grows the whole system. If you have 400 new workers who are all making good wages and are all in the community, the money will cycle through the system. They'll spend a lot of money in Prescott and elsewhere in Wisconsin."

Champeau noted that the City of Shakopee structures business incentive deals so that companies must meet job-number and wage-level requirements set by the city. "They're not just handing a check over and then wondering if it ever comes back," he said. "Cities are smart and they will look at what that building and that workforce will contribute to the tax base long-term and they say it's worth X dollars toward a project. Sometimes they might overpay, but I believe many times they don't."

Different types of development are drawn to different locations. An interviewer asked where the focal points of development in the Twin Cities are located. Menke said sizable industrial businesses are going to be looking for major arterial highway connectivity, generally in greenfield locations. For housing, he said, there is strong demand for more urban, transit-oriented development. For example, Opus is building a high rise in downtown Minneapolis at a light-rail station. For office development, "when and if it comes back," transportation is a strong driver, so it will be more urban, less greenfield development, he said.

Champeau said companies have figured out ways to save space and to have office workers work in less space. Because of that, there has been little office expansion or new office building development for a number of years.

Companies want to be centrally located. An interviewer asked if there is a linkage between where workers are located and where facilities are going up. Nordland said there was a lot of sprawl before the recession, but now companies want to be centrally located. Employees are coming from all over, he said, so if you're relocating, you don't want to move too far from where you are.

Menke pointed out that Wells Fargo plans to make a big investment to locate on the east side of downtown Minneapolis, near the new Vikings stadium. "They concluded that access to transportation, access to a large employee base, being urban and having that urban environment for their employees trumped everything else," he said.

The new Vikings stadium will compel development in downtown Minneapolis. An interviewer asked whether the massive public investment in the stadium is justified. Menke said the stadium-related development is "fabulous for downtown" and that the sheer size of the stadium and the adjacent park will compel development.

An interviewer commented that the Twin Cities area is the 15th largest metro area in the country and asked how important it is for the area to be "major league" and "to fight above its weight." Champeau replied that it's very important. He lives in the North Loop in downtown Minneapolis, just a few blocks from Target Field. Between April and October on Twins game nights, he said, "the neighborhood buzzes with people. It's dramatically changed the area in a very positive way."

Transportation is extremely important in competing with other cities. An interviewer asked how Minnesota stacks up on foundational assets, like preK-12 education, higher education, public safety, natural resources and transportation. Menke replied that transportation is coming along. "Denver is ahead of us in that regard," he said. "But the transportation investment we're making is significant and necessary."

Champeau and Nordland both agreed that transportation is extremely important in competing with other cities and in attracting young people here. "We need to finish the transit system," Nordland said. "We need to finish the system so that it's a legitimate transit system that someone could actually use, not one people take just so they don't have to pay for parking downtown, which is what I think it's used for now. Also, we can't neglect the roads. Our road system is OK, but it's degrading." He pointed out all the growth that has occurred in Shakopee after the state fixed the 169/494 interchange.

Minnesota must not tax itself out of competitiveness. Nordland said the Twin Cities area has the arts, education, sports and a "tricky" tax climate. "We need to be careful about things like business property taxes and income taxes and make sure we don't tax ourselves out of competitiveness," he said. "That affects more of the working-class jobs than the higher-end, more intellectual jobs. Medtronic is still going to be here, even if they have to pay another couple of bucks in property taxes on their building. But if they need to put up a facility someplace that doesn't require the skill of the people here, they can go elsewhere."

There is a new trend of locating smaller distribution centers in the Twin Cities to distribute locally. An interviewer asked about the importance of moving the product, as well as the people. Menke said the Twin Cities are not considered a large distribution marketplace, so product movement is not so important. Nordland noted a new trend of companies locating smaller, 100,000 to 300,000 square-foot distribution centers in the area to distribute locally. "They need to be able to get around town fairly quickly, so you've got to keep the roads unclogged," he said.

Government can capture the value of a new infrastructure investment on development through new property and income taxes. An interviewer asked who should be paying for additional capital outlays and operating costs of transportation investments. He noted that land values skyrocket when a new interchange is built and the landowners pocket those increased values without having done anything. Champeau noted that whenever the new Hwy. 610 interchange is built, people will want to develop there and the new growth will generate property taxes and income taxes from jobs created there. "All of us will be looking to develop when something like that happens," he said.

The interviewer asked how at least some of that increased value can be captured to help pay for the public highway investment. Nordland said the value of an infrastructure investment is captured when farmland, which pays low property taxes, is developed and becomes home to a business paying high property taxes and employing 500 people. All of that money then circulates back into the economy, he said.

Transit benefits companies at the urban core, not those located on suburban light-rail lines. An interviewer asked whether UnitedHealth should pay a special tax when the Southwest light-rail line comes in because so many of their employees will take the light rail to work. Nordland believes only a "minuscule" number of UnitedHealth employees will ride the light rail to work. He said the idea that people are going to take suburban light-rail lines to suburban job locations is "overcooked." He said transit benefits the urban core, because employees will ride the light rail to downtown jobs.

Financial tools for economic development are very transparent. An interviewer asked how to keep the unprecedented amount of competition for economic development honorable. "The financial tools we all use are very transparent: tax-increment financing (TIF), tax abatement, state grants," Menke replied. "They're very much in front of everyone to see. They get voted on by commissions, councils and the state." He said one community might be more aggressive than others. "We don't influence that," he said. "Those are the commissions and councils that operate in that manner."

Champeau added, "The downside of the incentive discussion is that we pass these bills that give money to DEED and it's up to DEED to decide which companies will benefit." Menke agreed: "The DEED process is a little unclear."

But, Nordland said, there is a fairly transparent system in place now, where companies get a certain amount of money, depending on the number of jobs they are bringing and what those jobs pay.

Developers are not in the business of land speculation. Responding to an interviewer's question about landowners' benefitting from road construction, Nordland explained, "Usually it's farmers that hold the land for longer periods, or sometimes there are land speculators involved. But putting a road in somewhere doesn't result in a windfall for developers. We usually pay market rate for the property and create value on the land."

An interviewer asked if the developers own a lot of land. Nordland responded that his company buys land right before developing it. "Usually, we buy it with a user already in tow," he said. "We don't buy it to develop in 10 years. We buy it to develop in the next five to seven years, at the most."

"We all learned a few lessons in the last few years, where we bought thinking we were going to develop in the next six months," Champeau said. "Then the recession hit. We have land positions that we bought in 2005 that we're trying to work our way out of."

Retail development is smaller and there is less of it. An interviewer asked the developers how they view retail development. Menke said retail is clearly different now. "The retail Opus is doing today is much smaller and there's much less of it," he said. "It's more neighborhood grocery-anchored retail. The users of big boxes are all reinventing how they get things to their customers. It's untested; it's very fluid. We're being very careful about where we're deploying our equity in the retail sector."

"The connection between retail and industrial, specifically distribution and warehousing, is colliding at an incredible pace," Champeau said. "Retailers are going to give back one-third to one-half of their space in the next 10 years in exchange for distribution space. Buying will be about convenience. Shopping will be about experience. There's always going to be a need for retail, but it'll be smaller stores, where you can see the product and it'll be delivered to your home." Nordland added that showrooms for things like mattresses and beds are much smaller now. Menke said some former big-box stores are being repurposed into health clinics.

Champeau said the old model for retail distribution was to have four large facilities around the country. Now companies want more and smaller distribution centers, closer to their customers. "That's what's dangerous about the warehouse tax that the Legislature passed last year," he said. "That's the future of distribution and the future of retail. If we want to tax those warehouses out of our state, it's going to impact not only the distribution that comes here, but also the retail that comes here."

High-level jobs need good access to the airport. An interviewer asked how important the airport is. "We've got a great airport and we've got a lot of flights," Nordland replied. The high-level jobs need good access to the airport, but the \$15 to \$20-an-hour manufacturing jobs don't, he said.

Conclusion

Menke said Greater MSP has been helpful from a developer's perspective. "It feels like there's an organized, aggressive effort to tell our story," he said. "I view that as very important. Other states had been doing much better telling their stories. I view Greater MSP's efforts as very valuable."

Champeau remarked that the state needs to think of itself as a business. "It needs to look at the things we're good at and keep pushing those," he said. "And for the things we're not ranked well in, we need to figure out how to move those up the scale." Specific to real estate, he added, "Real estate development cannot be outsourced. It's a local business that employs local trades and, when we can be competitive with other states for deals, it can generate a lot of hidden economic activity."

"Maintaining the foundation we have here is good," Nordland said, "but not doing it to the detriment of other things. We've been able to build this foundation. We know we're a high tax state. We get something for that. I don't think we can pile on more. The human service element is growing and it's difficult to turn that away. But we have to balance everything. And we need a few more tools. We don't need to win all those deals, but we need to be closer to other states in the region."

"NAIOP members are experiencing a significant increase in the fees and costs imposed on commercial real estate development by local units of government," Rakow observed. "This, coupled with the maze of overlapping regulations at all levels, makes it more challenging to get economic development and construction projects off the drawing board. We should carefully monitor Minnesota's overall investment attractiveness. If we tax our employers too aggressively, they will invest elsewhere, taking new jobs and economic development with them. Policymakers' actions should build confidence and reassure investors, entrepreneurs and employers that they are welcome, appreciated and have a bright future here."