THE CITY OF NEW YORK
INDEPENDENT BUDGET OFFICE
110 WILLIAM STREET, 14TH FLOOR
NEW YORK, NEW YORK 10038
(212) 442-0632 • FAX (212) 442-0350 •EMAIL: ibo@ibo.nyc.ny.us
http://www.ibo.nyc.ny.us

Testimony of IBO Deputy Director George Sweeting To the New York City Council On Recent Hudson Yards and Number 7 Extension Agreements

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Chairmen Weprin, White, and Liu, and members of the Finance, Economic Development, and Transportation Committees. Thank you for the opportunity to testify before you today regarding the recent agreements between the city and the Metropolitan Transportation Authority (MTA) concerning Hudson Yards and the extension of the Number 7 subway line to 34th Street and 11th Avenue.

I will focus on two issues in my testimony. The first relates to the level of tax incentives being offered to support the financing plan for the larger Hudson Yards development. This summer, when the Industrial Development Agency (IDA) board approved a set of tax incentives to be used in Hudson Yards, IBO noted that important questions about the financing plan remained unanswered and that too little information was available to know if the proposed incentives were appropriate. The fate of the rail yards has now been answered in a way that reduces the need for such generous tax incentives. My testimony will also briefly consider the terms of the deal for the MTA and the lack of a firm commitment to cover cost overruns which could pose a risk to funding for other projects in the MTA's capital program.

Hudson Yards Tax Incentives

The new agreement between the MTA and the city will result in additional revenue to Hudson Yards Infrastructure Corporation (HYIC), strengthening the security of the infrastructure bonds the corporation will sell to finance its $2 billion contribution for the Number 7 and for other infrastructure in the Hudson Yards area. HYIC will now receive Payments in Lieu of Taxes (PILOT) from development on the western portion of the rail yard. (HYIC was already scheduled to receive PILOT from the eastern portion.)

The amount of new revenue will not be known until the design guidelines and rezoning are completed for the western portion of the rail yards and a developer is selected, but assuming the zoning is similar to that adopted for the eastern portion of the rail yard, it is likely that PILOT revenues will be at least 10 percent higher than was anticipated as recently as this summer. The stream of PILOT revenue that will be available to meet Hudson Yards debt service expenses has also been increased by the recent agreement with the Javits Convention Center Development Corporation. The developer chosen to build the mixed-use project on the block between Javits and the western rail yard will now make PILOT payments to the Hudson Yards Infrastructure Corporation.

With additional Hudson Yards PILOT revenue, and continued evidence of a resurgent office market, it seems prudent to reexamine the assumptions behind the property tax discounts that will be offered in Hudson Yards under the policy adopted by the Industrial Development Authority board in July. The extent of the tax incentives offered is directly tied to the Hudson Yards financing plan. Although the city has committed to providing interest costs in the early years of the project while development gets underway, the plan's ultimate financial success depends on the extent to which developers choose to build in Hudson Yards and over the rail yards. Tax incentives are being used to help attract developers to the area to ensure there will be sufficient PILOT revenue to service the infrastructure bonds.

At the time of the IDA Board meeting, IBO noted that there were a number of questions that remained unanswered that could influence the appropriate level of tax incentives, including the fate of the rail yards. That question at least has now been answered in a way that implies more revenue for HYIC, greater security for the bonds, and therefore less need for such substantial tax incentives throughout the area.

How the MTA Fares

Under the agreement, the MTA will now solicit bids from developers for the right to build over the rail yards, consistent with zoning and development guidelines to be prepared in conjunction with the community and the city's regular land use review process. Depending in large part on expectations of the cost of building necessary platforms over the rail yards, the bidding will likely result in a higher price than the city offered in July. With the MTA's 2005-2009 capital plan counting on $1 billion from the sale of real estate assets, this deal should be a big step forward in meeting that target.

In a related action, the MTA and the city agreed on the financing the Number 7. Under the September 28, 2006 agreement, HYIC is to provide $2 billion towards the cost of the Number 7 extension. There is also provision for an additional $100 million from HYIC to cover potential cost overruns. What is less clear is what happens if the project costs more than expected. Except in the case of a change in the overall project scope there is no commitment from the city to cover additional costs. An outcome where the MTA was forced to absorb some or all of any cost overruns above the $2.1 billion provided through the current agreements, could result in diversion of funding from other projects in the MTA capital plan—several of which the MTA ranked as more important that the Number 7.

And the likelihood of costs overruns is high. Consider that the estimated cost of the Number 7 extension was $1.9 billion in 2004 with construction assumed to begin in fiscal year 2005. Two years later, the projected cost has barely changed. However, a recent report by the New York Building Congress noted that construction costs in the city have recently been rising at rates well above the long-term annual average rate of just under 6 percent. In 2005 construction costs rose by 9 percent, and this year they are increasing at a rate of 1 percent each month. With construction now expected to begin two years later than originally anticipated and costs rising well above the long-term average rate, it is surprising that the cost estimate has barely changed.

To summarize, now that we see that the Hudson Yards tax incentive decision was made before important issues were resolved, it seems reasonable to reconsider whether the tax discounts really are at an appropriate level. As for the MTA, while an open bidding process may well bring the authority a higher price than it would have obtained from the city, the lack of a firm commitment from the city if costs escalate could end up drawing upon funds already allocated to other transit capital projects.

Again, thank you for the opportunity to testify. I would be happy to answer any questions you may have.