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Testimony on the Penn Station Area Civic and Land Use Improvement Project

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Thank you for the opportunity to testify on the Draft Environmental Impact Statement and Draft General Project Plan for the Pennsylvania Station Area Civic and Land Use Improvement Project (Penn Station Area GPP or the GPP). I am Sean Campion, Senior Research Associate at the Citizens Budget Commission (CBC), a nonpartisan, nonprofit think tank and watchdog devoted to constructive change in the finances, services, and policies of New York City and New York State.

The Penn Station Area GPP is an ambitious proposal designed to achieve multiple goals. The GPP would establish a new zoning framework to catalyze office and residential development in the Penn Station area, with developers also funding or building public realm improvements, such as plazas, open spaces, widened sidewalks, and new subway entrances and station renovations. This new development also would generate recurring revenue that Empire Station Development (ESD) would use to finance a renovation of Penn Station, and, in time, for a potential transit expansion of Penn Station as part of the larger Gateway project.

Individually and collectively, these projects could contribute to New York's long-term competitiveness and well-being. New York City is the engine that powers the regional economy, and there is no location more appropriate for commercial development than the area around Penn Station, the nation's busiest rail station. Allowing additional density should contribute to economic activity. Likewise, improving rail service at Penn Station will enhance mobility, access to jobs, and quality of life for commuters and New York City residents alike.

However, to ensure the project has the maximum and most cost-effective impact, the plan should be designed and executed well and appropriately leverage City, State, federal, and private resources. In its current form, the plan leaves unanswered many questions about the State's proposal to capture the value created by a rezoning to finance the renovation and potential expansion of Penn Station. The State has provided high-level information about how that value capture plan would work, but many important details have not yet been presented or determined, some of which should be negotiated with New York City and other public and private stakeholders. Therefore, currently available information simply does not provide enough detail to allow us to evaluate the appropriateness of the project's financing. It also raises concerns about the State's proposal to capture property tax revenue from the City without the City's approval.

I will focus today on three topics related to the value capture elements of the Penn Station Area GPP: first, background on the concept of value capture and guidelines for its use; second, the GPP's proposed use of value capture for the Penn Station project; and third, questions and concerns about the proposed GPP.

Value Capture and Guidelines for Use

Public actions, such as rezonings, mass transit expansions, or utility extensions, can increase land values or induce private real estate development that otherwise would not have occurred "but for" those public actions. Governments can choose to capture a portion of that newly created value to pay for the original public improvement or for other public goods.

Governments can "capture" this value in a variety of ways. Often, value capture mechanisms generate one-time payments from private developers at the start of a project through payments for development rights or impact fees. Cities also can capture upfront value indirectly by requiring developers to build on-site infrastructure or public space or to set aside income-restricted units through inclusionary housing requirements.

To capture value over time, governments can generate recurring revenue streams through special assessments, which are charges levied on parcels on top of property taxes. Another common version of value capture is tax increment financing (TIF). Governments create TIF districts to capture some or all of the property taxes paid by property owners who directly benefit from a public action. Governments can then use that revenue to repay upfront public spending that created the new value. TIFs do not generate new taxes; instead, they divert incremental property taxes that otherwise would flow to a city's general fund. (See CBC's 2017 report *Tax Increment Financing: A Primer* for more information on how TIFs work.)

While value capture at times can help or even be essential to achieve specific policy goals, it can have negative consequences if inappropriately used. Value capture mechanisms have been used by governments to capture revenue that otherwise would have been collected by other taxing entities. It also has been used to circumvent legal restrictions on revenue, spending, or borrowing, and can obscure exposure to long-term debt or liabilities. Extensive use of TIF districts can divert funding from other needs or from areas outside of TIF boundaries. Special assessments or fees on new development can increase the cost of projects and shift the cost of providing public goods onto new construction projects. Accordingly, value capture proposals must be examined closely to determine whether they appropriately balance fiscal priorities and are the most appropriate financing strategy for a given project.

CBC's primer on tax increment financing included five guidelines to evaluate a value capture plan:

- Whether the development and property value appreciation would occur in the absence of—"but for"—the publicly funded capital project;
- Whether the public investment would catalyze new economic activity;
- Whether the project's return on investment would be strong enough to justify diverting revenue from other uses;
- Whether the district would generate enough revenue to repay debt service and other costs if bonds are issued and how shortfalls would be covered; and
- Whether it is possible and advantageous to finance the project with conventional financing strategies like general obligation bonds.

The Penn Station GPP's Value Capture Proposal

The GPP and draft environmental review documents indicate that the State, through ESD, intends to create a new value capture district comprised of portions of several blocks surrounding Penn Station.

The GPP uses a four-step process to create a value capture framework:

1. Using its authority to override local zoning, ESD would create new zoning rules and design guidelines for eight development sites in the project area.

2. After the GPP is approved, owners of the development sites could enter into ground leases with ESD in which the State would take title to the land and lease it back to the owners. This would allow property owners to build new projects under the GPP's design guidelines.
3. For privately-owned or occupied parcels that enter into ground leases, ESD will negotiate a payment in lieu of taxes (PILOT) agreement with the private leaseholder in which the owner would pay a PILOT to the State, likely based on the property taxes that would have been due to the City. (ESD taking title to the land as part of the leaseback arrangement removes the parcels from the City's property tax roll, as all State-owned land is exempt from taxation. The development sites remain on the City tax roll until the ground lease is executed.) The PILOT could be structured to include a tax abatement—essentially a reduction on taxes due. For example, residential PILOT agreements have been structured to offer tax benefits that otherwise would have been available to the project under as-of-right incentive programs like 421-a if the project were not built under a GPP. Other value capture programs have included a discretionary schedule of PILOT discounts or payments that are available to all qualifying properties in the district.
4. ESD decides how to use this PILOT revenue. It can keep the PILOT revenue or pass some or all of it through to New York City, which otherwise would have collected the tax revenue had ESD not taken title to the land under the GPP. ESD also could capture any ancillary revenue generated by these development projects by structuring payments in lieu of mortgage recording taxes or requiring payments for development rights granted under the GPP. ESD has said that it will develop this value capture plan in consultation with the City of New York, though the plan does not require City approval, and ESD is under no legal requirement to share revenues with the City. In a document of proposed revisions to the GPP, ESD said that it would share a portion of the development revenues, likely based on the pre-redevelopment property tax revenue generated in the project area, with the City in order to hold the City's general fund harmless.

While documents released by ESD make it clear how the first steps would work, the State has provided little information about how it would calculate PILOTS or how the value capture plan would be structured, including the types of real estate revenue that would be captured, how much revenue would be raised, how the City's hold harmless share would be calculated, or how the funds would be used.

Based on public comments and the experience of previous rezonings in New York City, the project likely would tap two revenue sources:

- One-time, upfront payments from new development projects in the Penn Station district, including upfront lease payments, payments in lieu of mortgage recording taxes, and payments for development rights. In conjunction with obtaining additional development rights, developers likely would fund or build new public plazas, subway entrances, or renovated subway concourses, following the model of One Vanderbilt and other commercial projects in East Midtown; and
- Recurring payments in the form of PILOTs that ESD would retain and potentially use to back loans or debt used to fund improvements at Penn Station and in the surrounding area.

Unanswered Questions and Concerns

The GPP's value capture proposal raises several questions, including why this financing approach is the most appropriate option for this project, what is the impact of diverting property revenue from the City, and what will be the City's role in forming and agreeing to the plan. In its current form, the GPP also does not include sufficient information needed to evaluate the capital improvements that would be funded by revenue generated under the plan or to evaluate the proposal against reasonable financing alternatives.

Specifically, ESD should provide additional information to answer the following questions before proceeding with the GPP:

- **What is the scope of capital improvements and what is the estimated cost for each phase?** The GPP and environmental review documents focus on the rezoning plan and do not include a scope of work for the proposed capital projects that would be funded by new development or how much each component would cost. The entire Penn Station project, including the renovation and expansion of Penn Station and related land acquisition, demolition, and public space improvements, has been reported to cost as much as $17 billion. A scaled back renovation project without the proposed Penn South expansion could cost $6 to $7 billion. Cost estimates have not been provided for the proposed public realm or streetscape improvements, some of which will be built directly by private developers. Without more detail, it is difficult to assess whether the project would achieve its goals of improving safety, circulation, and functionality, or whether these goals would be accomplished in the most cost-effective manner. The plan should avoid costly, non-essential cosmetic improvements and should not preclude the possibility of future capacity or service enhancements, including both allowing for through running or for additional track capacity.

- **How much of the project would New York State fund and what portion of that would be funded through value capture?** Currently, the documents do not report New York State's share of the total cost would be, or how much of the State's share would be funded from the value capture plan. The GPP and other public documents group all of the projects together and anticipate the funding split will mirror the Gateway project: 50 percent by the federal government, 25 percent by New Jersey, and 25 percent by New York. As of now, it is unknown whether New Jersey or the federal government would agree to fund all portions of the project in this manner. The State's Fiscal Year 2022 Enacted Budget also included $1.3 billion for Penn Station-related projects, and the State has not yet said how it plans to use that funding. Without this information, how much funding New York will need to raise for the project is unknown. Similarly unknown is what portion of that could be funded by upfront payments, built directly by private developers, or paid for with loans or bonds backed by PILOT revenue.

- **How would the financing plan work?** The plan does not include information on how the financing plan would be structured and does not address how ESD would handle many of the risks inherent to value capture projects. Specifically, which entities would backstop the financing before new development and PILOT revenue comes online; what sources of funding those entities would use to cover shortfalls; how cost overruns would be funded or shared; how surplus revenue would be divided among the City, State, and other entities; whether the PILOTs would be permanent; and how or when PILOTs would revert to the City. These questions about financing and timing risks are particularly important, both because it is difficult to project the timing of new development and because many recent transit capital projects in New York have been delivered years late and have gone billions of dollars over budget.

  The public approval process should include broader discussions about financing risks and the most effective strategies for mitigating and managing those risks.

- **What is the decision-making role of the City of New York, and what are the project's revenue impacts on the City?** The Penn Station Area GPP would extend ESD's authority over local land use and fiscal matters beyond previous uses. We have found no recent precedent for ESD diverting property tax revenue from privately owned and occupied parcels in a redevelopment area without a local government's permission. New York City should have a substantive role in the planning process and should be a partner that agrees to the use of tax revenue that would otherwise flow to the City's general fund.

When the New York State Fiscal Year 2019 Executive Budget proposed to fund the renovation of Penn Station and other MTA projects through "transportation improvement subdistricts" funded by captured City property tax revenue, CBC said that the Mayor and City Council, not the State, should determine how the City's property tax revenue is spent. While the Penn Station project and its financing have evolved in this updated form, the City still should determine whether and how much of its future tax revenue should be dedicated to a mass transit project instead of other needs like public safety, education, or housing.

Other value capture frameworks allowed under New York State law are based on this principle, and require that municipalities, not the State, initiate the creation of a value capture district. The State's MTA TIF law, for example, requires local governments to designate district boundaries and to decide the types and amounts of revenue to pledge to MTA projects.

The GPP also does not quantify the fiscal impact of the proposal on the City. ESD reports that it will hold the City fiscally harmless, but without more specificity, it is not possible to determine whether the City will receive the same future revenues as it would have without the State's action.

It is important to note that under State law, ESD is not required to seek City approval for any element of the Penn Station Area GPP. A GPP requires approval only by ESD's Board of Directors or the Board of an ESD subsidiary. ESD is required to notify and accept comments from the City Planning Commission, but if the planning commission recommends modifications or disapproves, ESD's board can approve the original proposal by a two-thirds vote.

- **Is it appropriate to divert tax revenue generated by new development to finance the transportation improvements and is that the best financing strategy?** Generally, the test of whether it is appropriate to use a TIF is whether the incremental value that could be captured would not have happened "but for" a specific public action. Under the Penn Station Area GPP, the rezoning will catalyze private redevelopment; the development would not happen "but for" the rezoning.

  The development will generate incremental value that ESD will capture to fund the renovation of Penn Station and other related capital projects. Using the proceeds to fund a project not essential to creating the value captured breaks the causal chain of most TIF projects, which fund capital projects necessary to create the incremental value. At Hudson

Yards, for example, the subway extension created the potential for Class A office development that would not have been feasible without the transit extension. The City then captured the incremental value created by the subway extension through a rezoning and value capture plan that would repay the debt incurred to build the subway.

While the Penn Station renovation projects would have very positive benefits for City residents and other commuters and travelers who use Penn Station, the renovation and other projects are unlikely to generate significant incremental economic value. The value of that transit service is already capitalized in the land and a substantial increase in that would likely only come from expanding capacity.

Since the value capture funds are not being used to create the value itself, it is important to make the case that this investment of the captured funds is more appropriate than alternative uses for infrastructure or services, or that the planned investment of funds will create significant value (even if that is not what is being captured).

In addition, the GPP, draft environmental statements, and other public ESD presentations have not explained why the proposed value capture plan is better than more conventional financing strategies. Value capture plans are complex and typically more expensive than conventional financing sources like general obligation bonds. Compelling policy and fiscal reasons should underlie the choice of value capture over alternatives that are backed by broadly-based taxes, particularly since the benefits of Penn Station accrue to the entire MTA region, not just to the blocks immediately surrounding the station.

There should be additional public discussion about the merits of the financing strategy compared to other alternatives and whether this is the most appropriate financing approach for the renovation of Penn Station.

There will be additional discussions about the Penn Station Area GPP in the months to come, including debates over a number of important topics not yet addressed in the public planning process. One topic is why the rezoning should be limited to the blocks immediately surrounding Penn Station. The market analysis commissioned by the City in support of the recent Hudson Yards refinancing found strong demand and a positive outlook for modern Class A office buildings, such as those proposed in this project. However, the study also described higher vacancy rates and an uncertain future for older and lower quality buildings – a challenge that predated the pandemic and has only grown more pressing given questions about the future of remote work. The Penn Station Area GPP does not consider how the redevelopment plan will affect both the Penn Station area submarket and the City's office market more generally. A

broader rezoning, perhaps led by the City, could take a holistic approach to the neighborhood that also includes policies that encourage property owners to reinvest in outdated buildings and reimagine the future of Midtown.

Likewise, there should be a robust discussion about potential tax incentives or abatements for redevelopment projects in the GPP district. As with all economic development projects, discretionary tax abatements should be considered in context. For this project, the discussion should take into account broader economic conditions, including whether or how much abatements would accelerate redevelopment and revenue generation and the value of that occurring. It should also factor in office market competition more generally, and how projects in the GPP district would complement or compete with other potential development sites in the far west side or in East Midtown.

Conclusion

ESD's Penn Station project has many merits, both in whole and in its component parts. The Penn Station district is an important and appropriate location for new commercial development and allowing additional density should contribute to economic activity; growth there would benefit the entire New York region while also improving the public realm in the surrounding neighborhood. Likewise, modernizing Penn Station could improve quality of life for both commuters and New York City residents, help encourage transit ridership, and enhance regional competitiveness for decades to come.

It is of utmost importance that ESD and the City work together to develop a financing plan and a rezoning that makes sense for both parties, as well as for New York State and City residents.

Thank you for the opportunity to submit testimony on this important project, and we look forward to working with public officials in the coming months.

FURTHER READING

Tax Increment Financing: A Primer (2017) https://cbcny.org/research/tax-increment-financing-primer

Tsk-tsk on Governor's TIF Proposal (2018) https://cbcny.org/research/tsk-tsk-governors-tif-proposal