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PLANNING AND PROGRAMMING COMMITTEE
MAY 15, 2013

SUBJECT: VALUE CAPTURE – TRANSIT INVESTMENT DIVIDENDS

ACTION: RECEIVE AND FILE VALUE CAPTURE ANALYSIS

RECOMMENDATION

Receive and file a report containing a further analysis of best practices for value capture in transit agencies and recommendations for further value capture options for consideration in the Metro system.

ISSUE

At its March 2012 meeting the Board adopted a motion by Director Ridley-Thomas directing staff to prepare a report summarizing the best practices for value capture and recommendations relating to value capture programs at Metro. In the intervening months, significant further developments have occurred that warrant further study. This report provides further analysis and recommendations for moving forward.

BACKGROUND

As noted in the earlier report, in recent years, shrinking state and local budgets, declining purchasing power of fuel tax revenues, and growing capital and maintenance costs have resulted in substantial shortfalls in transport funding. With the growing realization that the cost of transport will not be sufficiently met by the existing financing and revenue generation methods, new methods to augment the present system have been studied, one of which is value capture.

Value Capture Defined:

Value capture is the identification and capture of the increase in land value resulting from public investment in infrastructure. Its principal theory is that those who benefit from a particular infrastructure or service should also help pay for it. In the context of public transit, providing new or enhanced public transit systems provide tangible value and benefits to the neighboring properties which often result in higher land values. Value capture theory posits the position that if these properties benefit from the public transit systems they should contribute toward funding the systems.

As earlier noted, various methods have been devised and utilized, both in the United States and around the world, to directly of indirectly capture the increased land value can be captured through various mechanisms. The principal methods utilized include:

a) Transit Impact Fees

b) Property Tax Increment Financing

c) Special Assessment Districts

d) Joint Development (Including air-rights) Special Assessment Districts;

e) Increased Property Taxes Through Re-Assessment

While all of these mechanisms can and have been utilized in a variety of contexts, the implementation of many of these mechanisms is heavily dependent on such factors as: a) the availability of state and/or local enabling legislation; b) stakeholder support (from either or both the development community and/or in California voter approval in the case of fees or assessments); c) the willingness of cities and counties to implement value capture techniques for transit funding and; d) institutional capacity (i.e., financial, administrative and technical capacity of the governmental/transportation entities to undertake joint development or to administer special assessment districts or tax increment programs).

Our present transportation funding system emphasizes user fees (essentially fares and tolls). This is in contrast to value capture systems which attempt to recover the value of benefits received by property owners or developers due to infrastructure improvements and use those revenues to fund current or future transportation improvements. The rationale for such value capture systems is that the beneficiaries of transportation investment are not limited to direct users but also include landowners and developers who may benefit from enhanced land value brought by new transportation infrastructure improvements.

A significant body of transportation legislation on both state and federal levels has reinforced the need for integration of land use and transportation and the provision of public transit. However, the public transit systems typically require significant operating and capital subsidies and with all levels of government under significant fiscal stress, the search for new transit funding mechanisms has intensified.

Increased Agency Land Costs - Private Sector

It is worthy of note that as a continuing trend Metro has recently experienced higher land costs as it moves to acquire right-of-way, station sites, construction staging areas and required land for parking and ancillary operations. The private sector, as well as local municipal and other land owners, have recognized the increased land value brought by transit. The timing of our purchases – restricted as it is by law to a period after the full environmental certification of a project - puts Metro at some disadvantage since the projected route and placement of our facilities is well known in advance of our ability to negotiate and consummate a purchase. Thus, unless some form of value capture can be devised and implemented, we will continue to forfeit much of the increased land value created by our aggressive building programs and pay much of that increased value to existing landowners.

The following is a further analysis of recent developments that may impact the major forms of value capture utilized in the United States and, in particular, our southern California area More detailed information is provided in the very substantial body of literature and studies emerging as value capture is increasingly reviewed by transportation providers. A number of the more prominent studies and surveys are listed in Exhibit A of this report.

Value Capture Mechanisms:

1) Impact Fees

The imposition of an impact fee requires state and local enabling authority and only a few states allow transit (as opposed to general re-development) impact fees. The legislation requires real estate developers to contribute or fund public facilities, infrastructure, and/or services that would otherwise be paid for by the transportation provider.

The design and implementation of a transportation impact fee system also requires a high level of governmental and/or transportation agency institutional involvement and cooperation as well as careful documentation of the nexus between transportation improvements and land value in order to aid in the defense of any legal challenge. Resistance from stakeholders is largely confined to the development community. It is also important to recognize that these fees must be levied by local municipalities who may have other value capture priorities.

Studies suggest that such fees have, in particular circumstances provided varying percentages of funding - depending on (among other things) the type/cost of the transportation infrastructure improvement and the relative strength of the local real estate market in the area to be assessed. They are also dependent for their stability on the local strength of the real estate market as well as the supply of infill or green field land available adjacent to the transportation improvement. If strong real estate markets and suitable land is available, there is a higher likelihood of stronger revenue growth and lower volatility.

A significant recent local development is the passage in March 2013 of the *City of Santa Monica Transportation Impact Fee ("TIF").* It provides a new framework to integrate transportation and land use with policies to encourage walking, biking and transit use and identifies transportation improvements for which the generated fees will be utilized. The methodology proceeds from a "nexus study" that seeks to determine negative transportation impacts of new development and to levy a fee to mitigate those impacts.

The stated purpose of the *TIF* is to insure that new development pays its fair share of the cost to provide necessary transportation infrastructure to achieve no new net PM peak hour vehicle trips and to fund transportation capital projects that expand transportation choices.

The nexus study process used to determine the fee first establishes the relationship between new development and transportation impacts by calculating trip generation by land use, determines fee rates by land use based on trip generation then identifies capital projects to be funded by the fee.

Even though, as is the case with most impact fee regimes, the TIF would exempt government and religious facilities, affordable housing day-care facilities and the like, the revenue generated by such fees can be significant in Santa Monica. For example the City's current estimates in two defined City areas project that approximately 37% of the $50 million necessary to mitigate traffic in those areas can be raised by the *TIF.* The City's economic study further projects that the effect of such a fee on developer/investor return is relatively minimal (-1%) as is the reduction in residual land values (1%-8%).

Our further continuing review indicates comparable *TIF's* already exist in Pasadena, Culver City and several defined zones of the City of El Segundo. While these methodologies are unique to governmental agencies rather than transit agencies, potential exists to devise a sharing mechanism that would integrate the funding mechanisms with the agency transportation plans to augment funding for line improvements and betterments as well as projects per se.

2) Tax Increment Financing:

As noted in the earlier report, tax increment financing requires the creation of a defined geographic district – often administered by a special authority - which authority on a national level is usually a redevelopment or economic development agency. Once such a district is created, the assessed property value is pegged at its then current level for a period of years and, as development occurs, the property values in the district increase as do the property tax revenues. The property-tax "increment" (the tax assessed on the now higher valued property less the property tax at the "pegged" level) may be granted to the transportation agency through the special authority.

It is important to note that this revenue will be diverted to transportation uses rather than to the agencies that would normally receive it (city, the county, school districts, etc.) and from the special authority itself. Opposition from such interests may be significant. Creation of such a system would also require a relatively high degree of institutional capacity and cooperation among the municipal and county to administer the system as well as to garner support of other public agencies and the community at large.

As earlier noted in our previous report, California, as well as most other states have enacted enabling legislation allowing tax increment financing, however it remains unclear whether use of such funds for transit infrastructure related purposes is allowable and there is wide variation among the states as to permissible uses of tax increment revenue ranging from the highly restricted (defined blighted area revitalization projects) to very liberal (general development, job creation etc,) as witnessed by current efforts in California to implement infrastructure finance districts using tax increment techniques.

Once implemented, however, the revenue can remain relatively stable although, as in the case of most other value capture techniques (impact fees, joint development, air rights etc.), they are dependent on real estate market conditions as the level of new development is the main contributor to such added revenue. Two bills recently introduced in the California legislature show some promise to clarify and simplify this mechanism as it relates to transit.

1) Recently introduced California legislation attempts to clarify the use question by specific reference to transportation infrastructure as an allowable use. Notably the introduction of SB 33 (Wolk) which eliminates the requirement of voter approval and allow local agencies to use "infrastructure financing districts ("IFD's") to pay for public works projects without impacting the school district's share or property tax or the state's general fund. The legislative body (city or county) could create the IFD for bond issuance with five (5) board members (3 elected and 2 public members) to levy for financing of specified projects – including transit. A majority vote of the board (subject to the approval of the legislative body) could adopt a financing plan and issue bonds against property tax increment diverted for the purpose. This as well as the Compos bill (AB 690) discussed below are essentially meant to fill the gaps created by the abolition of Community Redevelopment Agencies (CRA's) but in a more targeted manner and with the specific inclusion of transportation related projects.

2) AB 690 (Campos) introduces the concept of a jobs and infrastructure financing district ("JID") upon a 55% voter approval but with 2/3 voter approval necessary to adopt a plan and issue bonds. As such many of the existing difficulties in implementation remain, however the specific inclusion of highway and transit facilities as eligible for such financing makes certain their ability to participate in such funding. As noted above, both this and the Wolk bill (SB33) are more targeted version of prior CRA authority and

include creation of housing, hazardous waste clean up as well as to target for industries might locate or expand within the jurisdiction and thus create new jobs for eligibility.

3) Special Assessment ("Benefit Assessment") Districts:

As the name suggests, Special Assessment Districts (or "Benefit Assessment Districts" or "BAD's" as they are generally labeled in California) are geographically defined areas for which governmental or quasi-governmental agencies are legislatively enabled to collect mandatory fees based on benefits provided by public infrastructure improvements.

As they are seen nationally, and as local experience strongly suggests, a highly concerted effort on both the state and local level is required for the formation of such a district. In addition, a substantial institutional effort (initial expertise to devise and set-up systems as well as administrative staffing by both the transportation agency and the administering authority) is also required in order to properly devise and operate such districts.

As noted in our earlier report, in assessing the viability, utility and revenue potential of such districts, a number of key decisions must be made that will affect the effectiveness of such a system. When dealing with public infrastructure assessment districts, including transportation infrastructure, the evidence suggests that most districts exempt lower-income households (if they assess residential properties at all – the trend recently has been to completely exempt residential and small property parcels), and then base the assessment on the benefit to each property individually.

Several states, including California in the case of transit, currently require the vote of the majority of property owners or residents for special assessment district formation thus making it more difficult to provide such districts. However, a recently introduced bill in our California legislature seeks to alter that dynamic and the shows promise, if passed, of making both easier to form such districts and clarifying that the revenue generated from such districts can be utilized to fund transportation infrastructure.

A) The newly proposed legislation -SB 142 (DeSaulnier) – would broaden the overall general provisions of the current statutory authority. In contrast to current law which requires owners of real property to approve BAD's in a weighted ballot election, this bill would authorize a "transit operator" itself to create one or more BAD's within the service area of the operator by action of the "governing board" of the operator and to levy assessments on real property to finance the acquisition, construction, operation maintenance and repair of one or more eligible transportation projects if the action is consistent with the general or specific plans or the city or county within which the BAD is to be created.

The bill's provisions are closely modeled on statutes that already allow the Santa Clarita Valley Transportation Authority (VTA) to levy assessments for transit projects.

However the VTA has never used its statutory authority to levy special benefits assessments and recent court decisions have subjected common types of benefit assessments to heightened scrutiny in determining their compliance with Proposition 218's requirements. Because the methodology is untested it may invite legal challenges, creating fiscal uncertainty for operators that use them to finance transit projects.

B) A Potential Alternative Solution:

The courts have ruled that assessments on businesses, as opposed to real property, are not subject to Proposition 218's provisions. State law allows local governments to create districts (commonly called "business Improvement Districts" or "BID's") that levy benefit assessment on businesses to pay for improvements and services that provide special benefits to those businesses. The pre- Proposition 218 ad valorum assessments that the Southern California Rapid Transit District (MTA's predecessor) levied to help finance the Red Line excluded residential properties and were instead levied based on the economic benefits conferred on commercial property resulting from its proximity to transit stations. It has been suggested that to avoid potential legal challenges under the provisions or Proposition 218, transit operators may find it easier to levy assessments that reflect the special economic benefits conferred ion businesses that are in close proximity to transit, As an alternative to authorizing real property-based special assessment districts, legislation such as SB 142 cite above might allow transit operators to establish business assessment districts around transit to finance their projects

4) Joint Development and Air Rights:

As noted in the previous report, in the context of transportation funding, and as the name implies, joint development involves a partnership between the transportation provider and private developers to build and operate residential and commercial ventures on land owned by the transportation provider. While property may be sold, Metro's model involves "ground leasing" pursuant to a "joint development agreement" that provides a framework to assure that the development is (and remains throughout the lease term), one that promotes transit use while "unlocking" the value of otherwise underutilized real estate at and around transportation stations and parking facilities. The development – totally financed and operated by the private developer – provides regular periodic payment to the transportation agency. Because Metro retains ownership of the underlying land, at the end of the lease term the property as well as any improvements built on it revert to Metro's full control and Metro is then free to provide for continuing operation, re-leasing or other use of the property.

Revenue generation can vary widely due to the individual characteristics of the land available for development. For example in Metro's experience, there was robust growth in joint development during the real estate "up years" from 2006-2009 when such projects as; a) the Hollywood & Vine Hotel/Apartment/Retail project (total lease revenue from 2012 through lease termination approximately $350 million) and; b) the Wilshire/Vermont

Apartment/Retail project (total lease revenue\from 20012 through lease termination approximately $50 million) among others.

However several other "mega-projects" that were negotiated just prior to the severe economic downturn that would have yielded approximately $10 million annually or over $500 million in its initial lease term (North Hollywood) and $4+ million annually or over $200 million during its initial lease term (Universal) were put completely on hold as it became next to impossible to finance such projects.

While during the intervening years (2009-present) we have been able to complete negotiations on a number of smaller projects due to the availability of financing for those containing significant affordable housing components (Westlake/MacArthur Park Phase I – approximately $2.5 million in capitalized rent; and the One Santa Fe project – approximately $105 million over its lease term) as well as several others, most larger projects remained on hold until very recently.

As the economy continues to improve, it is likely that we will now see (and in fact are already witnessing) a surge in demand and the availability of financing for rental apartments. This is offset by the demise of Redevelopment Agencies who were a significant aid to financing affordable apartment projects. It is likely, therefore, that we will be able to complete a number of new market rate unit mixed-use projects within the next several years. However the financing and market demand for the "mega-project mixed office/retail etc. projects remains highly uncertain and is unlikely to be resurrected in the near term.

Also as previously noted, apart from revenue generation and cost sharing, joint developments can bring other benefits to transit agencies, including increased transit ridership by increasing station-area density or adding destinations on transit lines. The increased ridership can, in turn, raise the transit agency's fare-box revenue. Transit agencies may also enter into joint agreements to promote economic development and job growth or to create affordable or transit-accessible housing. Furthermore, private developers can share the costs of construction and/or maintenance of stations and other facilities, such as heating and ventilation systems. A number of Metro joint developments have included developer-built transportation facilities (e.g., the bus layover facilities located beneath the apartments at Hollywood and Vine etc.) and can further contribute to enhanced ridership in a variety of ways (e.g., the developer-paid transit passes furnished to each household at Metro's Westlake/MacArthur Park development).

<u>Additional "Incentive" Development Revenue</u>:

An additional form of incentive development agreement – often in the form of a "density bonus" or infrastructure construction agreement, is also gaining some currency. Developers are granted the right to build residential units or additional square footage over and above that normally allowed by existing zoning or entitlement legislation (thus increasing the developments value) in exchange for contributing to the transit agency's revenue derived from the development of other transit related objectives. This type of agreement is most common in New York City, where density bonuses are extremely valuable to developers due to the high rent structure and would have applicability to many areas of Los Angeles as well.

Note however, that implementation of such agreements will, in most cases, require special legislation and/or a significant degree of “partnership” with state and/or local governing authorities as transit agencies are not empowered to change local land-use rules and regulations. Increasingly, local jurisdictions are looking to such density bonuses or other land use or zoning benefits as a mechanism to fund their own priorities including affordable housing, parks, and street and sidewalk infrastructure and other community benefits.

Scale and Use of Revenue

As noted, all forms of value capture remain to a greater or lesser degree dependent on both the condition of the real estate environment at specific locations and at a particular point in an economic cycle (e.g., joint development) and/or on the specifics of the real estate market timing and the scope and definition of the program (e.g., the geographic location of assessment districts: the exemptions granted to either or both residential and small parcel or lower income participants) and thus must be studied on an individual basis).

In its current state, the revenue derived from value capture is relatively unrestricted and, absent Board or other legislative direction, would accrue to Metro’s general fund and could therefore be utilized for multiple purposes and, thus for augmentation of any Board approved project.

SUMMARY:

The performance of all value capture mechanisms must be evaluated based on the same criteria that transit providers consider when designing and implementing any funding mechanism: the enabling legal environment, stakeholder support, institutional capacity, revenue yield, revenue stability, and equity. In terms of the categories of value capture reviewed, the following characteristics emerge:

In terms of scale:

Tax Increment Financing and Special Assessment Districts are the mechanisms likely to yield the highest and most stable revenue. However, to allow the use of Tax Increment or Special Assessment Financing, significant institutional capacity, community support, and agreement among taxing agencies is a pre-requisite. Recently introduced legislation, if enacted, may greatly enhance the utility of these mechanisms for transit funding.

Local governments may use a combination of value capture mechanisms. For example, Tax Increment, Special Assessment Districts and Joint Development have been successfully implemented in a single project in appropriate situations.

Value Capture System	Used by Metro	Authorized By Current State Law as related to Transit **	Require Local Government Concurrence and/or "Sharing" of Revenue *
Transit Impact Fees	No	No	Probable
Tax Increment	No	? as to transit	Yes
Spec. Assessment Dist.	Yes (previously)	Yes	No
Joint Development	Yes	Yes	No
Joint Dev. Added Incentives	No	No	Probable

* As noted in the body of this report, the power to impose fees; utilize tax increment or grant entitlements of zoning variances or exceptions resides with State and local governmental entities. The imposition of any such benefit and the revenue or other benefit derived therefrom would not flow to the transportation agency unless such state of local agency grants it cooperatively.

** A full analysis of enabling legislation, particularly as it relates to the availability of same for transit-related purposes is complex and will, as noted herein, require a full analysis in each case to determine what, if any, further authority may be needed to enable imposition of particular value capture strategies.

NEXT STEPS

In order to make a decision on whether to move forward toward implementation of any new value capture system (e.g., Special Assessment Districts, Property Tax Increment Financing, Transit Impact fees, etc.) or to augment existing programs (i.e., adding to the existing Joint Development program the ability to "incentivize" via density bonus etc., thus increasing revenue) it will be critical to continue our study of each of the most promising (in terms of significant revenue) systems on an individual basis.

Each should be measured in terms of a presumptive geographic and system specific basis for its potential revenue generation and in terms of the relative complexity of implementation including the need, if any for enabling legislation, inter-governmental and inter-agency cooperation as well as institutional capacity and the potential need and cost to augment such capacity.

A further important step to be considered would be establishment of a cross-jurisdictional committee or task force to study the interaction among agencies required to successfully tap the value created by infrastructure and to recommend appropriate methods of implementation of new value capture mechanisms. As many of these value capture methodologies require significant cooperation and coordination as well as "buy-in" from multiple governmental organizations, it will be critical to assess both the required mechanisms and the willingness of the various organizations to participate.

CONCLUSION:

The imposition of new value capture systems can be highly complex, will in most cases require the acquiescence of local regulatory agencies, and is clearly dependent on local (and particularized to the proposed transit system to which it is to be applied) real estate and financial systems. Due to the complexity and attendant expense, both in terms of added institutional governmental and transit provider structure and administration, great care must be taken to determine whether the potential revenue generation likely to result from many of the newer value capture systems justifies the attendant costs.

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