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Committee onFinance

The Proposed Financing for the Hudson Yards Project East of 11th Avenue

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The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on the broad range of tax, budget, economic and related public policy issues that affect the quality of life and the economic well-being of New York City and State residents. Thank you for the opportunity to present FPI's views on this topic.

Through a proposed Hudson Yards Infrastructure Corporation (HYIC), the City is proposing a $4.0 billion investment in infrastructure (mainly the extension of the #7 subway line) and public amenities for the Hudson Yards redevelopment east of 11th Avenue. The $4.0 billion represents the principal to be borrowed; interest costs will be additional.[1] This debt would be repaid with PILOT payments from developers of commercial property, property taxes from residential developments, land sales and development fees in connection with the Hudson Yards plan.

It makes sense to rezone the Far West Side to promote mixed use, residential (including affordable housing) and commercial development. It also makes sense for the city to invest in infrastructure improvements to support that development, and then for the city to seek ways to recapture some of the increased land values that result as a way to help defray the costs of the city's infrastructure investments. However, the city's proposed Hudson Yards financing scheme is fraught with several serious problems and, in my opinion, should be scrapped and instead, a plan of infrastructure improvements for the Far West Side should be incorporated into the city's capital budget.

The city's proposed Hudson Yards financing scheme suffers from five serious flaws. First, it has been proposed as an "off-budget" scheme to circumvent City Council review and approval. Second, it has been misleadingly billed as a "self-financing" scheme that would not affect or possibly jeopardize the city operating budget and the services that operating budget sustains. Third, it is a costly method to finance infrastructure improvements. Fourth, by tying the

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[1] For example, the City indicates that the total debt service over 40 years for the $4 billion borrowed by the Hudson Yards Infrastructure Corporation will be $10 billion. Office of the State Deputy Comptroller, Review of the Mayor's Executive Budget for Fiscal Year 2005, May 2004, p. 50.

repayment of Hudson Yards Infrastructure Corporation debt so heavily to a PILOT (payment-in-lieu of taxes) payment mechanism rooted in substantially reduced property taxes, the financing scheme unnecessarily and unwisely locks the city into an ill-conceived economic development approach. And fifth and finally, the combination of a massive and ambitious scale and schedule of commercial development required to meet the HYIC's debt service needs and that the repayment mechanism is rooted in tax breaks on the Far West Side has the potential to erode the city's commercial property tax base in Midtown and Downtown Manhattan and thus represents a serious tax policy threat to the City budget. There is absolutely no need to jeopardize the city budget for decades to come in order to sensibly develop the Far West Side.[2]

The first criticism needs no elaboration. The City should not be using off-budget mechanisms to carry out the city's business and the City Council should not allow its budget authority to be eroded since the Council and the public generally lose a voice if that happens.[3]

It was always a fiction that the HYIC was "self-financing". By selling $4.65 billion in new Hudson Yards-related debt over the next few years, the City will be adding considerably to its outstanding debt. If the projected revenues from the Hudson Yards redevelopment do not materialize according to plan, the City budget, directly or indirectly, might then be on the hook. Even though the project-related debt will be issued by special purpose entities, and not directly by the City, it is seems unlikely the City would permit a default to occur. As it is, part of the proposed financing already uses the Transitional Finance Authority to provide credit enhancement for up to $1 billion in commercial paper debt that will be needed to meet interest payments on the infrastructure borrowing until sufficient project revenues are generated 12 years or so into the project. The use of the TFA directly involves the city budget and city income tax revenues.

The expenditure side of the city budget is also directly involved because this is a long-term development project that will necessitate City expenditures for public safety, sanitation and the full array of other essential services. Yet, for the first several years, the project will generate very little in the way of City tax revenues. The City is proposing to enter into PILOT agreements with developers that will channel in-lieu-of-payments for property and sales taxes to

[2] It is also troubling that the Mayor has not, to date, indicated where the city resources will come from to pay for the city's $350 million contribution to the expansion of the Jacob Javits Convention Center or the $300 million contribution to the construction of the New York Sports and Convention Center, also known as the proposed Jets Stadium. There are other problematic aspects to the proposed financing for the stadium; among them, the proposed use of tax exempt financing, the use of PILOT payments by the Jets to pay the debt service on $400 million in borrowing by a city-created entity, and the fact that it is not clear how much the Jets will pay the MTA for development rights over the West Rail Yards or how the Jets will pay for those development rights.

[3] In his October 20, 2004, letter to Mayor Bloomberg, City Comptroller William C. Thompson, Jr., wrote: “You chose not to include this project in the capital budget, avoiding City Council approval. In doing so, 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. … Indeed, if your plan for the West Side is worthy of our City’s investment, it should be included in our capital budget and subject to scrutiny beyond what has been offered to date.”

pay project debt service, rather than general revenues that could fund City services. If the development unfolds on or close to the scale and the schedule envisioned by the City's proposal, business and personal income taxes will be generated that could fund City services. While the City estimates these general revenues at $60 billion over the next several decades, it has so far not provided to us the details of those revenue projections.[4]

The HYIC financing is an extremely costly approach since it involves a fair degree of credit risk and contemplates the use of short-term commercial paper borrowing to cover interest costs for the first several years until development-related payment streams materialize. Since the HYIC borrowing takes place outside the city's capital plan, the city's Independent Budget Office estimated that this adds $1.3 billion (or 26%) in costs compared to financing through city general obligation bonds.[5] This additional $1.3 billion in financing costs otherwise would be available to fund general city operating expenditures.

Another issue of particular concern to us is the proposed economic development subsidy policy for the Hudson Yards area. On the one hand, the City points to studies showing that the project will help New York City capture a significant share of the growth in office demand over the next several decades. On the other hand, the City is proposing a Uniform Tax Exemption Policy (UTEP) that will subsidize that development across the board. The City expects all office developers to sign up for UTEP because they are making it financially attractive to do so. Under UTEP, office developers will receive a three-tiered subsidy through the UTEP PILOT mechanism: a built-in reduction in property taxes; a very small annual increase to reflect but not capture market appreciation; and protection against any general property tax rate increases.

Here is one of the great paradoxes in the City's proposal. With the City assuming enormous risks in developing the West Side, and making multi-billion investments in infrastructure and amenities, why would the City need to also provide substantial tax breaks to attract new development? Under the City's vision for the project, development unfolds gradually over a long period of time. That is understandable. But why assume that sizable subsidies will be needed? Shouldn't we wait to see how strong market demand is, and shouldn't the pace of development be adjusted to closely reflect the strength of market demand?

The City has had a very problematic history of providing economic development subsidies. The Council is still grappling with how to monitor and restrain the unwise use of subsidies. UTEP would only institutionalize those problems, completely beyond the reach of the Council, and could set in motion unrelenting pressure to further escalate subsidy amounts throughout the city. If the pace of commercial development on the West Side falls short of projections, the city will come under pressure to enhance subsidies further. The city would come under pressure to speed up the pace of development and it may then resort to even deeper subsidies. The city may feel it has to start subsidizing tenants as well as developers. It's a treadmill. Once you get on it, it's hard to get off. Economic development subsidies currently cost the city about $1.3 billion in lost

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[4] New York City Economic Development Corporation, "Economic Impact Analysis of Hudson Yards Project, Summary & Findings," November 30, 2004.
[5] New York City Independent Budget Office, "West Side Financing's Complex, $1.3 Billion Story," Fiscal Brief, August, 2004.

tax revenue each year.[6] While it is hard to precisely estimate the potential cost of the HYIC commercial property tax subsidies, it is conceivable that they would surpass that amount after a few years.

Finally, the HYIC financing has potentially harmful implications for city tax policy. The application of the UTEP PILOT approach on the west side could result in enormous pressure on commercial property taxes elsewhere in the city such that it might further jeopardize the City's tax base. With the city under the enormous pressure of paying the HYIC debt service leading it to do everything it can to get office tenants to move to the west side, commercial property owners in Midtown or Downtown will likely raise demands to reduce their property taxes "to level the playing field." Thus, the HYIC financing approach has the potential to seriously erode the city's commercial property tax base.

Putting UTEP in to the plan locks the city into this subsidy and tax policy for the next 40 years. Given the uncertainty of projecting what the development needs are going to be and what the market rate will be at those times, I think it's extremely ill-advised to say now -- 10 years before any development starts -- that we're going to offer substantial tax breaks. Of course, if the City lessens the property tax breaks it lessens the attractiveness to developers of the PILOT agreements, and thereby diminishes the adequacy of the backing to repay the Hudson Yards debt.

The proposed HYIC financing is seriously flawed for these five reasons: it's an "off-budget" capital project outside of the normal review and approval by the Council, it's misleadingly billed as "self-financing", it's very costly, it's ill-advised economic development policy, and as tax policy, it could jeopardize the city's core property tax base. My recommendation would be, that if the Council and the Mayor deem the Hudson Yards plan and infrastructure investments to be a worthy public priority for New York City, the capital projects should be put in the city's capital budget and general obligation financing used. This would improve the project's financing and its accountability and would represent sound economic development and tax policy.

Thank you for the opportunity to present our views on this important matter.

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[6] Current tax expenditures include the one that provides Madison Square Garden with a full property tax exemption worth at least $10.6 million.