

How Risk Undermines TIF's Self-Financing Premise: A Case Study of Hudson Yards

Bridget Fisher^a and Flávia Leite^a

^a**Schwartz Center for Economic Policy Analysis**
(SCEPA) Department of Economics
The New School for Social Research
6 East 16th Street, New York, NY 10003
economicpolicyresearch.org

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HOW RISK UNDERMINES TIF'S SELF-FINANCING PREMISE: A CASE STUDY OF HUDSON YARDS

Bridget Fisher^a and Flávia Leite^a

^a Schwartz Center for Economic Policy Analysis (SCEPA), The New School, New York City;

HOW RISK UNDERMINES TIF'S SELF-FINANCING PREMISE: A CASE STUDY OF HUDSON YARDS

Tax increment financing (TIF) has exploded in popularity on the municipal finance landscape as cities compete for scarce public resources to fund economic development. Previous studies evaluate TIF's efficacy and ability to spark economic growth. This research expands the evaluation of TIF by questioning the widespread understanding of TIF as a self-financing tool through an analysis of its risks and costs to taxpayers. We present a case study of the Hudson Yards redevelopment project in New York City, the country's largest TIF-type project. Described as a self-financing project by its supporters and elected officials, our analysis reveals Hudson Yards cost the city \$2.2 billion largely due to tax breaks to incentivize development and costs resulting from the materialization of standard development risks. We conclude that TIF's self-financing rhetoric can be used to shift risk onto taxpayers. Disclosing and assigning project risk is necessary before the project's public approval to provide a robust cost-benefit analysis to municipalities considering TIF implementation and to fully inform taxpayers.

Keywords: TIF, Hudson Yards, development risk, self-financing, economic development, megadevelopments

INTRODUCTION

Tax increment financing (TIF) is a tool commonly used by local governments to finance economic development projects. It allows a municipality to pay for the cost of public infrastructure and/or economic development projects using the expected increase in tax revenues, most often in the form of property taxes. TIF is based on the expectation that public investment in infrastructure will induce private development that, in turn, increases property values and leads to higher property tax revenues. Under this framework, TIF districts are entitled to the resulting additional property tax revenue since the revenue growth would not have occurred “but for” the public sector’s upfront investments. Since TIF offers local governments the promise of financing development with the very revenues they are expected to generate, it is described as self-financing.

Given the goal of TIF use, a large share of the academic study focused on TIF investigates its claim to increase economic development. In this article, we seek to broaden the research on TIF by arguing that TIF’s risks and costs must be included as variables in the determination of TIF as a self-financing mechanism. In theory, TIF entails a closed loop of initial costs balanced out by future revenues. Yet on the ground, TIF projects often include tax expenditures that undermine public revenues needed to pay back TIF’s upfront costs and fall prey to development risks that create revenue shortfalls and unforeseen costs. Without assigning responsibility for these risks in the project’s design, TIF projects directly or indirectly compromise municipal finances by requiring support from a city’s general fund. We argue that

city officials misrepresent the costs of TIF-type projects by using TIF's self-financing label when simultaneously shifting development risk onto taxpayers.

We demonstrate this argument through a case study of the Hudson Yards redevelopment project on the Far West Side of New York City. Based on a \$3.5 billion bond issuance, Hudson Yards is the largest project in the United States to use a TIF-style financing mechanism. Fifteen years after its approval by the New York City Council under the rubric it would be a self-financing project, the redevelopment of Hudson Yards has spanned multiple stages of the business cycle, implemented shortly before the Great Recession, extending through the recovery, and now into the pandemic.

As such, it provides a unique opportunity for evaluating TIF's translation from theory to practice, especially given that the visibility and size of Hudson Yards as been used to support calls for other high-dollar TIF proposals, both locally and globally.¹ We conclude that disclosing and assigning TIF's risks and potential costs is necessary before project approval to provide a robust cost-benefit analysis to municipalities considering TIF implementation and to fully inform affected residents.

¹ In September 2016, the engineering firm AECOM proposed a TIF-funded extension of the Seventh Avenue Line (Number 1) subway at Rector Street Station to Brooklyn. In early 2018, New York Governor Andrew Cuomo included a provision in his proposed state budget that would allow the Metropolitan Transportation Authority (MTA) to use TIF to raise revenue for the agency in New York City. In February 2016, Mayor Bill de Blasio introduced the Brooklyn Queens Connector (the BQX), a TIF-funded streetcar that would run along the East River and connect Brooklyn's Sunset Park with Queens' Astoria. In one of many international examples, the private sponsor of a multi-billion redevelopment proposal in Cape Town, James Wilson, said, "We see how Hudson Yards, a similar large-scale development on Manhattan's West Side, has become New York's newest tourist attraction because of its contemporary design elements. Harbour Arch will do the same for Cape Town, already regarded as one of the best cities in the world to visit" (Patel, 2020).

In this article, we first define tax increment financing, its implementation process and use in the United States. Second, we provide a review of the body of literature dedicated to TIF evaluation and describe our research methodology. Third, we explain the use of TIF in the Hudson Yards project in the form of PILOT financing, including a description of the use of the self-financing label in the project's public deliberation. Next, we document the project's costs to New York City so far, concluding that rather than being self-financing, the Hudson Yards project cost the city \$2.2 billion, largely due to tax breaks to incentivize development and costs attributable to the materialization of standard development risks. Last, we discuss that positioning TIF and its variants as self-financing without disclosing costs and assigning risk before project approval denies the public consideration of the trade-offs inherent in the public investment. Our findings call for further research investigating the use of the self-financing label in additional case studies and identifying the institutional safeguards necessary to ensure the full breadth and depth of TIF risks and costs are considered before project approval and implementation.

How TIF works

TIF is an urban development finance tool authorized at the state level 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.

TIF was first used in California in 1952 to raise the local matching funds required by the federal urban renewal program. TIF was developed as a means to circumvent the need for citywide bond issues requiring voter approval, which were frequently voted down (Briffault, 2010). TIF didn't become popular until the late 1970s, when the end of the urban renewal program coincided with states' growing backlash against taxes, embodied in California's 1978 Proposition 13 (Ibid). During the 80s and 90s, over \$20 billion in TIF bonds were issued as local municipalities increasingly found themselves on their own to finance development efforts (Kerth and Baxandall, 2011). Today, every state except for Arizona has a TIF-enabling legislation (Merriman, 2018), and it is characterized as the "most widely used local government program for financing economic development in the United States" (Briffault, 2010).

Tax increment financing has economic and political advantages that help explain its widespread use in the country. First, in theory, TIF does not involve an increase in tax rates or new taxes, making it appealing to both voters and elected officials in a fiscally conservative environment. Second, unlike general obligation bonds which are backed by a municipality's full faith and credit, TIF debt is backed by future revenue streams. As such, TIF use does not go through a municipality's annual budget process, does not contribute to the city's official debt, nor require voter approval. Further, TIF empowers local government officials, enabling them to shape not only the economic but the physical development of an area.

Two common preconditions set by states for TIF implementation are compliance with blight and “but for” requirements.² The former refers to a legal requirement that an area is considered blighted to qualify as a TIF project. The blight designation is a legacy of TIF’s genesis under the federal urban renewal program targeting removal of urban blight (Briffault, 2010). The latter represents the idea that a TIF should only be implemented if the subsequent development would not happen “but for” the TIF. The underlying assumption is that if this condition is met, property tax increments can be attributed to the TIF-related investment, rather than from other sources such as inflation or regional growth³.

In general, TIF implementation begins when local officials designate a geographic area as a TIF district. The area’s assessed value is 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 property value above the base value, the increment, are set aside in a separate account within the

² Thirty-four states require a finding of “blight” to establish some or all types of TIF districts. Eighteen states require a designation that development would not occur “but for” the establishment of the district. Thirteen states require both blight and “but for” requirements (Merriman, 2018).

³ TIF’s “but for” test is based on a project’s counterfactual analysis, or the study of what would happen in the district without the TIF-related investment. This analysis is meant to provide evidence that property values will not rise in the area without the TIF-related investment. Because these studies are based on predictions and projections, results are often determined by the assumptions chosen. Project supporters can therefore select consultants that provide the counterfactual analysis they are looking for through the use of unrealistic scenarios and assumptions that prove an area is in need of redevelopment (Lefcoe, 2011). As a result, TIF districts are often created in areas where growth is already taking place or on undeveloped land, where dramatic increases in assessed value may occur by simply rezoning the district (Youngman, 2011). When this is the case, TIF ends up capturing an increment that it is not related to the TIF, but to other economic or regulatory factors.

municipality or directed to an outside economic development authority operating on its behalf. For the life of the district, the increment is used to repay costs associated with the upfront public improvements or new economic development projects within the district.⁴ While not common, TIF districts may capture other revenue streams besides property taxes, such as sales taxes, payments in lieu of taxes (PILOTs), personal property taxes, or state or federal matching funds, among others.

Over time, municipalities created multiple methods to pay TIF's upfront development costs and debt. However, the most common is bonds backed by projected incremental revenues. Municipalities can also use a "pay as you go" structure, reimbursing developer's up-front costs as the tax increment comes in each year. A less frequent form is developer-financed TIFs, where developers take out conventional loans for infrastructure investments and then are repaid by the TIF increment. Regardless of the financing form, TIF is described as a self-financing mechanism because, theoretically, the increment pays for the investment.

RELEVANT LITERATURE

TIF is considered an attractive tool due to its promise to boost local economic development. It follows that the bulk of academic research on TIF is focused on its economic development effects. Yet, a review of this literature reveals the tool often fails to meet its primary goal of

⁴ State legislation varies regarding TIF duration. Some states do not specify an expiration date, other states close only after debt is expired, and others set a sunset date varying from 10 to 40 years. For more information see Merriman (2018).

increasing property values and spurring economic growth (Merriman, 2018).⁵

However, less attention is paid to a central question regarding TIF use: fulfillment of its self-financing premise and the consequences of failure. As part of this small body of literature, Jan Brueckner (2001) documented that TIF is not self-financing if the newly created public good in the TIF district was overprovided or slightly underprovided before implementation. Stinson (1992) found some TIF districts in Minnesota unable to meet future debt service requirements without assistance from the general fund and, therefore, were not self-financing. Lawrence and Stephenson (1995) found TIF negatively impacts the service burden of other taxing districts through an evaluation of who funds expenditures and receives subsidies within TIF districts in downtown Des Moines, Iowa. Merriman (2010) provides evidence that TIF adoption increases municipalities' revenue volatility as TIF districts are dissolved and created, complicating fiscal management.

While few academic studies investigate TIF's self-financing premise, on the ground many TIF projects required the explicit or implicit financial support of sponsoring municipalities

⁵ Merriman (2018) conducted a meta-analysis of 31 studies measuring the effects of TIF adoption on economic activity, including employment, retail sales, assessed values, and growth in median house value, among others. Of the 31 studies reviewed, 13 presented positive results, meaning that TIF adoption had positive impact on the economic variables; eight studies reported neutral results; five reported negative outcomes; and three reported mixed effects. Negative results suggest that TIF reduces economic growth, while neutral and mixed results present both positive and negative outcomes. In general, neutral results suggest that TIF adoption did not stimulate economic development. Mixed outcomes do not show meaningful positive effects. Making a generalization about the studies is a task limited by the different areas, time periods and outcome variables considered in each. Despite these limitations, it is indisputable that the results suggest that, overall, TIF has not been a successful policy in its goal of boosting economic development. For more detail see Merriman (2018).

and their taxpayers.⁶ The additional costs to municipalities typically stem from subsidies awarded to attract private development to TIF districts, the materialization of standard development risks, and costs stemming from risks inherent to TIF's design. Subsidies decrease project revenue needed to pay back TIF debt, increasing the risk the city will be called on to make up for revenue shortfalls (Cerciello, 2005). Standard development risks include recession, cost overruns, benefit shortfalls, and cost spillovers. Resulting from strategic misrepresentation and optimism bias common in urban development and infrastructure projects, Flyvbjerg (2009) describes that these risks can both decrease revenues and increase project costs.⁷ Risks associated specifically with TIF projects include completion risk (e.g. the TIF project is never built or completed), valuation risk (e.g. property values do not rise as projected) and taxation risk

⁶ Although not focused on discussing its self-financing premise, some academic and non-academic studies and reports describe cases that challenge the depiction of TIF as a self-financing tool. For example, Weber and Godderis (2007) present the case of Atlanta's second TIF district, a brownfield redevelopment in the central city that ended up requiring approximately \$170 million in city support. Baker (2016) reported the case of an urban renewal authority in the City of Westminster that failed to meet its financial obligations as it did not generate enough additional tax revenue. As a result, the municipality had to purchase the outstanding TIF bonds to avoid a default. Another example is a TIF district in Port St. Lucie, Florida, that issued \$58 million in bonds. In 2016, TIF revenues were insufficient to pay for the operating cost and the debt service, leaving the city responsible for the project (City of Port St. Lucie, 2016). Similarly, Kemanski (1990) writes about two TIF districts in Minneapolis that failed to generate enough revenue to repay their TIF debt in 1984, requiring the city to make up the difference. For other examples see: Cerciello (2005).

⁷ Flyvbjerg (2009) describes a sample of megaprojects covering a 70-year time period and across 20 nations and five continents, concluding that nine out of 10 projects have cost overruns and that demand and benefit forecasts are wrong by 20-70 per cent compared with actual development. Flyvbjerg provides evidence that as projects get larger, costs increase, putting cities and nations at risk when they must support financial and economic disasters.

(e.g. other taxing entities change their tax rates) (Weber, 2010, pp. 260). In these cases, the TIF does not pay for itself. Rather, the municipality directly subsidizes the project.

Several authors describe the likelihood that public officials will seek to obscure costs and risks in economic development projects to smooth opposition or promote their own ventures. Flyvbjerg et al. (2002, 2005) and Wachs (1989, 1990) conclude that planners and promoters purposely spin scenarios of success and underestimate the potential for failure. Spindler and Forrester (1993) describe how policies that are invisible to the public in terms of costs, such as tax abatements or subsidized loans, reduce citizen involvement in economic development projects and leaves political influence as the final arbiter of what gets built. Stoker (1987) argues the costs of urban projects are often masked by complex negotiations and decision-making processes that limit public awareness. Weber (2010) cites Chicago's efforts to control potential TIF opposition by discouraging and limiting public participation in the process of designating a TIF.

Limited academic study of TIF's ability to fulfill its self-financing premise highlights the need to broaden the investigation of TIF as a self-financing mechanism. This paper aims to fill this gap by analyzing how the self-financing label was misused in the case study of New York City's Hudson Yards redevelopment project. We argue that city officials misrepresented the project as self-financing while leaving taxpayers exposed to the risks inherent in the project's design and implementation.

METHODOLOGY

This article seeks to evaluate the self-financing premise behind the country's largest TIF-type project, New York City's Hudson Yards, by describing how the label was used to promote and pass the project and comparing the projected and actual costs of implementation over its first fifteen years. The single case study method is appropriate because of the project's extreme size and because Hudson Yards is frequently used as an example to other municipalities of how to design TIF for megaprojects.

The research on the concept, implementation and efficacy of tax increment financing was culled from academic journals and studies issued by think tanks and public policy institutes. This literature spans the theoretical model of TIF as well as studies of the mechanism's effects in specific projects and states.

The description of the Hudson Yards project was established through official public documentation and press materials. The documentation includes reports published by the Department of City Planning (DCP), the New York City Economic Development Corporation (EDC), and the New York City Department of Transportation (DOT), as well as reports from Manhattan Community Board 4, City Council reports and press materials.

The analysis of the project's funding structure, including tax breaks, project costs, projected and actual budgets, relies on public documentation and databases from the Hudson Yards Infrastructure Corporation (HYIC), Hudson Yards Development Corporation (HYDC), city-commissioned reports from consultant Cushman & Wakefield, New York City Independent Budget Office (IBO), Department of Finance (DOF), documentation from the Office of

Management and Budget (OMB) and other information obtained on the basis of New York's Freedom of Information Law (FOIL).

HUDSON YARDS

TIF, PILOT Financing and New York City

New York State's Municipal Redevelopment Law authorized TIF use in 1984. However, prior to the approval of New York City's Hudson Yards project in 2005, only two municipalities used TIF to fund relatively small projects, the Town of Victor (\$8 million TIF project) and the city of Greenburgh (\$770,000 TIF project) (Cerciello, 2005).⁸ Although commonly referred to as a TIF project, Hudson Yards is based on a TIF alternative called PILOT Financing.

While similar, there are key differences between the two mechanisms. First, PILOT financing is not subject to the constraints of the TIF enabling law, such as district size and length and the revenues that can be used (Citizens Budget Commission, 2017). Second, all properties inside a TIF district contribute to generating the increment, while under PILOT financing, a municipality can specify which properties share revenues with the district. Third, TIF revenues are determined by formula, whereas PILOT financing revenues are determined by local officials. Under TIF, landowners are charged property taxes according to the locality's assessment rules. The base continues to go to the original taxing authority while the increment is used to pay off

⁸ Cerciello (2005) argues that the limited number of TIF projects in New York is due to its reliance on tax abatements: "Because TIF depends on new property tax revenue, it essentially precludes the use of tax abatement programs as incentives to attract private development. If developers are given tax breaks, there will be less incremental tax revenue to collect" (pp.817). However, the Hudson Yards project includes both a TIF-type financing mechanism as well as tax abatements.

development costs and debt. In contrast, under PILOT financing, local officials have the discretion to designate revenues from multiple sources, including negotiated or discounted PILOTs that substitute for property taxes, designated or created fees, and sales tax, among others.

Despite these differences, PILOT financing and TIF share the same basic structure. Under both mechanisms, a local government, through a redevelopment agency, issues bonds and uses the proceeds to finance public improvements intended to increase property values. Their similar structure allows us to apply the lessons learned from TIF to PILOT financing.⁹

The project

The area known as Hudson Yards encompasses 360 acres on the Far West Side of Manhattan. Hudson Yards is roughly defined by West 28th Street to the south, Seventh and Eighth Avenues to the east, West 43rd Street to the north, and the Hudson River to the west.

Underdeveloped compared to neighboring communities, Hudson Yards elicited the attention of previous government officials and developers for decades. In 1969, the Lindsay administration put forward a plan to expand Manhattan's commercial business district to the Hudson River. In 1994, the Giuliani administration planned to bring the Yankees and the 2008 Olympics to a proposed stadium on the West Side. However, the area's redevelopment remained elusive until the Bloomberg Administration's proposal to rezone the area for mixed-use development linked to the city's (failed) bid to host the 2012 Olympics.

⁹ See Cerciello (2005) for a robust description of how diverted PILOTs constitute TIF debt.

The Bloomberg Administration argued that Hudson Yards needed to be redeveloped as an office district to protect and increase the city's share of the regional market for commercial space. This assertion was supported by a 2003 study commissioned from private consultants showing Midtown's share of occupied office space was decreasing despite increasing demand in the New York region (Economics Research Associates and Cushman & Wakefield, 2003). The cause for the drop off in market share was cited as insufficient space for office development. Hudson Yards' proximity to Midtown offered the opportunity to capture growth in the office market by extending west the historic appeal of the city's premier business center (Cushman & Wakefield, 2006).

In 2003, Bloomberg's Department of City Planning issued a proposed master plan for Hudson Yards, the "Preferred Direction" (NYC Department of City Planning and the NYC Economic Development Corporation, 2003). The document put forward the city's "but for" justification: without public investment to overcome the area's outdated zoning and poor transportation and infrastructure, the Hudson Yards district would not realize its potential as the only large, underutilized area where Midtown could expand. Citing the need to spur private development in the district, the city launched the area's third and last redevelopment plan based on three, interconnected interventions: (i) rezoning the area, (ii) investing in public infrastructure, and (iii) using a self-financing mechanism to fund the city's investment.

The first element of the Hudson Yards redevelopment plan was the area's upzoning. Prior to it, the district was home to commercial and light industrial uses, parking lots, garages, and about 12,000 residential housing units (Manhattan Community Board 4, 2004). 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 (NYC Department of City Planning, 2014). The new zoning allows for 24 msf for commercial office development, 13,500 housing units, 1 msf for retail spaces, and 2 msf for new hotels and 5.45 acres of open space (Hudson Yards Development Corporation, n.d). 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 5 msf for apartments, office, hotel, retail, cultural and parking uses.

The second element of the Hudson Yards redevelopment plan was a \$3.5 billion dollar investment in public infrastructure. The largest portion of this expenditure, originally estimated at \$2.1 billion, was for the extension of the No. 7 subway line from its terminus in Midtown to a newly created station on 34th Street between 10th and 11th Avenues.¹⁰ Funds were also allocated for the creation of Hudson Boulevard, a new street spotted with both public and privately-owned parks running between Tenth and Eleventh Streets, at an estimated cost of \$1.2 billion.¹¹ An additional \$200 million was used to purchase a 50 percent interest in the transferable development rights of the space above the rail yards, owned by the MTA. These rights are sold

¹⁰ To build or extend a portion of the New York City subway, the state-administered MTA usually pays 80 percent of the costs, the state 15 percent, and the city 5 percent. In the case of Hudson Yards, the MTA and the state refused the city's request to make the 7 line extension a capital funding priority, leading the city to take the unusual step of picking up the entire tab. See: Kiernan (2007).

¹¹ The first phase of construction of Hudson Boulevard and Park ran from 33rd and 36th Streets at an estimated cost of \$700 million, which included public amenities, property acquisition and the creation of the Boulevard itself. In August 2018, the City Council approved an additional \$500 million in bonds for a 3-block extension to 39th Street (Barnett, 2018).

to developers to increase the allowable densities on specific sites in the district outside the rail yards.

Beginning with Mayor Giuliani, the city's proposed infrastructure investment to develop a commercial office district on the city's Far West Side was sold to city residents as a self-financed TIF-type project. This description was used to assure residents the project would pay for itself, implying taxpayers would not pay additional costs to build Hudson Yards.

Dan Doctoroff, Bloomberg's Deputy Mayor for Economic Development, first lobbied for the project through his Olympic booster non-profit NYC2012. He lays claim to the use of TIF in Hudson Yards in his book "Greater Than Ever: New York's Big Comeback." Explaining his rationale for TIF, he writes, "The idea here is that the project essentially pays for itself" (Doctoroff, 2017, pp. 162-163). According to Doctoroff, his influence resulted in the Giuliani Administration's use of TIF in its initial proposal for the redevelopment of Hudson Yards, which he later incorporated into Bloomberg's subsequent proposal. The Giuliani Administration issued a press release describing that "The Far West Midtown plan is designed to pay for itself,"¹² whereas Bloomberg's "Preferred Direction" master plan states: "because of this self-financing structure, the infrastructure requirements will not compete for scarce public resources for other worthwhile projects" (NYC Department of City Planning and the NYC Economic Development Corporation, 2003). The administration also reassured the City Council that "the financing of the [Hudson Yards] improvements will not be a burden to the City's taxpayers." (New York City

¹² For more information see: NYC Department of City Planning (2001). "Far West Midtown: A Framework for Development". New York. <https://www1.nyc.gov/assets/planning/download/pdf/plans/hudson-yards/fwmt.pdf> (accessed February, 2020)

Council Committee on Finance, 2004, pp. 8) The New York Post quotes Mayor Bloomberg as saying, “Most of the monies that would be used to do the Hudson Yards are dependent on revenues that would be generated so they’re not monies that we have already” (Topousis, 2004).

TIF, by design, presents a gap between debt payment and revenue materialization (Citizens Budget Commission, 2017). To ensure the project would fulfill its self-financing mandate, Bloomberg’s original financing proposal for Hudson Yards included the use of short-term commercial paper to cover the project’s initial debt service, covering the construction period when development-reliant revenues were yet to materialize (NYC Independent Budget Office, 2004). However, the Council objected to the extra interest cost for the short-term paper, estimated at \$1 billion (New York City Council transcript, 2005, pp. 8-9), agreeing instead to commit city funds to cover interest costs in the form of interest support payments (ISPs). However, instead of limiting potential debt support to the early years, the city committed to pay ISPs if and when the project could not do so on its own at any time during the life of the TIF district.

The financing supporting the city’s infrastructure investment was approved by the City Council in negotiation with Mayor Bloomberg in two resolutions: Resolution 760, in January 2005, and Resolution 547 passed in 2006, which included the western rail yards. Under Mayor de Blasio, the Council passed Resolution 469 in August 2018 to fund remaining infrastructure costs and extend Hudson Boulevard and Park.

This legislation authorized the Hudson Yards Infrastructure Corporation (HYIC) to issue \$3.5 billion in bonds backed the city’s interest support payments to pay for the upfront

development costs discussed above.¹³ The bonds are backed by designed revenues generated by the new development in the project area and include (i) recurring revenues through property taxes, (ii) one-time revenues and (iii) city appropriations.

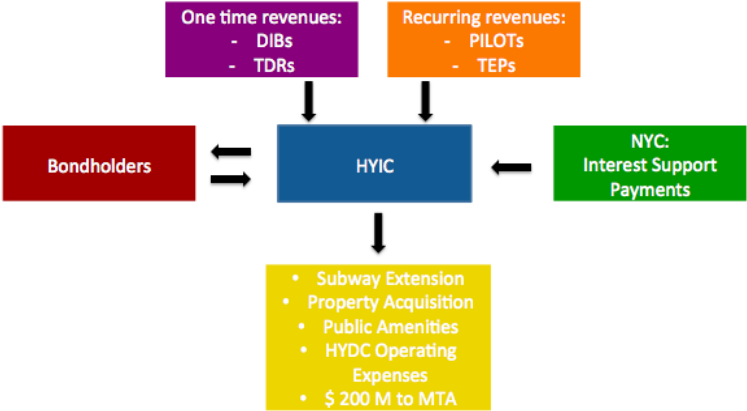


Figure 1 - HYIC's Revenue Sources and Costs. Source: Infographic by the Authors [DIBs: District Improvement Bonuses; TDRs: Transfer Development Rights; PILOTs: Payment in Lieu of Property Taxes; TEPs: Tax Equivalency Payments; HYIC: Hudson Yards Infrastructure Corporation]

Recurring Revenues: Property Taxes

Property taxes from new commercial and residential developments comprise HYIC’s largest revenue streams.

¹³ To manage and fund the project, in 2005 the city created two local development corporations. The planning, design and implementation would be the purview of the Hudson Yards Development Corporation (HYDC). The Hudson Yards Infrastructure Corporation (HYIC) was created to finance the project’s property acquisition and infrastructure work. HYIC’s first bond offering in 2007 was for \$2 billion, followed by a \$1 billion offering in 2012. The third offering, approved in August of 2018, is yet to be issued.

PILOTS for Commercial Property Taxes

New commercial developments within the Hudson Yards financing district make payments in lieu of taxes (PILOTs) to HYIC rather than paying property tax to the city.¹⁴ The amount of PILOTs to be paid by new developers was established by the New York City Industrial Development Agency (IDA) through the Uniform Tax Exemption Policy (UTEP) in December of 2006. The Hudson Yards UTEP provided tax abatements for new, privately-owned, commercial developments in the project area. Discounts can reach up to 40 percent of property taxes (Hudson Yards Infrastructure Corporation, 2007).¹⁵ Discounted PILOT payments extend for a 15-year period following construction and then phase-out to the equivalent of full property taxes over a five-year period. On the 20th year, owners pay full property taxes that continue to go to HYIC for the life of each agreement, which is expected to be 35 years. The annual increase in PILOT payments is capped at 3 percent (Hudson Yards Infrastructure Corporation, 2007).

Tax breaks were added to the project based on the city's assertion that developers would not be willing to develop without tax abatements (Cushman & Wakefield, 2006). According to IDA Chairman Joshua J. Sirefman, the commercial property tax break was created to provide "financial assistance to overcome the high-cost barrier to development that will enable the city to capture demand for new Class A office space and will fuel the continued growth of the city's

¹⁴ Commercial developers enter into PILOT agreements with the city's Industrial Development Agency (IDA). They make payments in lieu of property taxes to the IDA, which funnels the revenues to HYIC.

¹⁵ The amount of an individual developer's PILOT is determined by two factors. First, projects that are further west and therefore more difficult to develop receive steeper discounts. Second, to reward pioneering developers who act early, discounts decrease after every 5 million square feet of land is developed (Hudson Yards Infrastructure Corporation, 2007).

economy" (NYC Independent Budget Office, 2013). Ultimately, the decision to discount PILOTs to developers in the Hudson Yards project area added a second layer of incentives to the overall project. Not only would developers be enticed by the development potential and the new public infrastructure in the district, but also by tax breaks.

Tax Equivalency Payments

Property taxes collected by the city from new hotels and residential developments in Hudson Yards are forwarded to HYIC as Tax Equivalency Payments (TEPs), subject to annual appropriation through the city budget. While these properties do not receive a discount on their property taxes due to their location in the Hudson Yards district, their payments can be discounted through other property tax abatement programs available to non-commercial properties. Residential properties in the project area can participate in the 421-a tax exemption program, detailed in the next section.

One-Time Revenues

One-time revenues, albeit smaller streams, were designed to provide HYIC revenue during the pre-construction period.

Density Bonuses

HYIC receives one-time revenues by selling two types of density bonuses to developers, both of which allow for an increase in development space through higher floor area ratios (FAR). These include district improvement bonuses (DIBs) and transferable development rights (TDRs). As of right, properties in the project area have a FAR of 6.5 for residential developments and 10 for

commercial developments. By making DIB payments to HYIC, developers can increase the FAR, depending on the location, up to 33 for commercial buildings. After the maximum DIB FAR has been reached, owners of commercial buildings within designated receiving sites¹⁶ in the Hudson Yards district can purchase transferable development rights from HYIC that originated in the Eastern Rail Yard (Cushman & Wakefield, 2006).

PILOTS for Mortgage Recording Taxes

Payments in lieu of mortgage recording taxes (PILOT MRT) are one-time payments equivalent to the full amount of the mortgage recording tax and paid by commercial developers in the district making PILOTs payments. These PILOTs are the equivalent of the tax, which is 2.8 percent for mortgages on commercial properties exceeding 500,000 square feet. These funds are diverted from the city, which would receive 1.75 percent, and the state, which receives the remaining 1.05 percent.¹⁷

City Appropriations – Interest Support Payments

As previously mentioned, the city agreed city to cover Hudson Yards interest costs if the project's revenues fall short at any time during the life of the financing district.

UNASSIGNED RISKS

The project's financing plan was based on revenue projections from a November 2006 study

¹⁶ The eight blocks north of West 33rd Street between Tenth and Eleventh Avenues within the Project Area.

¹⁷ For properties belonging to the MTA, HYIC share of the PILOTs MRT is 91 percent (Cushman & Wakefield 2006).

commissioned by HYIC from Cushman & Wakefield, a private real-estate consultancy.¹⁸

However, because TIFs require anticipated revenues to fully cover actual costs, the assumptions underpinning self-financing mechanisms are inordinately sensitive to changes in revenues and costs. In 2004, the IBO stated, “Failure of any of these assumptions could be very costly for the city” (NYC Independent Budget Office, 2004). In a 2004 letter to Mayor Bloomberg, City Comptroller William C. Thompson, Jr., described the city’s plan as “extremely risky” (Bagli, 2004); saying it “could yield little return to city taxpayers and may in fact cost them billions of dollars” (Topousis, 2004). The city’s public deliberation identified factors that put these assumptions at risk, including tax breaks, development risks standard to megaprojects, and specific risks due to TIFs design.

The city’s inclusion of tax breaks for commercial and retail property taxes, in the form of discounted PILOTs, increased the risk there would not be enough revenue from the project to pay back the debt on the HYIC bonds. Discounted PILOT payments have a direct but inverse relationship to the city’s commitment to pay interest support payments. By lowering property tax revenue going to HYIC, the city decreased HYIC’s ability to pay its interest payments, thereby increasing its own potential costs in the form of ISPs. In testimony before the City Council’s Finance Committee in 2004, Economist James Parrott, Chief Economist at the Fiscal Policy Institute, argued against the inclusion of tax breaks and states, “If the projected revenues from the Hudson Yards redevelopment do not materialize according to plan, the City budget, directly

¹⁸ In 2006, HYIC hired C&W to analyze the real estate market impact of economic scenarios, including a base case and cyclical recession (modest downside) scenarios. The comparisons in this article are based on the 2006 base scenario.

or indirectly, might then be on the hook” (Parrott, 2004). Despite this public debate, the city passed its legislation codifying Hudson Yards’ financing mechanism in 2005 citing PILOTs as the main source of revenue for the project’s debt without mentioning the inclusion of tax breaks. A year later, the city’s IDA formally established the inclusion of tax breaks and specified the steep discounts (up to 40%) available.

A number of sources identified the need to address the project’s vulnerability to standard development risks that could decrease revenues or increase costs, including recession, cost overruns, and cost spillovers. Christopher Jones, Vice President of Research at the Regional Planning Association (RPA) warned of the project’s recession risk, “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, pp. 2). In 2004, the Independent Budget Office warned about a “lull in the economy or project delays.” The IBO also cautioned the city was likely to end up paying the project’s costs overruns: “Cost overruns also seem probable in a project of this magnitude. A significant increase in project costs to the city would not reduce revenue, but it would raise project debt service....” (NYC Independent Budget Office, 2004).

Megadevelopments are also subject to cost spillovers, or additional costs stemming from new needs within the project area. As an area develops, it attracts new residents, workers, and visitors, who, in their turn, require additional public services and infrastructure investment.

The IBO also labeled the likelihood of cost spillovers as a risk, as did the city’s 2004 Final Generic Environmental Impact Statement (FGEIS) of Hudson Yards by the City Planning

Commission (CPC) and the Metropolitan Transportation Authority (MTA). The report recognized that the project would bring many thousands of daytime users and new residents to the project area, requiring the public's provision of a new firehouse, school facilities, and a new day care center. Yet, the city did not include cost estimates for these necessary investments, limiting itself to state that the city will monitor development of the Project Area and "respond as appropriate" to provide the capacity needed for all these facilities and services (FGEIS, 2004). The IBO summarized, "The cost of these capital projects and municipal services is not addressed in the plan" (NYC Independent Budget Office, 2004).

Despite these warnings, the city included only \$100 million in the bonds for cost overruns for the subway, an amount that would turn out to be woefully inadequate for the subway, let alone the entire project. While standard practice for multi-faceted development projects sponsored by public private partnerships should include a robust process specifically designed to assign risks (Rybnicek et al, 2020), the city's passage and implementation of the project left these risks ambiguous and unassigned.

NEW YORK CITY PAYS FOR PROJECT RISK

Without assigning these risks to responsible parties prepared to handle them, the city was left paying \$2.2 billion in direct and indirect costs in addition to the \$3.5 billion in bonds for the Hudson Yards redevelopment project. The additional cost was due to the materialization of

project risk that decreased revenues, including tax breaks and the Great Recession, 19 and risks that increased costs, including cost overruns and cost spillovers. By jeopardizing the project's financial feasibility, these risks required additional public subsidies in the form of interest support payments to pay the project's debt and in the form of direct payments from the municipal budget.

Tax Breaks

According to the IDA, the cost to the city of the PILOT benefit, or the present value of the foregone property taxes, of eight commercial buildings in the project area is over \$1.1 billion over a 25-year period (NYCIDA Projects Cost/Benefit Analysis - FOIL Request). This is the difference between the property tax liability in the absence of PILOT benefits and the estimated PILOT. This figure will increase when new commercial and retail buildings are developed in the project area.²⁰

The Hudson Yards financial plan did not include specific incentives for residential developments. However, they already existed in the form of 421-a, a state program that pre-dates the Hudson Yards project and provides city tax breaks for residential developers. Although the

¹⁹ In 2006, HYIC hired Cushman & Wakefield (C&W), a private real-estate firm, to forecast revenues stemming from the Hudson Yards development. The firm analyzed the real estate market impact of economic scenarios, including a base case and cyclical recession (modest downside) scenarios. In a 2011 update, C&W analyzed a cyclical scenario. The figures in this article compare actual expenses and revenues to C&W's 2006 base scenario.

²⁰ The magnitude of the Hudson Yards' tax breaks briefly became a news topic in October 2014 when JPMorgan Chase publicly considered constructing a new headquarters in the Hudson Yards district and sought an additional subsidy of \$1 billion. In rebuffing the bank's request, the de Blasio administration pointed out that the bank would receive \$600 million in tax breaks under the as-of-right program established under Mayor Bloomberg (Bagli, 2014)

tax benefit is a state program, it played an important role in the development of Hudson Yards at significant cost to the city²¹

Residential tax breaks for development in the Hudson Yards area between 2009 and 2019 cost the city an estimated \$410 million in lost property tax revenue. This is a conservative number, as data limitations don't provide data for the project's early years (2005-2008). Nor does it include the cost of tax breaks that continue past 2019 (buildings can receive the tax break for 10 or 20 years post-construction).²² Because the city forwards all new property taxes in the Hudson Yards area (with the exception of those under PILOTs) to HYIC, revenue lost to the 421-a program is also revenue lost to HYIC.

Recession and Revenue Shortfalls

Between 2006 and 2019, only two of HYIC's multiple revenue streams matched its projected performance. The rest came in significantly lower than anticipated. In 2006, C&W projected HYIC revenues would be \$2.1 billion by FY 2019 (Cushman & Wakefield, 2006), but actual revenues came in at only \$1.5 million. This left HYIC \$573 million short, or 27 percent less than

²¹ The 421-a program has been part of New York City's development policy since the early 1970's, albeit in different forms. See: <https://www1.nyc.gov/site/hpd/services-and-information/tax-incentives-421-a.page>

²² Differently from commercial tax breaks (PILOTs), these figures are actual numbers and do not include future discounts. The estimate is based on the annual assessment rolls of Hudson Yards Residential Properties available in New York City's Department of Finance's Real Property Assessment Database (RPAD). To estimate the value of the 421-a benefit, the authors calculated the actual taxes owed for each property in the project area, or the assessed value times the tax rate. The value of the benefit is the difference between what a property owner would pay with and without the 421-a exemption. We consider the historical property tax rate for each year for each tax class. The estimate goes back to the latest year of available data, which is 2009.

projected.

TEPS and PILOTs MRT were the revenue sources that matched or exceeded the original forecast. By the end of the FY2019, HYIC collected \$498 million in TEPs from the city, \$30 million more than C&W's 2006 projection of \$528 million. The increase was driven by high demand for non-commercial space, in particular for hotels. The amount collected for PILOTs MRT was \$32.7 million more than projected.

REVENUES: 2006 to 2019 (Amounts in \$ million)	Projected Revenue by 2019	Actual Revenue by 2019	Difference
Recurring Revenues			
Commercial & Retail PILOTs	615.6	82.7	-532.9
Tax Equivalency Payments (TEPs)	498.0	528.1	30.1
One-time Revenues			
District Improvement Bonuses (DIBs)	550.6	475.4	-75.2
Transfer Development Rights (TDR)	322.6	294.5	28.0
PILOTs for Mortgage Recording Taxes	134.5	167.2	32.7
TOTAL REVENUE SHORTFALL	2,121.2	1,547.9	-573.3

Table 1- HYIC's Shortfall in Revenues to Pay Back Bondholders. Source: HYIC Annual Reports (HYIC, n.d.) and (Cushman & Wakefield, 2006)

Much of HYIC's revenue shortfall is due to a lack of PILOT payments, which were expected to bring in \$615.6 million between FY2006 and FY2019, the majority of HYIC's projected revenue. Instead, total PILOT revenue was only \$82.7 million, over 7 times less than

expected. This drop off was largely due to the Great Recession. Hitting in 2008, the financial crisis delayed the pace of office development citywide. In Hudson Yards, construction delays moved the first PILOT payments back from the target date of 2012 to 2015. Between 2006 and 2019, DIBs also fell short, coming in \$75 million less than projected.

Interest Support Payments

HYIC's revenue shortfall increased the city's payments covering the project's debt costs. In 2007, HYIC's bond's statement projected that interest support payments would cost the city \$7.4 million through 2015. Instead, the city ended up spending \$359 million - over 40 times more than expected.²³ The city's commitment to pay the interest on HYIC bonds was meant to compensate for a temporary mismatch between revenue materialization and debt payment. Having fallen prey to significant but common project risks, this short-term fix turned into long-term compensation through FY2015.

Costs Overruns and Spillovers

Cost Overruns

Hudson Yards' cost overruns totaled \$155 and stemmed from project items intended to be fully funded by HYIC's bond proceeds. However, because Hudson Yards' financing plan did not account for a method to pay cost overruns, the city ended up picking up the tab.

²³ See HYIC Annual Reports (HYIC n.d.)

- *Subway Extension:* HYIC’s bond proceeds covered the estimated cost for the subway extension, which was \$2.1 billion in FY2006. However, bids for the excavation of the line were higher than expected, increasing the cost by \$267 million, for a total of \$2.37 billion. Out of this amount, HYDC and the city’s OMB absorbed \$235 million through cost savings and other contingencies within the project budget (Hudson Yards Infrastructure Corporation, 2012). As further described, the remaining \$32 million of the subway cost overrun will be funded by HYIC.²⁴
- However, the subway continued to cost the city additional funds. Between FY2005 and FY2019, the city spent an additional \$50.9 million on the subway. Completion of the extension was also delayed by two years, coming online in 2015 rather than 2013.²⁵
- *Property Acquisition and Public Amenities:* HYIC’s bond proceeds were meant to cover the first stage of the construction of Hudson Boulevard Park, including a new street and open space between 10th and 11th Avenues, estimated to cost \$1.2 billion. However, the city paid an additional \$92.5 million from its capital budget on top of the expenses paid by the bond proceeds. These costs include the construction of Hudson Boulevard and Cross Streets (\$0.3 million), the reconstruction of water infrastructure and sewers (\$3.7

²⁴ HYIC bond documents stated that "An additional \$100 million for possible cost overruns is to be provided by the City, the Corporation or HYDC under terms to be negotiated by and among the MTA, the City, the Corporation and HYDC." (Hudson Yards Infrastructure Corporation 2007, 11).

²⁵ In 2006, C&W acknowledged that any delay in the subway would likely delay office development, which would subsequently delay HYIC’s resulting PILOT payments (Cushman & Wakefield 2006). As specified above, actual PILOT revenue was more than seven times less than projected.

million) and street reconstruction (\$88.5 million). Additionally, the city spent \$12 million from its expense budget on demolition of buildings in the area (NYC Independent Budget Office, 2013)

CITY SPENDING (\$ Millions)	ACTUAL Expenses (FY05-19)	PLANNED Expenses (FY20-25)	TOTAL (FY05-25)
CAPITAL SPENDING			
Subway Extension	50.9	-	50.9
Prop. Acquisition and Public Amenities	3.7	88.8	92.5
<i>Hudson Boulevard and Cross Streets</i>	0.3	-	0.3
<i>Reconstruction of W 33rd St, 11th Av.</i>	3.4	85.2	88.5
<i>Reconstruction of Water and Sewers</i>	0	3.7	3.7
TOTAL CAPITAL SPENDING	54.6	88.8	143.4
EXPENSE SPENDING			
Building Demolition	12		12
TOTAL EXPENSE SPENDING	12		12
TOTAL CITY SPENDING	66.6	88.8	155.4

Table 2 - City Spending on Hudson Yards' Cost Overruns. Source: (NYC Independent Budget Office, 2013)

This trend - the city absorbing additional costs necessary to complete the project – is projected to continue. For the costs of property acquisition and public amenities described above,

the bulk of the city's committed capital funds (\$88.8 million) is future spending between Fiscal Years 2020 and 2025.²⁶

Cost Spillovers

While spillovers are a normal part of a development project, the size of Hudson Yards makes these additional costs significant at \$182 million. The added residents in the area require the city to build a new school, budgeted at \$106 million (New York City School Construction Authority, 2020). A new firehouse and daycare center are also needed, but as of yet not budgeted (New York City Planning Commission and the Metropolitan Transportation Authority, 2004).

Anticipated but not budgeted as part of the overall project, the city must now backfill these funds out of its capital budget, raising the overall cost of the redevelopment project for taxpayers.

While some of the cost spillovers due to needed city services are yet to be determined, the city spent \$76 million to support the construction of the Culture Shed, a multidisciplinary art hub built in the project area.

DISCUSSION

In New York City, the term self-financing was used by elected officials to assure the public the Hudson Yards redevelopment project would pay for itself. This assurance would later prove

²⁶ In FY2017, HYIC stated it did not have the funds to cover \$96 million in cost overruns over the next two years for infrastructure costs. As mentioned earlier, in August 2018, the city authorized HYIC to sell an additional \$500 million in bonds August 2018 to fund the second stage of Hudson Park's construction. However, the city estimates the cost of the park extension to be \$374 million (Anuta 2018), which opens the possibility that the remaining bond proceeds were used to cover HYIC's \$96 million shortfall.

hollow when tax breaks and debt service support were included and standard development risks materialized, requiring both the explicit and implicit support of the city. As detailed above, the city is paying an additional \$2.2 billion for the Hudson Yards project (Table 3).²⁷ These funds were not included in the city’s projections or in costs covered by the HYIC bonds and represent 60 percent of the city’s original and planned investment of \$3.5 billion in bonds. This figure includes lost revenue in the form of tax breaks to attract private development, payment for cost overruns and cost spillovers, as well as direct support from the city in the form of interest support payments.²⁸

COST TO THE CITY	AMOUNT (\$ Million)
INTEREST SUPPORT PAYMENTS	359
TAX BREAKS ²⁹	1.526
COST OVERRUNS and SPILLOVERS	337
TOTAL	2.222

²⁷ All figures summarized in Table 3 are presented in nominal values, except for the tax breaks included as PILOTs, which are presented as real values.

²⁸ In May 2017, HYIC refinanced its bonds and created a new legal structure for management of its revenues and debt (Mayor’s Office of Management and Budget, 2020).²⁸ The bond refunding allowed HYIC to reduce its interest payments and begin principal repayment on some of its debt in 2018. Because of the additional funds, HYIC remitted approximately \$110 million to the city in FY2017 and \$100 million in FY2019. This is not a “refund” of the city’s costs, which is not required by the city legislation authorizing the ISPs. Rather, this transfer of funds is specified in the contract between HYIC and its bondholders and based on the availability of funds rather than a commitment to repay city costs.

²⁹ As previously described, the estimate of tax breaks only includes the discounted PILOTs for commercial and retail properties and the 421-a tax breaks for residential developments. Other tax breaks, such as the ICAP program for hotels and sales tax breaks, were not included in this article’s estimate. Office developments entering into PILOT agreements may also receive an exemption of up to 100% of sales taxes due on construction materials and tenant improvement materials.

Table 3 - The Actual Cost to the City of the Hudson Yards Project. Source: Authors' estimates

The city was warned during the public deliberation process that the project's financing structure left the city open to standard development risks. As documented earlier, this included the City Comptroller, the IBO, the Regional Planning Association, and the Fiscal Policy Institute, among others (Bagli, 2004). Representatives in these offices and organizations represent the city's highest levels of expertise in budget management, economic development and planning, economics, and municipal finance. Yet, their repeated warnings went unaddressed. With the exception of an insufficient \$100 million included in the bonds to cover subway cost overruns, assignation of responsibility for these risks was ignored and costs associated with their materialization was underestimated or not priced at all.

The city not only refused to address known risks, but actively took two significant steps to shift additional risk onto taxpayers. First, the city provided tax breaks for private real estate developers to decrease the developers' risk investing in a new development. Second, the city pledged to pay the city's debt when its revenues fell short to decrease risk for bondholders.

While asserting that commercial development in Hudson Yards was "necessary to meet projected office demand," the city simultaneously argued that market forces alone were not sufficient to spur private development of the district.³⁰ Tax breaks, or discounted PILOTs, were added to the project based on the city's assertion that developers needed financial assistance to overcome the high-cost barrier to development in Hudson Yards. C&W's 2006 development

³⁰ Studies show tax incentives are an inefficient means of promoting economic development (Bartik, 2018; Florida, 2017; Fisher et al, 2012).

study for the area justified the substantial subsidies by assuming the locational disadvantage of Hudson Yards would command lower rents than Midtown.³¹ However, just over a year after the project's launch, the average asking rent in Hudson Yards was 20 percent higher than Midtown's average asking rent, and one of the highest in the city (JLL, 2020).³² This fact reveals the tax breaks were merely a form of funneling city resources to private developers.

The beneficiaries of the tax breaks - the commercial development firms and their executives - are among the largest real estate development firms in the United States. They are also New York City's largest property owners and the most politically powerful real estate interests in New York.³³ It is likely this political influence, combined with the size and scope of the project which narrowed the list of qualified developers, motivated city officials to bolster their negotiating position by shifting development risk away from developers and onto taxpayers in the form of substantial subsidies.

The city made a similar decision when it decided to pay the project's debt whenever its revenues fall short. By choosing to financially back the bonds through ISPs, the city shifted risk from HYIC's bondholders to city taxpayers. This motivation was overt; City Council officials

³¹ That analysis assumes new development in Hudson Yards will earn rents 13% to 18.5% less than comparable properties in Midtown. These rent discounts were applied to reflect "the locational disadvantage of these compared to properties located closer to the existing Midtown submarkets" (Cushman & Wakefield, 2006, pp. 103).

³² As John Lang La Salle Office Outlook for the first quarter of 2020 shows, the average asking rent in Hudson Yards Class A commercial towers was \$117/sqft, while the average in Midtown was \$96/sqft. Hudson Yards also appears as the 4th most expensive office district in NYC, only behind of the districts of Central Park, Meatpacking, Greenwich Village and TriBeCa (JLL, 2020).

³³ In addition to the Related Companies, the company building the site's platform over the rail yard and the development on top of it, developers in the area include Brookfield Property Partners, Tishman Speyer, and the Moinian Group.

are on record during a hearing right before the vote expressing their support for the inclusion of ISPs precisely because it will de-risk the project in the bond market (NYC Council Committee on Finance, 2005). It was also effective; Fitch's HYIC Bond analysis explains, "The 'A' rating is primarily supported by New York City's obligation, subject to appropriation, to pay interest on the bonds if project revenues are insufficient for this purpose." (Fitch Ratings, 2013).

The inclusion of ISPs fundamentally changed the project's effects on the taxpayer. First, the city took proactive steps to incur additional costs after assuring taxpayers it would pay for itself. Second, ISPs are funded from current city revenues. As such, once tapped, the project is no longer self-financing according to the rubric that TIF costs are paid out of the project's future revenues. Third, the one-two punch of the city's choices to consciously diminish the city's main revenue source through tax breaks while simultaneously backing up the project's revenue shortfalls increased the costs to the taxpayer two-fold. Because PILOTs are the project's main revenue stream, the higher the PILOT discount, the lower HYIC's revenue and the greater the need for city support in the form of ISPs.

The process and timeframe of how ISPs and tax breaks were included in the project elucidates how the self-financing label was used to avoid discussion and debate regarding the risks and costs likely to emerge from an urban megaproject unfolding over several decades as well as hide the city's conscious efforts to shift project risk onto taxpayers. First, city leader's continued to use the label while refusing to address experts who cited the need to prepare for the inherent development risk. Second, the City Council and Mayor included ISPs in the project's financing at the last minute, without additional rounds of public testimony to re-vet the project

once ISPs were included and it could no longer be called self-financing. For example, the legislation that codifies the financing, Resolution 760-2005, was introduced in the City Council, passed by the Finance Committee as a “pre-considered resolution” absent testimony from the public, and passed by the full City Council - all in the same day of January 19, 2005. Third, city leaders advocated for Hudson Yards by describing it as self-financing while simultaneously discussing plans behind the scenes to erode their own revenues with tax breaks. Tax breaks were discussed in City Council hearings among Council Members and experts before the project’s passage (New York City Council Committee on Finance (2005), but were not included in the 2005 City Council legislation approving the project’s financing. Instead, tax breaks were added by the IDA – a non-representative city agency - a year later.³⁴

As Flyvbjerg (2009) describes, the systematic underestimation of costs and overestimation of benefits is best explained by political-economic reasons and strategic misrepresentation. Promoters of megaprojects have plenty of incentives to provide biased costs and benefits projections, only to get projects approved. In Hudson Yards this was no different. This allowed for a smooth approval process, leaving the city to bear the responsibility when risks materialized.

Returning to Doctoroff’s book (2017), he describes his expectation of resistance from the city’s bureaucracy: “Selling such density to the City Council and local residents is usually nearly impossible” (p 168). He adds, “We braced ourselves for draconian demands (from the Council) given the unprecedented scope of the Hudson Yards plan. It never happened” (Doctoroff, 2017,

34 The effects of discounted PILOTs were deepened in 2013 when the IDA expanded the incentive to qualifying retail developments (NYC Independent Budget Office, 2013).

p169). Doctoroff credits this smooth sailing to the merits of his plan and even gives a nod to the distraction provided by the corresponding stadium debate, but doesn't mention his earlier claim (mentioned above) that the choice for a self-financing model would ensure stakeholders and residents that Hudson Yards would pay for itself. The power of the self-financing argument is reflected in the legislative history, where Council Members repeatedly cite the project's self-financing nature as a primary reason for support (Fisher, 2015).

Unfortunately for New York City taxpayers, the Hudson Yards project is only halfway through its 2-stage development plan and the risks they bear due to the project's design continue to emerge. In late 2019, work on the second platform over the western rail yards stalled (Gannon, 2019), reflecting the "completion risk" that comes with TIF projects due to the uncertainty of the future. And nothing better illustrates the unknown future than the onset of global pandemic. The IBO warned that "you have to worry again" about Hudson Yards' finances now that the project has hit its second recession in the pandemic's wake (Chen, 2020). In the short-term, HYIC forwarded an additional \$350 million to the city in June of 2020 as required by its 2017 bond refunding.³⁵ However, these proceeds are the result of pre-pandemic market conditions, which have reversed course since the city's onset of its lockdown to contain the coronavirus. The current recession renews the possibility of property tax delinquencies in the district - threatening HYIC revenues in 2021, the same year HYIC is required to start paying principle on its bonds - while the virus questions the safety and future of the urban commercial office market.

³⁵ HYIC's 2017 bond refunding requires any residual revenues in excess of debt operating costs for the current and future year's debt service be forwarded to the city (Hudson Yards Infrastructure Corporation, 2017, pp. 21). However, the city does not require these funds be refunded (NYC Independent Budget Office, 2004, pp 11)

This is significant if HYIC should once again need city funding to pay its debt service. ISPs are not limited to the project's construction phase, but are available to HYIC at any point in the 35-year lifetime of the Hudson Yards Financing District (the TIF district). As the economy falls into a post-pandemic recession, the city's real estate lobby group, the Real Estate Board of New York (REBNY), of which Related's leadership are members, has called on the city to give property tax relief to developers and landlords (Kromrei, 2020). If the city were to provide Related and Hudson Yards' property owners any discount or delay on their property taxes, HYIC might once again face revenue shortfalls and turn to the city to make its debt payments.

The pandemic also highlighted the valuation risks inherent to TIF. Hudson Yards' developers receiving property tax breaks as part of PILOTs agreements have appealed their taxes. Data from New York City Tax Commission shows that 40 petitions in Hudson Yards since 2017 were considered "successful," or resolved in favor of the owners' requests. This includes 10 Hudson Yards, a 52-story building developed by Related/Oxford, which received tax reductions of \$12.3 million in 2017 and \$18.7 million in 2018 (NYC Tax Commission, n.d). This same building paid \$22 million in PILOT payments in 2018 (Mayor's Office of Management and Budget, 2018).

Elucidating the limitations behind TIF's self-financing premise, the Hudson Yards case study reveals the public policy trade-offs inherent in Hudson Yards and in other TIF projects. When the self-financing premise fails, municipal officials often choose to absorb the costs in the city's current budget, as did local officials in New York City, rather than face a downgrade in their credit rating. But Harvard Law's Gerald Frug reminds us of the opportunity costs associated

with TIF-type development policies: “Tax increment financing thus allocates limited city resources to the development rather than to other city priorities” (Frug, 2017, pp. 4). In the case of Hudson Yards, this goes beyond the \$3.5 billion in city property taxes diverted to pay back bondholders rather than adding to general city revenues. It also includes \$2.2 billion in direct and indirect costs that represents almost 75 percent of the city’s capital expenditure in 2019 for the Department of Education.³⁶ And it prompts the question: Would New Yorkers have chosen to build a new commercial office district in Manhattan if they understood that rather than it being cost-free, they would end up footing a \$2.2 billion bill?

CONCLUSION

This research seeks to add to the TIF literature by shedding light on a debate highly consequential to local city finances but frequently overlooked – how TIF’s self-financing label can be misused to elicit taxpayer support for projects while simultaneously shifting TIF risk and corresponding costs onto taxpayers.

The reality is that TIF was not designed to “self-finance” standard development risks, leaving expenses unpaid, projects uncompleted, or municipalities footing the bill. What is at stake here are the consequences of advertising TIF and TIF-type financing as self- financing and eliminating the public debate over the additional costs directly borne by taxpayers. Describing TIF as self-financing creates the appearance of a benign instrument for urban economic development. The use of this theoretical description allows local elected officials to promise

³⁶ See: Citizens Budget Commission (2020)

development and economic growth, maintain an image of fiscal discipline, and shift future risks onto taxpayers.

New York City's TIF experience is 10 times larger than any other TIF-type project on record (Manhattan Community Board 4 2004). 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. In a context of increased political pressure to deliver economic growth without additional upfront tax hikes, local officials are likely to embrace TIF and TIF-type projects. In that spirit, documenting and sharing the actual costs of the Hudson Yards project is vital to help future elected officials and voters make the best decision regarding the use of their development dollars.

These findings illuminate the need for further lines of research more broadly on TIF's benefits and cost (including tax breaks), and particularly on the use of the self-financing label in additional case studies. The TIF literature would also benefit from further research on transparency, accountability and governance to ensure the full breadth and depth of TIF costs are considered before project approval and implementation.

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