Schwartz Center for
Economic Policy Analysis

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

Submitted to New York State Senate Committees on Corporations, Authorities & Commissions; Finance; and Cities 1

June 24, 2022

Bridget Fisher, Researcher, The New School's Schwartz Center for Economic Policy Analysis (SCEPA)

Thank you for the opportunity to testify today. And thank you to Chairs Kruegar and Comrie for hosting this hearing and Senator Hoylman and staff for their assistance.

I am Bridget Fisher, a researcher with the Schwartz Center for Economic Policy Analysis at The New School. I research value capture mechanisms and have studied the value capture tool used in Hudson Yards, which is similar to that proposed for Penn Station.

Value capture comes in many forms, but the mechanism we are discussing today is a variant of tax increment financing known as PILOT increment financing. These tools are simple in theory – future revenues can pay upfront costs. But in practice, they are complex, sensitive to change, and carry more risk than traditional state and local bond financing.

The risk is in the imperative to match upfront costs with future project revenues. To be successful, this form of value capture requires correctly predicting two highly unpredictable things: 1) the costs of large construction projects that unfold over time; and 2) the resulting revenues likely to materialize decades in the future.

Should these predictions fall short, the precarious balance that is the promise of value capture is lost. The public entity that took on the project's debt will not have enough revenue to pay its financing costs or, worse, its principal. When this happens, there are two results – either the

sponsoring entity defaults and ratings agencies take notice or the public sponsor must step in and plug the holes with general revenues.

This latter is what happened next door in Hudson Yards, another "self-financing" project that ended up costing the city $2.2 billion in unexpected costs.

These costs were primarily a result of shifting risk onto taxpayers, which took three forms:

First, the city ignored calls to plan for standard development risks. As a result, taxpayers had to pick up the tab when the subway cost more than expected and when the Great Recession stymied the development needed to pay back the bonds.

Second, the city's inclusion of tax breaks reduced the risks of developing in the area at a cost of $1.1 billion in revenue that otherwise would go to pay back the debt. This decision was based on a Cushman & Wakefield analysis that said Hudson Yards would earn lower rents than Midtown competitors. Yet, in 2020, one year after opening, Hudson Yards was and still is commanding higher rents than its neighbors.

And third, the city committed to pay the project's debt whenever project revenues were insufficient. This was done to "reassure the market," which shifts risk from bondholders onto taxpayers. This so-called 'credit enhancement' ended up costing the city $359 million, 40 times more than projected. While Hudson Yards' revenues rebounded once their commercial office buildings could open, it was city taxpayers who bailed out Hudson Yards when anticipated future revenues failed to materialize on time.

Unfortunately, the Penn Station proposal seems to ignore the valuable lessons learned in Hudson Yards. The project begins with the same high-risk financing mechanism and then adds even more by shifting risk from other stakeholders – namely developers and bondholders – onto taxpayers.

It repeats these steps with three important caveats. First, the price tag – and therefore the debt – is twice the size as Hudson Yards. Second – Penn Station relies on far less property to pay back more debt. And third, to do so, it must play out over a much longer time frame, which adds more unpredictability to the mix.

Such high stakes for taxpayers would seem to demand rigorous projections, analysis, testing, and review. However, I second the many others who come before me in stating that the failure to share needed financials with elected officials and the public makes a clear choice impossible

in the face of large risks. I – along with my colleague Flávia Leite - have modeled the project's potential overall revenues and Hudson Yards-like tax breaks. We hope to finalize this data and be able to share it publicly soon.

Last, it is these risks – inherent in the very structure of PILOT increment financing – that traditionally have disqualified these mechanisms as a tool of first resort. Use of this form of value capture has historically required evidence as to why traditional municipal financing is not feasible. Unfortunately, this proposal skips this step and furthers a precedent that lacks the accountability that was originally baked into the value capture process.

Thank you for your time and consideration.