# Financing Development of Public Transport-Oriented Urban Growth and Subway Infrastructure at New York City's Hudson Yard through Profit Gained from the Development Itself

-Part 3-

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## 5. Development of Public Infrastructure, Such as Subway Extension and Financing Mechanisms

### 5.2 Finance Mechanisms

#### 5.2.2 Revenue

Ordinary revenue sources for the Hudson Yards Project include (1) Payment in Lieu of Taxes (PILOT) agreements, with fees levied on property assets instead of property taxes, and (2) Tax Equivalency Payments (TEP), where the City government withdraws from their budget to pay the Hudson Yards Infrastructure Corporation (HYIC) for residential property and commercial assets not participating PILOT at amounts equivalent to the property tax revenue.

Temporary income sources include (3) District Improvement Bonuses (DIB), which consider increased Floor Area Ratio (FAR) for commercial assets, and (4) PILOT for Mortgage Recording Taxes (PILOT MRT), which is an alternative levy for mortgage registration taxes. This usually refers to exempting NYC and state taxes (which were at 1.75% and 1.05%, respectively at the time of the project) for a commercial property of 500,000 square feet or more at 2.8% of the mortgage value, and instead having this amounted collected by HYIC. These measures are expected to occur early in the project, even before buildings are complete.

This revenue forecast is based on Cushman & Wakefield's 2006 development demand survey, etc., and was premised on the completion of the project in 2013.

#### 5.2.3 Bonds Issued by HYIC

HYIC was given an allocation of $3.5 billion in bond distribution, and issued $2 billion in 2007 and $1 billion in 2012. Also, as mentioned in Part 2 of these reports, issuance of an additional $500 million is allowed.

Furthermore, HYIC also issued refinancing bonds in 2017 to reduce interest rates.

Looking at the bond issued in 2007 (Hudson Yards Senior Revenue Bonds Fiscal 7 Series A), it is a senior bond maturing in 40 years, and comes with a 4.5% or 5% coupon.

HYIC can set a "Conversion Date" on the basis of whether operating expenses and debts, such as from interest payments, can be fully covered solely by ordinary revenue. Before then, principals are not redeemed and only interest is paid.

HYIC sets the "Conversion Date" if the following conditions are met: in the last two fiscal years, ordinary revenue was (1) 125% or more of the maximum debt for senior bonds and (2) 105% or more of the maximum debt of all junior bonds.

When a "Conversion Date" is set, the Hudson Yards Development Corporation (HYDC) must establish an accumulation plan for a sinking fund installment and notify the trustee of the plan for the amortization of all bonds.

On the other hand, after February 2017, or 10 years after the bond issuance, HYID can redeem all or part of a bond at the price of the bond value plus interest at the time of redemption, even if it is before the date of maturity,

After voluntary redemption becomes possible, senior bonds must be redeemed if there are surpluses after paying operating expenses and interest payments, even if it is before the "Conversion Date."

In addition, interest arising from bonds are exempt from federal and New York state income taxes. 15)

#### 5.2.4 Interest Support Payments by New York City

At the beginning of the project, it was expected that HYID's income would be short of interest payments.

Initially, the Bloomberg administration proposed to cover this shortfall with a short-term commercial paper program. However, it was opposed by the city council, who viewed this as a risk. 3) Eventually, the City and HYIC signed an agreement (The Support and Development Agreement), and the City compensated the difference between the actual income and the interest payment amount from their budget for debt expenses.

If during the year there is a surplus in HYID's income, and interest payment support had been provided, the City will be refunded for their assistance. However, no refunds will be expected for past support. 15) In the event of a surplus of city funds at the end of the year, New York City has customarily used it for debt redemption or to advance payments of subsidies to the MTA and libraries.

Therefore, it is preferable if the city balances its finances.10)

It is understood that the assistance provided under this agreement is not regarded as City debt defined under the New York State constitution and other laws. 15)

## 6. Status of Project

### 6.1 Issuance of a HYIC $2 Billion Bond

In 2007, $2 billion worth of HYIC senior bonds were issued by National Association, a U.S. commercial bank. Regarding the credit worthiness ratings of agencies outside of their insured bonds, Moody's has an A3 rating, S & P has an A, and Fitch has A-[1], which is the minimum level to qualify for bonds, but is recognized as having a low possibility to default. (If they were insured, they could expect the highest ratings of Aaa, AAA, and AAA, respectively.) 15)

### 6.2 Delays in Infrastructure Development, Over-Budget Construction Costs, and Additional Burdens on the City.

#### 6.2.1 Subway Line 7 Extensions

The initial construction cost for the extension was estimated to be $2.1 billion, including an additional $100 million allocated to cover an increase in construction costs. Plans were made to finance the endeavor via bonds issued by HYIC. However, the lowest bid price for excavation work was higher than expected, and the city saved $450 million by canceling one of the two planned stations 10). Nonetheless, the construction costs still exceeded the budget by $267 million, making the total expenditures $2.367 billion.

HYDC and the City's Office of Management and Budget generated $235 million of the needed $267 million by managing the savings and financial reserves of the Hudson Yards Project. However, the City bore the cost of the remaining $32 million, and continues to bear additional costs. By 2022, the City is expected to be responsible for $55.4 million charges over the project budget, including previous burdens. 17)

The construction of the subway extension was scheduled for completion in 2013. However, it was delayed for two years, and only started operations in September 2015. This is also thought to have caused a delay in commercial development, which will be described below. 3)

#### 6.2.2 Property Acquisition and Environmental Improvements

Hudson Boulevard and its associated parks are spending $150.30 million dollars on city investment projects, in addition to $1.2 billion of HYIC bond financing. A breakdown of this spending includes: $101.70 million in road construction at Hudson Boulevard and Cross Street, $48.30 million in water and sewage reconstruction, and $0.3 million in street reconstruction. 3) In addition, the City is spending $12 million for the demolition of buildings.

### 6.3 Delays in Commercial Development, Shortages of HYIC Revenue, and New York City's Support of Interest Payments

#### 6.3.1 Delays in Commercial Development and Shortages of HYIC Revenue.

| **REVENUES: 2006 to 2018 (Amounts in $ million)** | **Projected Revenue by 2018** | **Actual Revenue by 2018** | **Difference** |
|---|---|---|---|
| **Recurring Revenues** | | | |
| Commercial & Retail PILOTs | 467.0 | 51.7 | -415.4 |
| Tax Equivalency Payments (TEPs) | 408.7 | 414.8 | 6.0 |
| **One-time Revenues** | | | |
| District Improvement Bonuses (DIBs) | 523.2 | 436.8 | -86.4 |
| Transfer Development Rights (TDR) | 322.6 | 294.5 | -28.0 |
| PILOTs for Mortgage Recording Taxes (PILOTs MRTs) | 128.6 | 96.6 | -31.9 |
| **TOTAL REVENUE SHORTFALL** | **1,850.1** | **1,189.5** | **-555.7** |

Table 2- HYIC's Shortfall in Revenues to Pay Back Bondholders B.Fisher & Flavia Leit,2018
Source: (HYIC n.d.) and (Cushman & Wakefield 2006) https://www.economicpolicyresearch.org/images/docs/research/political_economy/Cost_of_Hudson_Yards_WP_11.5.18.pdf

The Lehman Shock of 2008 delayed commercial development throughout New York City. 23) 31) Due to this, commercial development for the Hudson Yards Project was also delayed. PILOT's targeted first year of income, based on Cushman & Wakefield's 2006 demand forecast survey, shifted from 2012 to 2015

Although $467 million of PILOT revenue between 2006 and 2018 was expected in the survey, the actual amount was only $51.7 million, denoting a significant loss in earnings. In addition to the delay in development, another reason for the decreased revenue was that PILOT discounts were expanded to retail facilities.

On the other hand, demand for non-commercial facilities at Hudson Yard was higher than expected, particularly of hotels, with 12 completed between 2005 and 2011 comprised of about 2,900 rooms and roughly 1.13 million square feet (about 100,000 square meters). As a result, TEP generated $415 million in revenue between 2006 and 2018, up $6 million from the study's forecast of $409 million.

Due to delays in development, temporary income consisted of $86 million from DIB, $32 million from PILOT MRT, and $28 million from TDR between 2006 and 2018, which was lower than forecasted in the survey. This resulted in a total of $146 million in

[1] Moody's ranks credit worthiness ratings in the order of Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1…. S&P and Fitch rank them from AAA, AA +, AA, AA-, A +, A, A- , BBB+…

lost earnings.

Overall, although HYIC's revenue was expected to be $1850 million, the actual amount was $1190 million and $556 million between 2006 and 2018. It was a decrease of nearly 30%. (See Table 6-1) 3) 4) 18)


(References)

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