

The Myth of Self-Financing: The Trade-Offs Behind the Hudson Yards Redevelopment Project

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Abstract:

After using tax increment financing (TIF) to finance its economic development projects for 60 years, California revoked authorization of the value capture mechanism in 2011 due to its drain on state finances. One year later, New York State expanded its TIF law. In this context, this paper analyzes the country's largest TIF project in New York City as a case study on the financing mechanism's promises and fallacies. Approved in 2005, the plan to redevelop Hudson Yards on Manhattan's West Side was described as self-sufficient based on its value capture financing. This analysis compares the project's legislative history, negotiations and financial projections with the project's financials nine years later to reveal the self-financing frame to be a myth. Rather, positioning TIF as a tool absent public trade-offs eroded the public process necessary to consider its demands, risks, costs, and governance questions.

INTRODUCTION

Throughout his 12-year tenure, Mayor Bloomberg exemplified a neoliberal approach to urban economic development. While some have compared his mega-projects to feats last seen during the days of master planner Robert Moses (Campion 2013, 1; Angotti 2011, 209), Bloomberg did not have the benefit of direct financing through the federal urban renewal program. Instead, his administration implemented new funding mechanisms that use public, taxpayer dollars to prime the market for large-scale private developments.

These include the popular but controversial financing tools known as tax increment financing (TIF) and payments in lieu of taxes (PILOT) financing, both of which allow a municipality to sell bonds repaid with future tax revenues. Because these tools offer local governments the promise of financing development projects with the very revenues they are expected to generate, they are described as self-sufficient.

In 2002, the Bloomberg administration announced plans to redevelop the West Side of Manhattan and expand the midtown central business district (CBD) using PILOT financing. While Bloomberg's effort was not distinguishable by its details – his plan resembled Mayor Lindsay's 1969 proposal, including TIF financing - it was distinct in its success. In 2005, the City Council passed a rezoning proposal that unlocked the area's 26 million square feet (msf) for mixed-use development. Based on the premise that the area would not attract developers in its current state, the area's rezoning was accompanied by two City Council resolutions (Res. 760 in 2005 and Res. 547 in 2006) that financed infrastructure investments to attract developers, including the extension of the No. 7 subway and new green space.

The Hudson Yards financing plan was sold to the public as self-sufficient because, in theory, it should not detract from the city's general fund. This theory has been tested since TIF's

inception in California in 1952. While its popularity soared in the 80s and 90s with TIF statutes proliferating across the country, its home state of California revoked it in 2011 due to its excessive drain on state finances (“California Redevelopment Agencies” 2013). Rather than view this as a failure of the self-financing promise, New York State soon after expanded its TIF law. In 2012, the state budget amended the TIF statute to allow localities to capture more property tax revenue for urban economic development (DeMasi 2012).

Given the nationwide debate on TIF and its effects, New York City’s decision to implement the country’s largest TIF project in the \$3 billion Hudson Yards redevelopment plan serves as a case study on the financing mechanism’s promises and fallacies. Specifically, the following analysis reveals TIF’s self-financing frame to be a dangerous myth. Positioning TIF as a tool that does not necessitate public trade-offs erodes the public process necessary to properly consider its demands, risks, costs, and governance questions.

In the case of Hudson Yards, the project’s rhetorical backbone determined its implementation, skewing the project’s benefits to private interests and failing to provide institutional protections for the public good. This model serves as a cautionary tale for other states and municipalities considering these means of value capture financing.

LITERATURE REVIEW

Efficacy

Joan Youngman of the Lincoln Institute of Land Policy summarizes the academic literature on TIFs, “A plethora of economic studies have reached no consensus as to the effect of TIF on economic growth” (2011, 323). Richard Briffault of Columbia Law School agrees, “There is little clear evidence that TIF has done much to help the municipalities that use it” (2010, 65). He cites five studies investigating different locations that show TIF is not being used by areas in decline,

but rather in areas that are already growing or, in fact, affluent. He states his understanding of these results, “Growth can generate a need for new capital investment which might not be easily financed out of the local tax base, especially in a jurisdiction subject to legal limits on raising taxes” (81). Significantly, he cites two studies from Chicago and Detroit showing TIF is subject to “copycat” behavior, where the adoption of TIF in one area makes a neighboring area more likely to do the same (81).

Within a TIF district, Briffault cites three studies showing property value growth at lower rates than projected and points out that projects can fail. For example, the Englewood, Colorado, urban renewal authority defaulted on a \$27 million bond issue, and the Council of Development Financing Agencies acknowledges that certain TIF projects do not achieve their goals (82). While he also states, “for the most part, TIF districts succeed in creating a solid and robust revenue base,” it is “debatable” if this growth would have occurred anyway (pg. 82).

Recently, a 2016 report from the Center for Business and Economic Research at Indiana’s Ball State University investigated the effects of TIF in their state, concluding, “Recent research on TIF use in Indiana and elsewhere has confirmed earlier research that reported no economic development impacts for the average TIF district in Indiana” (Hicks et al, 1).

Commodification

Rachel Weber explores TIF’s role in the financialization of urban economic development policy by analyzing Chicago’s use of TIF from 1996 to 2007. She connects the structural changes in Chicago’s relationship to financial markets –increased municipal debt, the privatization and securitization of public assets and the corresponding new governance mechanisms to manage them, the financial services available to cities, and the “investor-orientation” of the city’s consumptive choices – to the increased investment of global capital in cities.

Weber is clear this process is not organic. Rather, it reflects a deliberative effort on behalf of local officials to construct the conditions necessary for a conduit between fast-moving international capital and its local repository – real estate (2010, 253). In her case study, she finds that Mayor Richard Daley’s political control over the city created the conditions necessary to offer investors enough confidence to invest in highly speculative TIF bonds, including a lack of transparency, hand-picked developers and financial advisors, targeting areas prime for gentrification, suppressing opposition, and a willingness on behalf of local officials to saddle their taxpayers with cost “premiums” in exchange for such control (269).

Governance

Youngman calls TIFs theoretical framework - “a perfect closed system of self-sustaining finance” - a practical failure, citing the mechanism’s draw on tax revenue that would normally go to other taxing authorities (2011, 321). Normally, practical abuses emerging out of theoretical failures are mitigated by institutional structures designed to flag and reform policies that devolve into moral hazard, or incentives for the misallocation of resources. According to Youngman, these institutions also failed in the application of TIF due to a lack of transparency (sustained by the myth that TIFs are self-financing) and the circumvention of voter-approved debt limits by courts, legislatures and local officials’ determination that TIF-secured bonds do not count under municipal debt limits (325).

Briffault also engages in the question of the context in which TIF has come of age (94). TIF’s design and implementation fit with the decentralization of government, the financialization of development policy, inter-local competition and entrepreneurial economic development. TIF “empowers” local governments to shape cities because of the statutory and legal relaxations of the conditions required for TIF use, the need for localities to produce revenue in an anti-tax environment, the possible capture of tax revenues from other taxing authorities, and the focus on small-scale projects rather than long-term investment and development (85).

He cautions that this concentration of decision-making power at the local level opens the door for corruption. Randal O'Toole of the Cato Institute specifies, "elected officials use TIF to engage in crony capitalism, that is, to provide tax subsidies to favored developers, who naturally respond by making campaign contributions" (2011). Acknowledging that the tool's potential for abuse has increased calls for public involvement, Briffault has little faith in increased citizen monitoring to curtail TIFs weaknesses. Rather, he suggests "a broader rethinking" of the state and local roles in economic development policy making (94).

Of course, these characteristics are subject to interpretation based on the assessor's criteria. George Lefcoe calls TIF a "win-win-win situation for the city, the private developer, and the taxpayers" (2011, 3). He reasons that city officials claim credit for development and an increased tax base, while developers benefit from public improvements and support in the land use process and the public benefits as the end-user of the project and increased tax dollars. He compares TIF to localities' other financing options - tax abatements, general obligation bonds, and special assessment financing - and finds TIF has the "distinct advantage" of the lack of a public process necessary for implementation (3). Concentrating on the procedural limitations of these more traditional incentives, he determines that necessary urban economic development projects would not have come to fruition without the procedural freedom of TIF (3).

Social Engineering

Briffault highlights TIF use as a "form of land use planning," citing studies from Chicago that show a preference to use TIF to convert industrial areas to mixed-use, residential or commercial uses (Briffault 2010, 83). These findings highlight a tension between the economic development goals of job creation versus property value increases. While industrial use is likely to create more and better paid jobs – in comparison to the low wage service jobs offered by the retail industry – TIF benefits are measured only by increases in property taxes, defining a preference for commercial or mixed-use development (83).

Hunter College's Tom Angotti decries the use of land use mechanisms to enact TIF. He argues the issue is not development itself, but the process. Land use regulation is "too often reactive, not proactive," and, as such, is used as a route to development that lacks "democratic control" (233).

METHODOLOGY

TIF research was culled from academic journal articles, studies issued by think tanks and public policy institutes. Research on New York City's use of PILOT financing in Hudson Yards was based on books providing academic studies of the plan, including New York for Sale: Community Planning Confronts Global Real Estate by Hunter College's Tom Angotti and Bloomberg's New York: Class and Governance in the Luxury City by Montclair State University's Julian Brash. Reviews of law journals, the legislative history (committee reports, transcripts and relevant legislative text), and press reports documenting the public dialogue surrounding the project's negotiation and implementation were also conducted. Documents pertaining to the project's trajectory through the city's Uniform Land Use Review Process (ULURP) were reviewed, including proposals and plans put forth by the Department of City Planning and the responding reports from the affected community board, Manhattan Community Board 4. Budget estimates and figures were provided by the New York City Independent Budget Office (IBO). In addition, the author interviewed Walter Mankoff, the (now former) Chair of Community Board 4 during the project's implementation.

HOW IT WORKS

Tax Increment Financing (TIF)

TIF is created by the state for use by local municipalities. While its specific rules and implementation vary from state to state, the basic mechanism is meant to allow local governments to finance development projects with the revenue generated by the development itself (Cerciello 2004, 103).

In theory, the process of TIF implementation begins when local officials designate a geographic area as a TIF district. The area's property taxes are then frozen on the tax roll. This becomes the base value, and property taxes continue to be levied at the same rate on this amount and paid to all applicable local taxing authorities, including local and county governments, school districts, fire and park entities, and any special districts.

Revenues resulting from applying the tax rate to any property value above the base value are set aside and paid to the municipality or an economic development authority operating on its behalf. These revenues are called the 'increment.' For the life of the district (the timeframe is determined by the municipality), the increment is used to pay for public improvements or economic development projects within the district. TIF payments can be made on a pay-as-you-go basis as the increment is received or, as is often done for larger TIF districts, bonds backed by the promise of the future increment are issued to pay the up-front development costs.

This process is described as self-financing because theoretically, the increment eventually pays for the expenditures that induce private investment (68).

TIF was first used in California in 1952 to raise the local matching funds required by the federal urban renewal program (69). It was developed as a means to circumvent the need for citywide

bond issues, which required voter approval and were frequently voted down (69). However, the financing mechanism didn't become popular until the late 1970s and the end of the urban renewal program coincided with states' growing backlash against taxes, symbolized by California's Proposition 13 in 1978 (70). In the two decades spanning the 80s and 90s, over \$20 billion in TIF bonds were issued (Kerth & Baxandall 2011, 5). By 2010, 49 states and the District of Columbia had authorized TIF (70). It is characterized as the "most widely used local government program for financing economic development in the United States" (65).

The expansion of TIF has not gone unchecked. In 2006, Arizona repealed its TIF law. Most famously, TIFs home state of California did the same in 2011, when Governor Jerry Brown waged a year-long battle to eliminate the state's 400 redevelopment authorities that administered TIF. With a \$28 billion state debt, Brown's winning argument was that the state could no longer afford to divert billions in property taxes to TIF projects rather than schools (O'Toole 2011, 2).

New York and TIF

New York State's Municipal Redevelopment Law authorized TIF in 1984 (Cerciello 2004, 104). However, TIF has not proven popular in the state. Other than the city's Hudson Yards project, there are only two small TIF projects in New York State, including an \$8 million TIF in the city of Victor and a \$770,000 TIF in Greenburgh (Cerciello 2004, 122).

Because the state's economic development agencies traditionally offer tax abatements as incentives, these work at cross purposes when coupled with increment financing. If an entity is not paying property taxes, there is no increment to pay back the development's incurred debt (122-123). However, the state's low level of TIF use is more likely due to the fact that before 2012, New York State did not allow school revenue to be diverted by TIF. That changed in 2012. New York's 2012 state budget amended the Municipal Redevelopment Law to allow schools to

opt-in to TIF districts, effectively contributing their portion of the property tax increment to local development.

PILOT Financing

PILOT financing is described as a “close variant” of TIF (Cerciello 2004, 123-124). The financing mechanisms share the same basic structure, where a local government creates a redevelopment agency to issue bonds and uses the proceeds to finance public improvements intended to increase property values and generate new tax revenue (126). PILOT financing and TIF share the same “legal issues, risk and policy considerations” (125). Because of these similarities, TIF and PILOT financing are used interchangeably in the following discussion.

There is one significant difference between the two mechanisms. Under TIF, private developers own the land and are charged property taxes according to the locality’s assessment rules. Under PILOTs, the city must own the land to remove it from the tax rolls, following which an owner/developer pays a discounted or negotiated payment to the agency instead of formulaic property taxes (127).

The Bloomberg administration increasingly used PILOTs in its economic development projects planned through the New York City Department of City Planning (DCP), a city agency, and the Economic Development Corporation (EDC), a city-owned nonprofit corporation. PILOT payments are set, administered and received by the Industrial Development Corporation (IDA), a public benefit corporation housed within the EDC and charged with administering public programs designed to incentivize private enterprise in the city.

HUDSON YARDS PROJECT

History

In 1969, the Lindsay administration put forward a comprehensive plan to expand Manhattan's CBD to the Hudson River by "redeveloping" the far West Side. The details are similar to what the Bloomberg administration would propose three decades later, including 30 msf of office space, hotels, housing, a new subway line, development of the waterfront, and a convention center. The financing was also the same – self-financing through tax revenue generated from the development (Brash 2011,145).

Most of Lindsay's plan fell victim to the fiscal crisis, only to be rejuvenated under the Giuliani administration. The Mayor's desire to bring the Yankees to a stadium on the West Side fused with the city's Olympic ambitions. In 1994, Daniel Doctoroff, then a managing director of a private equity firm, established the private, non-profit NYC2012 to advocate on behalf of the city's bid. NYC2012's plans targeted the area for both an Olympic stadium and put forward the idea to build it on a platform over the MTA's West Side rail yards ("Helping New York Grow," 2001).

Late 2001, Mayor Giuliani's DCP, in coordination with NYC2012 (Brash 2011,152), released "A Framework for Development: Far West Midtown." The Framework was more specific in its plans for financing the development of the Far West Side. It called for two financing mechanisms, including TIF and a "zoning bonus strategy" that would allow developers to build at increased densities if they made payments into a district improvement fund (DIF) (VIII).

The Framework presented these "innovative financing strategies" as necessary due to three factors (VII). First, the city's capital budgets were constrained, especially in light of the financial toll of 9/11 on the city and its economy (VII). Second, while the city could fund the project's

called-for capital improvements through the city's general revenues (contradicting the Framework's previous statement), the project's capital needs would then be in "direct competition" with all other capital projects. According to the Framework, this would mean, "decreasing the likelihood that these improvements...would be implemented in a coordinated and timely factor" (61). Third, the proposed financing mechanisms, TIF and DIF, would create "a financial linkage between the proposed zoning density increases in Far West Midtown and the provision of needed infrastructure" (VII).

The Bloomberg Administration

In February 2002, Bloomberg's DCP and EDC published a development plan for the area known as the "Preferred Direction." The plan was clear in its diagnosis of what was standing in the way of Hudson Yards' potential: poor infrastructure.

The solution was for the city to invest \$3 billion to extend the No. 7 subway line from its current end at Times Square to 34th Street and Eleventh Avenue and create Hudson Boulevard, a new street spotted with public parks running between Tenth and Eleventh Streets from 33rd to 42nd Streets (CB4 2014). Under normal circumstances, the city pays only 5 percent of subway construction costs (Kiernan 2007, 2). However, the state-administered MTA refused to make the expansion of the 7 train a funding priority (2) and the city decided to pick up the entire tab. In 2004, the subway cost was estimated at \$2 billion.

The Preferred Direction recognized that the cost of these infrastructure projects were "substantial," but Bloomberg's argument again followed Giuliani's Framework in employing the rhetorical benefits of TIF. "Here, as in few other places, the public sector can pay for this infrastructure with the revenues received from development. Because of this self-financing structure, the infrastructure requirements will not compete for scarce public resources for other worthwhile projects" (DCP 2003, 10). However, a report by real estate consultant

Cushman & Wakefield supporting the Preferred Direction reveals that the project's price drove the plan design. The report states a goal "to create a realistic plan to fund the infrastructure improvements that will spur private investment in the area" (ERA 2003, 2). It also recognizes that office development has the "highest incremental property value" (7).

Packaged with the city's bid for the Olympics and a Hudson Yards stadium, the community resented the top-down determination that their neighborhood was needed for a new CBD, especially when community activists had already created their own plan for the area's future. In 1995, the Hell's Kitchen Neighborhood Association (HKNA) led community workshops that resulted in a plan supported by Manhattan Borough President C. Virginia Fields. While the HKNA plan recognized the need for office development, it opposed a "wall of towers" that would separate the neighborhood from the river (Angotti 2011, 210). Instead, they insisted on prioritizing development that would support a diverse community with a mixture of uses, "not just another downtown business complex" (210).

The HKNA plan was used as a point of reference by Manhattan Community Board 4 (CB4), the local community board charged with providing the city with an analysis of the plan's effect on the existing community (Manhattan CB4, 2). The Board's report states that after "hearing from the public...the Board found that the City plan did not meet the needs of the community or the City." It echoed the HKNA's opposition to high-density development and expressed "concern about precedent-setting aspects of the plan, including its financing" (i).

Public opposition from HKNA and Community Board 4 contributed to the demise of the stadium and the Olympic bid went to London. However, these groups did not have a formal vote in the city's land use process, and the proposal to rezone the area moved forward despite the community's stated disapproval.

Rezoning

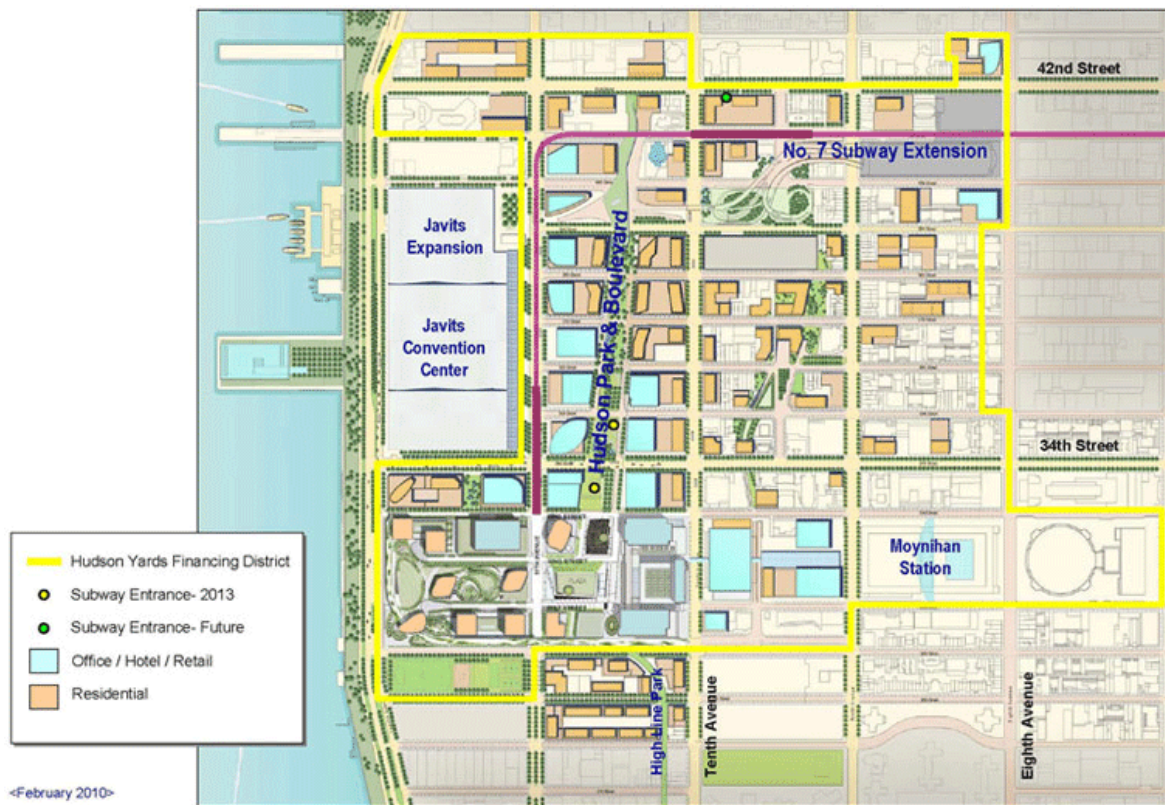


Photo 1: Hudson Yards Redevelopment Project

Source: HYDC 2014

The redevelopment plan is encompassed by the Hudson Yards Financing District, including the area of Manhattan bounded by 42nd and 43rd Streets, Seventh and Eighth Avenues, West 28th and 30th Streets and Hudson River Park (HYDC 2014).

Prior to the rezoning, the area was home to commercial and light industrial uses, parking lots, garages, and about 12,000 residential housing units (CB4 2014). Transportation infrastructure dominated the area, including Penn Station, Port Authority bus terminal, access roads to the

Lincoln Tunnel, and 26 acres of MTA rail yards. Eleventh Avenue bridges the yards, creating what has come to be known as the eastern and western yards (DCP 2014).

The 2005 rezoning changed the area's land use from manufacturing to commercial and residential. It now allows for 26 msf for commercial office development, 20,000 units of housing, 2 msf for retail, and 3 msf for hotels (HYDC 2014). In 2009, the western rail yards (left out of the original rezoning due to plans for a stadium under Albany's jurisdiction) were rezoned to allow for an additional 12 msf for office, hotel, residential, cultural and parking space, and a 750-seat public school (HYDC 2014). The MTA chose The Related Companies to develop both the eastern and western rail yards, requiring a platform over the rail yards. At a cost of \$20 billion, the deal was called "the biggest private real estate development in U.S. history" (Levitt 2014).

Financing

Because New York State law limited TIF to capturing property tax revenue only, the city determined TIF would not provide enough revenue to fund the \$3 billion project (Brash 2011, 203-4).

The administration issued an RFP to investment banks to help determine a funding plan, indicating a preference for a self-financing plan (204). However, the resulting proposal proved too costly and too risky to garner City Council approval.

Instead, rather than funding the project through the city's general obligation bonds like other capital projects, the Council and Mayor agreed to use PILOT financing and to use the city's general revenues to pay for the upfront costs until the project's development-reliant revenues were sufficient to pay the bills. According to the Council's Deputy Director of Finance Larian

Angelo, the cost of paying the interest on HYIC debt for an expected 10 to 12 years (NYCC Transcript 2005, 8-9) was estimated at \$1 billion (65).

The financing package was approved in two non-binding City Council resolutions, Resolution 760, passed in January 2005 for the eastern portion of the site and Resolution 547, passed in 2006 and covering the western rail yards.

The agreement established a non-profit local development corporation, the Hudson Yards Infrastructure Corporation (HYIC), to sell the bonds and finance the project. Revenues would come from a combination of PILOTs, payments in lieu of sales taxes, payments in lieu of mortgage recording taxes, DIF payments, and proceeds from the sale of newly-created development rights over the rail yards (205). The city also agreed to forward property tax revenue generated in the district and not covered by PILOTs in the form of annual tax equivalency payments (TEP).

PILOTs were expected to account for approximately 85 percent of the project's revenue (NYCC Committee on Finance 2005, 4). PILOT payments are determined by the Uniform Tax Exemption Policy (UTEP) through the city's IDA and represent a "substantial discount" from the real estate taxes the developer would otherwise pay (Kiernan 2007, 4). Within the Hudson Yards Financing District, PILOTs are discounted by rates determined by the site's distance from the subway, up to 40 percent relative to real property tax payments (Campion 2013, 7). Additionally, the annual increase in PILOT payments is capped at 3 percent, insulating developers from increases in property taxes (Kiernan 2007, 13).

Revenue from the development funds and DIF payments were expected to bring in 10 to 12 percent of project revenues and were designed in part to provide early revenue during the construction phase (Manhattan CB 4, 2004, 8).

HYIC eventually issued \$3 billion in PILOT-backed bonds, \$2 billion in 2007, followed by another \$1 billion in 2012 (Campion 2013, 2).

FINANCING ANALYSIS

While the city's commitment to finance HYIC's early expenses – without reimbursement – makes the project no longer self-financing, the label continued to be used. While considering Resolution 760 in the Council's Committee on Finance, Council Member Christine Quinn, representing the Hudson Yards district, states, "Although this is self-financing and will bring us in money, it does include borrowing. And taking that amount down...will lower our finances overall." She continues "...this is self-financing. This plan will not only raise the money it needs to pay for itself, it will bring money into our city budget" (77-78).

Under the rubric of a self-financing plan, these economic benefits appear to need only time to materialize. However, as opposed to a private investor choosing to engage in high risk for high reward, Bloomberg's decision to use PILOT financing to pay these upfront costs for future reward exposed taxpayers to the consequences inherent in TIF projects, including neighborhood commodification, governance compromises, systemic risks and direct and indirect subsidies. As *Daily News* columnist Juan Gonzalez said of Deputy Mayor Doctoroff, "he was gambling with our money" (2011).

Commodification

The Preferred Direction states "...we must recognize that little, if any, development will occur without these public investments, and financing them will only be possible by encouraging a critical mass of densities and uses" (DCP 2003, 10). This statement is unambiguous. Self-

sufficient financing demands the most bang for the city's buck. Specifically, it links high-cost infrastructure to the high-risk/high-reward development of commercial real estate.

A focus on increasing property values, the basic idea behind all value capture mechanisms, by definition commodifies a neighborhood. In Hudson Yards, opening the West Side to highly profitable commercial development opportunities “multiplied land prices overnight, amounting to a big welfare check to property owners and investors” (Angotti 2011, 207).

This can also be seen in Doctoroff's response to why the city wasn't building an additional subway station along the extended No. 7 line. “It's not that there's no need,” explained Doctoroff. “The development around it doesn't contribute to paying back the bonds” (Cuza 2006).

Property also has more value if it is built out to its maximum. Therefore, using TIF required higher density development. The rezoning included numerous mechanisms to increase building height and size, including the DIF, the creation and sale of development rights, and incentivizing commercial development through reduced PILOTs (Manhattan CB4 2004, i).

The local community board focused its opposition on both too much density and too little affordable housing. Because of the commodification demands of TIF, they were destined to lose both.

With a long history of opposing high-density buildings (Brash 2011, 164; Manhattan CB4 2004, 4), CB4 pointed to PILOT financing as the source of the need for commercial development. The office buildings, their report said, were “driven more by the financial needs than by sound planning consideration” (Manhattan CB4 2004, i). The board its concerns with the DGEIS, saying it “blithely minimizes and dismisses the current value of our neighborhood...it's entire character” (13).

The community board called the proposed rezoning density allowances “unprecedented,” “undesirable,” and “ultimately unnecessary” (Manhattan CB4 2004, 3-4). The first term described the rail yards’ development rights, which were created only to be sold to developers to build more and bigger; the second term referred to the negative consequences of massive 80-storey buildings lined up along the waterfront, creating shadows, increasing traffic, blocking light and air, and overburdening city services; and the third term refers to the Community Boards’ disagreement with the administration’s insistence that there was enough demand for office space to support 28 msf of office development on the West Side (3-4).

The Community Board used the city’s desire for density – and the need to make the financing spreadsheets work – as a bargaining chip. In an interview with Walter Mankoff, who served as chair of the Board during the project’s trajectory through the city’s land use process, he states, “We used the financing as a weapon. We used it as a way to fight the height and the lack of services, to get concessions on a number of items” (2014). The Board’s report clearly states their negotiating position: “CB4 has supported densities and heights higher than what it believes are most desirable for the neighborhood only if the City makes a concrete commitment for a substantial development of affordable housing within the Board’s boundaries” (Manhattan CB4 2004, 6).

Under TIF, the need to increase property values isn’t negotiable, it is necessary. In the case of CB4, its request for both lower density and more affordable housing was a two-fold attack on the project’s bottom line, as both requests would diminish either developers’ PILOTS or their incentive to build within the financing district.

In the end, the city had to go outside the project’s financing package to appease CB4’s representatives on the City Council and ensure their support for the rezoning vote; it agreed to

provide general revenue funds to build off-site affordable housing (Manhattan CB4 “Points of Agreement”).

Governance

The project’s financing determined not only its size, but also created an “exclusive privatized ghetto,” according to TIF critic Tom Angotti (209).

This statement derives from value capture’s diversion of property tax revenues and development fees away from the city’s general fund and into a separate fund guaranteed to build one area of the city, also known as an enclave. The IBO calls this “fragmentation of the tax base” (Manhattan CB4 2004, 9).

PILOT funds go directly from IDA to HYIC. Because they do not appear in the city’s budget (Campion 2013, 7), these funds also skip the city’s democratic budget-making process. Namely, they are not subject to the city’s annual budget process between the City Council and the Mayor, where spending of city resources is subject to oversight, openly debated and voted on by representatives of the whole city.

This administrative structure was determined by choice, rather than by need. At the time HYIC sold its \$3 billion in bonds for the project, the city was \$13.7 billion below its debt limit (Kiernan 2007, 7). As mentioned earlier, Giuliani’s 2001 Framework acknowledged that the city could fund the capital projects out of general obligation bonds, which are backed by the full faith and credit of the city (DCP 2001, 61). However, it used an argument that would be echoed by Bloomberg’s Preferred Direction – efficiency. “Because of this ‘self-financing’ structure, the infrastructure requirements will not compete for scarce public resources for other worthwhile projects” (DCP 2003, 10).

However, the New York City Bar suggested this was intended “to bypass lengthy and uncertain political approvals so as to avoid delay and enhance the Olympic bid” (Kiernan 2007, 3). The suggestion is not subtle. They go on to say that instead of face competing with other city priorities, PILOT financing provided “an alternative that accomplishes by indirection what the city may not have been able to accomplish by direction” (12).

In October 2004, City Comptroller William C. Thompson, Jr., criticized Bloomberg for the PILOT financing scheme, saying, “you removed the public’s only opportunity for meaningful and serious review of the merits of your plan against other priorities, such as the construction of new schools or senior centers” (6).

Other critics questioned the precedent-making possibilities of using a financing mechanism to create public policy. First, CB4 cited concern that the city was using the land use review process to create economic development policy. They cautioned that the city’s plan sought to “create an end-run around the requirement for informed debate on capital projects and their financing” (Manhattan CB4 2004, 11). In the Hudson Yards project, “land use applications are so inextricably intertwined with an aggressive and poorly understood financing plan.” They went on to say it would be “irresponsible for DCP to go beyond a basic rezoning of the area without a public discussion of the impact of the financing plan” (10).

Second, determining financial incentives is not a tool of city planning, but a political choice that determines how to spend limited resources (Kiernan 2007, 13). The New York City Bar notes that using the financing mechanism as a justification for political decisions results in “skewing of policy choices to enable the selected financing method,” and “should be subjected to close scrutiny” (16). They note this was how political decisions were made during the fiscal crisis; because the first priority was to regain access to credit markets, “financing was policy, rather than a means of implementing policy” (16).

This distortion is reflected in the language of the two City Council resolutions that codify the financing. Resolution 760 frames the Council's position throughout as playing a supportive role to reduce HYIC's borrowing costs. "Whereas, The Council believes that a substantial savings can be achieved by having the City undertake...." "Whereas, The Council also recognizes that HYIC's ability to borrow would be furthered if the City were to undertake...." "Whereas, The Council further believes that additional savings can be achieved over the life of the borrowing, if...." (NYC Council 2005, 2-3) This represents an acknowledgement of the high costs of employing PILOT financing to fund Hudson Yards infrastructure projects. However, the language reveals that the city positions itself as reactionary, providing city revenue to lessen borrowing costs. This position hides the fact that this is a choice between employing a high-cost financing plan instead of using the city's cheaper, but more regulated, capital budgeting authority.

This positioning directly results in taxpayers subsidizing developers and HYIC bond buyers (Kiernan 2007, 15), in the form of reduced PILOT payments paid by developers and the city's direct payments to HYIC to pay the high-risk premium associated with their bonds.

Here, again, the logic behind the city's positioning of the plan must be questioned. If Hudson Yards is truly the "last frontier" (DCP 2014) for office development in the city, why are subsidies required to induce development? As the New York City Bar states, "why should costly artificial economic incentives be offered to encourage development?" (Kiernan 2007, 13). In 2005, U.S. Senator Charles Schumer made public his opposition to reduced PILOTs expressly because the city was already subsidizing development through the infrastructure investments. He stated, "West Side developers should pay 'full fare' "(14).

Risks

Julian Brash called this positioning the administration's "logic of investment," where government acts as an entrepreneurial investor willing to take risks to earn – and then reinvest - profit (Brash 2001, 203). According to Brash, this drives officials to "tolerate a level of financial risk well above that typically seen in state-funded development projects" (202). Under TIF, these risks create a chain reaction.

First are the risks of either cost overruns or revenue shortfalls, or both.

The former is exemplified by the cost overruns for the construction of the No. 7 subway extension and its delay in opening. The subway was originally projected to cost \$2.1 billion and open at the end of 2013. Instead, subway construction cost the city \$2.4 billion and opened in September of 2015 (Fitzsimmons 2015).

The latter is seen in the effect of the 2008 recession on the project's bottom line. The recession had a devastating effect on the city's construction industry. It wasn't until 2012 that the number of construction jobs in the city stopped falling from its high in 2008 (NYC Building Congress 2012). The IBO reported that between 2006 and 2012, HYIC revenue was 40 percent less than projected and that only one building was expected to begin paying PILOTs in 2017 (Campion 2013, 7)

Unfortunately, any TIF or PILOT financing project is susceptible to revenue shortfalls due to a reliance upon real estate growth to produce needed revenues. Christopher Jones, Vice President of Research at the esteemed Regional Planning Association (RPA) predicted, "The challenge of building such a large-scale project years in development will be seeing it through the economic cycles that may affect office, retail and residential demand before the buildings are completed" (Levitt 2014, 2).

Cost overruns and revenue shortfalls trigger the next step in the chain reaction of risks. If PILOT revenues are not generated, the question remains of who is responsible for paying the bondholders. The city's decision to bypass use of general obligation funds means that HYIC bonds are not backed by the full faith and credit of the city. HYIC's Official Statement is explicit that HYIC debt is not city debt (Kiernan 2007,10).

While this sounds straightforward, significant grey area remains should HYIC face default. First, the two Council resolutions that embody the city's agreement to pay HYIC expenses until it can do so through its own revenue are non-binding. To provide more assurance to bond buyers, the city entered into a contract with HYIC for the duration of HYIC bonds called the Support and Development Agreement, which makes the city contractually obligated to pay HYIC expenses if revenue falls short. However, as a contract between two entities of the city, it is also not legally binding (7). Additionally, a past or current elected officials cannot bind the actions of future elected officials or legislative bodies (Kiernan 2007, 8; NYCC Transcript 2005, 15). Therefore, while the Agreement states that the city will pay HYIC debt, the legislative language is repeatedly qualified with the caveat, "subject to annual appropriations" (NYCC Res 760, 3).

The New York City Bar calls this arrangement "moral obligation" debt (Kiernan 2007, 8), a form of debt now considered discredited after state reforms were implemented to discourage borrowing not backed by legal liability (9). However, given the city's dependence on access to credit markets and its history of triggering a fiscal crisis due to similar financing schemes behind the development of Battery Park City, it is unlikely to let HYIC default on its debt (12).

Additionally, despite the fact that bondholders "knowingly took the risk of buying debt the city was not legally obligated to honor" (12), the credit markets would view it as the city's credit default no matter what the legal requirement (12). Mark Page, Director of the Office of Management and Budget (OMB), stated, "Given this city's absolute dependence on market

access, the distinction between city debt and appropriation debt – although it’s clearly there – is probably not a huge difference because of the consequences of overall market access of defaulting on a piece of city credit obligation” (Phillips 2006).

The legislative history supports this relationship. The need to assure bondholders is cited as one of the reasons why the city agreed to pay HYIC’s interest costs. The transcript of the Council’s hearing on the financing resolution in 2005 features assurances from Alan Anders, Deputy Director of OMB, that the city’s agreement to be responsible for HYIC payments would help sell the bonds (10). This effort was successful; the bonds were six times over-subscribed (Phillips 2006).

Finally, the last step in the chain reaction is political. Despite the legal ambiguity, the larger context makes clear the city would assume the costs should HYIC default. Unlike HYIC revenue, city payments going toward HYIC debt go through the city budget process, making politicians choose between paying bondholders and providing city services to residents (Kiernan 2007, 15-16).

Costs

The IBO states, “Based on its initial market studies, the city determined that the construction of office space on the Far West Side would not be economically feasible without some level of public subsidy” (2013, 7). According to Tom Angotti, Bloomberg “admitted that the city will have to sink some \$5 billion into the whole deal” (2002, 207).

First, the financing itself is more expensive. In 2004, the City Council’s Finance Committee estimated that issuing bonds through HYIC rather than the city’s general obligation funds would cost an additional \$1.32 billion (NYCC 2004, 16). This is due to three reasons: 1) the bonds carry more risk because they are not backed by the full faith and credit of the city, requiring the city

to pay higher interest rates to bond buyers, 2) the higher cost means it will take longer to pay back, and 3) higher costs require the city to borrow more overall (15).

Second, the city's unprecedented decision to directly fund the subway extension made the project expensive. Council Member David Yassky criticized the city's decision to fund the subway. During the Council Finance hearing on Resolution 457, he qualified his vote in support of the resolution by saying, "I do think that...as future Transit expansions are contemplated, I hope that people won't take it as a precedent that the City should pay for it. We should not" (NYC Council 2006, 12). By the time it opened in 2015, the cost was up to \$2.4 billion (Fitzsimmons), making it the "most expensive piece of mass transit in the world" (Angotti 2011, 208).

In 2013, the IBO reported that through the end of 2012, HYIC spent \$2 billion. In addition to costs for subway construction, it spent \$390 million on "land acquisition and public amenities" (3), and planned to commit an additional \$79 million in capital dollars through 2022 (3).

In addition to these upfront costs is what Juan Gonzalez of the *Daily News* called the "obscure subsidies" of the Hudson Yards project, "New York's next big money pit" (2011). Documenting the city's response to the chain reaction of increasing costs and decreasing revenues, he accuses the Bloomberg administration of obscuring the "balloon(ing)" costs by burying "more than \$10 million in infrastructure costs for Hudson Yards in the budgets of other agencies" (2011). His examples included \$51 million spent on the reconstruction of 11th Avenue for the park-lined Hudson Boulevard by 2011, with another \$63 million in spending planned before 2015. And in 2011, the Department of Environmental Protection's (DEP) budget included \$48 million for the Hudson Yards water and sewer reconstruction between 2015 and 2021 (2011).

During this time, HYIC revenue “fell well short” of its projected revenue of \$283 million (11). Through the end of 2012, HYIC collected \$170 million in tax and fee revenue.

While interest payments alone totaled \$478 million (2), projected revenues were simply not materializing. HYIC did not sell any development rights. As of yet there were no eligible projects in the area. HYIC did not receive any PILOTs. There was no PILOT revenue paid through June 2012. As of yet, there were no eligible office construction projects in the area (7). In fact, the IBO stated these were unlikely to begin before 2017 “at the very earliest” (3). DIF revenue through 2012 was only \$88 million and had slowed since 2008 (Campion 2013, 9).

To cover costs, the IBO reported the city contributed \$374 million during this time period. This includes both direct appropriations from the city budget and foregone tax revenue that would have otherwise gone to the city’s general fund (2013, 2). Between 2008 and 2012, the city paid HYIC \$78.5 million in TEP from the city’s general fund (7). In 2011, the *Daily News* reported that these costs left the city on the hook to pay over \$500 million by 2015. *Businessweek* credited the IDA when reporting that HYIC received \$510 million in total property tax revenues (Levitt 2014, 3). The IBO updated projections in 2011 to show the first HYIC surplus - \$1.4 million - in 2025, “if the economy doesn’t get worse” (Campion 2013, 22).

These costs can be documented. However, there has yet to be any documentation of the city’s indirect subsidies, including lost revenue in the form of discounted PILOTs. Because of the way the city structured payments to HYIC, discounted PILOTs have a ripple effect through the city’s finances. First, since PILOTs go to HYIC to pay interest on its bonds, discounted PILOTs are a revenue loss to HYIC. Second, because the city is committed to paying HYIC interest payments until its self-sufficient revenues materialize, discounted PILOTs increase the city’s annual payment to HYIC to pay interest on its bonds, eroding the city’s real estate tax base and the provision of city services (Kiernan 2007, 13). Third, a depressed real estate market will not only

slow down HYIC revenue sources, but creates an incentive for the city, through the IDA, to increase the PILOT discount rate and expand those eligible for PILOTs.

These financial incentives also affect the “market forces” of supply and demand (13). The OMB’s Mark Page summarized this consequence at The *Bond Buyer’s* 4th Annual Metro Finance Conference. Answering why the city would give tax breaks to developers in an area where the city said they were going anyway, he responded, “...developers in New York are accustomed to receiving tax breaks and felt entitled to them” (Phillips 2006).

CONCLUSION

New York City’s experiment with value capture financing in the Hudson Yards project is 10 times bigger than any other TIF project on record (Manhattan CB4 2004, 9). As such, it offers an opportunity to measure the effects of large-scale implementation of the financing mechanism, and offers lessons for officials poised to embrace, reject or modify its use in their own localities.

Describing TIF as self-financing creates the appearance of a benign tool for urban economic development. It allows local elected officials to promise development and its rewards of economic growth while simultaneously employing the rhetoric of fiscal discipline.

However, pulling back the curtain of the self-financing mantra reveals the public policy trade-offs inherent in TIF. Specifically, the demands of value capture financing require substantial public revenues to both implement and support the project. In Hudson Yards, the high cost of HYIC bonds and the need to reassure the markets they were a safe investment cost the city a minimum of \$1 billion before a single shovel hit the ground.

This case study offers little hope for reform. Even in the face of a robust land use review process and experienced community opposition, the Bloomberg administration's framing of Hudson Yards as a self-financed economic development project that promised citywide benefits rather than serving only a narrow real estate elite was never successfully challenged. Instead, the City Council, the Mayor's only opposition in the rezoning, debated the proposal on the merits as presented by the administration. Specifically, they supported the stated need to use public resources to prime the private market despite soaring upfront costs, a loss of their own oversight powers, and the lack of any accountability measures.

Given the literature's documentation of TIF's potential to elicit copycat projects and the fact that HYIC bonds flew off the shelf, the wrong messages will be delivered without a thorough understanding of the complicated trade-offs revealed in the finer, albeit byzantine, details of the deal. The future implications of this example are made all the more urgent by New York State's recent expansion of TIF's potential revenue sources. Assuming increased political pressure to deliver economic growth in an environment hypersensitive to government spending, local officials are likely to seize upon the rhetorical opportunities offered by TIF.

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