



Understanding Value Capture as a Transportation Finance Strategy in Massachusetts

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Background

The Massachusetts Legislature will soon explore options to increase transportation revenue. One area of transportation finance that may be considered are strategies related to Value Capture. This memo outlines the concept of Value Capture, the Value Capture programs that exist in Massachusetts, the kinds of transportation projects Value Capture could support, and issues to consider in encouraging the state and local governments in Massachusetts to pursue Value Capture.

What is Value Capture?

New public infrastructure investments such as building transportation or sewer and water facilities increase adjacent land values, generating increased values for private landowners and increased tax collections for local government. Improved infrastructure can also increase the potential for development, which can further increase property values, local taxes, and even sales and income taxes collected by state government. Value Capture is a type of public financing that uses some or all of the value created by public infrastructure to help pay for the capital, debt service, and/or operating costs of that infrastructure.

Most Value Capture strategies fall into a few categories:

- *Special Assessment Districts*: a special tax assessed against property owners within a defined geography that has been identified as receiving a direct and unique benefit as a result of public infrastructure. The assessment can be levied on all property owners or only industrial or commercially zoned areas deemed to receive the greatest benefit.

For example, in Seattle local property owners have agreed to help fund half the cost of the South Lake Union Streetcar transit expansion via a Local Improvement District that established a special property tax to reflect the benefit that the property owners will receive from the investment in the streetcar.

- *Tax Increment Financing*: a mechanism that allows the public sector to “capture” all or a portion of the growth in property tax (or sometimes sales tax) resulting from new development and increasing property values. A tax increment is the difference between the taxes generated at the beginning of the assessed value of the targeted property in its current state and the taxes generated from the assessed value going forward in time once a decision has been made to build the infrastructure. As the property’s value increases as a result of planned improvements, which can come from both public infrastructure and subsequent private development, all or a

portion of the tax increment is dedicated to supporting the debt service or operating cost of the infrastructure.

An example of a TIF that supported transit infrastructure is the city of Denver's 30-year TIF district comprising the entire Union Station rail hub and 20 acres of developable land to support transit expansions and the rehabilitation of the station. The property taxes generated in the TIF district will go toward the debt services on two federal loans: a \$145.6 million Transportation Infrastructure Finance and Innovation Act (TIFIA) loan and a \$155 million Railroad Rehabilitation and Improvement Financing (RRIF) Loan.

- *Developer/Impact Fee*: a fee assessed on new development within a jurisdiction as a means to defray the cost to the jurisdiction of expanding and extending public services to the development. In Massachusetts, the courts apply a more conservative impact fee analysis that limits the ability of municipalities to allocate the public infrastructure costs associated with new development. The courts have ruled that some impact fees are really taxes levied by local government, and therefore unconstitutional in Massachusetts. Courts in other states have upheld municipalities' ability to more liberally levy impact fees.

For example, in San Francisco a Transit Impact Development Fee is assessed on new commercial development as a mitigation fee to support the operating costs of the city's transit system.

- *Joint Development and Air Rights*: cooperation between the public and private sectors to develop publicly owned land (usually near transit or station areas). Joint Development usually funds vertical construction like transit oriented development (TOD), with lease payments coming back to the public entity. Joint Development becomes an infrastructure financing strategy when the lease payments to the public entity support the operating cost of the infrastructure or new infrastructure, like an upgrade to a transit station area or rail extension. In some cases the private entity pays for the infrastructure in return for use of the public land.

For example, Portland, Oregon's MAX Red Line was built 10 years ahead of schedule using a Joint Development model, by which a private firm (Bechtel Enterprises) constructed the light rail line to Portland International Airport and four stations along the line. Bechtel Enterprises contributed \$28.2 million to fund the rail line and in return received an 85-year lease to develop 120 acres of land at one of the stations, without paying rent to the City of Portland. Bechtel also received the \$125 million design-build construction contract for the light rail without a competitive bidding process. Total compensation to Bechtel included the value of its design-build construction contract (\$125 million minus their contribution of \$28.2 million) and the resulting profits from real estate development efforts at the transit station.

Massachusetts Value Capture Programs

In Massachusetts there are primarily four Value Capture programs. A recent publication by the Executive Office of Housing and Economic Development that accompanies this memo, *A Guidebook of Massachusetts' Public Financing Programs for Infrastructure Investment*, provides a strong overview and examples of these programs, which include:

Business Improvement Districts (BID)

BIDs are districts that allow property owners the right to levy an assessment fee on themselves within a defined district in order to fund additional public services and infrastructure improvements. The assessment is levied only on property within the district and expended within the district for a range of services and programs, such as sanitation, marketing, maintenance and public safety. 60 percent of the real property owners and 51 percent of the assessed valuation of the district must approve the BID. In Massachusetts BIDs are primarily used as a local management structure to help maintain a city or town center, or to fund modest improvements that support the revitalization of the district. The total fees assessed in any one year within a BID cannot exceed one-half of one percent of the sum of the assessed valuation of the real property owned by participating members in the BID district. To date BIDs have not been used to support major infrastructure improvements.

District Improvement Financing (DIF)

The District Improvement Financing Program (DIF) is a locally driven public financing alternative available to all cities and towns in the Commonwealth. The DIF program enables municipalities to finance public works and infrastructure projects in a designated area by “capturing” all or part of the increase in property tax revenues, or tax increment, derived from new housing, commercial or industrial activity in the designated area and applying the revenues toward the municipality’s development program. The DIF program is essentially Tax Incremental Financing as described above.

Infrastructure Investment Incentive Program (I-CUBED)

The I-Cubed program is an innovative bond funded program designed to generate private investment and economic growth. A partnership is formed between the Executive Office of Administration and Finance (including the Department of Revenue), the Executive Office of Housing and Economic Development, MassDevelopment, the municipality and the developer(s). I-CUBED is financed by the Commonwealth, but the state is reimbursed by capturing future income tax, sales tax, and/or hotel/motel excise tax revenue generated by the development. The program is capped statewide at \$325 million and has a number of requirements that the developer and municipality have to meet to make sure the funds are reimbursed to the state.

Local Infrastructure Development Program

A final infrastructure finance program exists in Massachusetts that is not a traditional Value Capture mechanism, but noteworthy nonetheless because it can be used in conjunction with Value Capture tools. On August 7, 2012 Governor Patrick signed into law MGL Ch. 23L, which established the Local Infrastructure Development Program. The new chapter empowers

MassDevelopment to issue bonds with more favorable interest rates to fund infrastructure projects for homeowners and commercial properties. The debt service on these bonds is then paid down by the private developer(s).

Infrastructure Opportunities: What Could Value Capture Support in Massachusetts?

While it is extremely rare for Value Capture on its own to fund major infrastructure projects, Value Capture can be part of the mix of financing mechanisms used to advance a project or contribute to on-going operations. In Massachusetts, Value Capture could be used to support infrastructure that would promote not only economic growth, but also sustainable and equitable smart growth development, such as:

Transit Expansions

Value Capture could be used to support the debt service for planned transit expansions for the MBTA, Regional Transit Authorities, or inter-modal centers to link automotive, transit, bicycle and pedestrian infrastructure. While a detailed market analysis would have to be conducted to determine its feasibility, Value Capture tools that harness increases in property values might play a supporting role in financing long desired transit expansions that will catalyze economic growth.

Station Area Improvements

Transit stations, depending on their size and location, have the potential to draw private development or redevelopment that can be leveraged to pay for station area improvements, public amenities, and even ongoing maintenance of the surrounding streetscapes. The MBTA's South Station Expansion, given its strategic location in Boston close to the Financial District and developing Seaport area, could allow private development inside or above the station, and leverage this valuable real-estate to help finance the capital costs of the expansion.

Transit Operating Costs

A few cities in the United States, such as Orlando and San Francisco, require that new development projects contribute to the operating costs of public transit via impact fees, thus ensuring that new growth and development pays a share of the cost of new and/or expanded transportation facilities necessary to accommodate such development. As mentioned above, the Massachusetts Courts have applied a more conservative interpretation of what an impact fee is, thus limiting the type of fees that municipalities can levy.

Roadway Improvements

New roadways or major improvements to existing streets could be funded by Value Capture mechanisms, above and beyond current developer mitigation fees. These would likely have to be improvements that unlock large development opportunities or directly and quantifiably

benefit a majority of existing property owners in an area to incentivize the use of a BID, DIF or the I-CUBED program.

Streetscape Improvements

BIDs are the form of Value Capture in Massachusetts most commonly used to improve the local street network around an area, providing bicycle and pedestrian accommodation, plantings, street furniture, lighting, and other amenities that make an area attractive for mixed-use development. Most of the existing BIDs in Massachusetts provide for these types of infrastructure improvements in a downtown area, as well as maintenance, hospitality and marketing services.

Open Space

Creating parks can contribute to the attractiveness of an area, which then spurs redevelopment and increases the property value around the park. Value Capture mechanisms could be used to create new open space or even revive underutilized public space. By contributing to the capital work on parks and recreational facilities, Value Capture could serve as a valuable supplement in communities that have adopted the Community Preservation Act.

Transit Oriented Development

Value Capture could even support vertical development that achieves smart growth goals, such as mixed-use developments with a strong residential component that provides people with housing close to jobs. Transportation improvements and the resulting increase in property value can push out lower-income people, students, artists, and senior citizens living in the area. To prevent this displacement, Value Capture strategies such as Joint Development or funding generated from a Special Tax District could be dedicated to achieving housing goals in the impacted area.

Issues to Consider

Based on national research, the use of one or a combination of Value Capture strategies depends upon a number of factors, such as:

Enabling/Regulatory Environment

Does state-level legislation adequately allow the use of Value Capture strategies? Massachusetts has a number of Value Capture programs (mentioned above), however they are underutilized. The Commonwealth's BID, DIF and I-CUBED programs are most often used for smaller, lower cost improvements to an area, not to support major infrastructure. Are changes to these programs needed, or new programs/legislation needed to unlock Value Capture? In addition, the state's Supreme Judicial Court has ruled that certain impact fees imposed by municipalities are taxes, and therefore unconstitutional in Massachusetts. Impact fees to support a public transit authority have been rarely used in Massachusetts.

Property Owner Support

Would local developers or property owners support Value Capture strategies such as transit impact fees or special assessment districts where an additional tax is levied against their property?

Municipal Support

Do municipal officials in Massachusetts believe that local government could play a larger role in funding infrastructure in light of the declining federal role? Can municipalities be encouraged to dedicate future property tax revenue to pay for infrastructure, or do local officials fundamentally believe that providing infrastructure is the role of the state and federal government?

Identifying Appropriate Geographies

Many Value Capture strategies involve the creation of a district that will be assessed a fee. What is the best way to determine the district and negotiate the terms, especially if it contained multiple municipalities? How can the proceeds of such a fee be distributed within the district, between different sections of the district, and even between multiple districts?

Equity

How do we make sure the benefit that the new development creates is equitably distributed and does not overly shift resources needed to fund other municipal services to just one part of the community?

Institutional Capacity

Do state agencies and municipalities have the financial, administrative, and technical capacity to undertake joint development, to analyze the potential for DIF, or to negotiate with developers? What support do state agencies and municipalities need, and what entity is best suited to provide it?

Timing/ Availability of Financing Mechanisms

One challenge for Value Capture strategies is that the improvement that generates the value (e.g., new transit service) often must be in place before the value can be realized. This creates a chicken and egg situation, unless financing mechanisms (e.g., bonds) are available to enable those up front investments.

Revenue Yield

Probably the most important analysis needed is to identify which areas in Massachusetts have the real-estate market and potential for development where Value Capture could generate enough funds to be a part of the infrastructure finance mix.