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 4-

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6. Status of Project

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

6.3.2 Increased and Extended Interest Payment Support of New York City

In 2007, at the time of the first bond issuance, it was predicted that interest payment support would remain at $7.4 million. However, it actually continued to grow until in 2015 it was $359 million. 3) 18)

6.3.3 Additional Issuance of $1 Billion in Debt by HYIC

Despite this situation, in 2012 HYIC issued an additional $1 billion bond (Hudson Yards Senior Revenue Bonds Fiscal 2012 Series A) to finance infrastructure development, similar to how funds had been used previously. They issued the bonds as Supported Bonds (meaning that the city promised interest payment support for them) of New York City. Except for S & P, the credit rating of the bonds rose from previous results, with scores consisting of Moody's "A2," S & P's "A" (stable), and Fitch's "A" rating. (Refer to Table 6-2)

Moody's said that the reason for the higher rating was that "The City of New York (general obligation rating of Aa2) has pledged to cover the interest costs for the life of the bonds when those revenues are insufficient; the city's obligation to pay interest is absolute and unconditional, subject to appropriation and thus the rating is derived from the city's credit quality. The three notch difference from the city's general obligation rating reflects the need for annual appropriation of the city's interest subsidy, the nature of the economic development projects being financed, and volatility in New York City's real estate markets that could delay development in the Hudson Yards area beyond what already has been experienced through the recent economic downturn." 22)

6.4 Recent Status

6.4.1 Status of Hudson Yard and the Manhattan Office Market

The Hudson Yard Project has completed construction of main buildings in the central area. In March 2019, a complex with department stores, retail stores, restaurants, etc. had a grand opening. 24)

Additionally, the headquarters of well-known companies have relocated as of now to the completed office building. 25) 26) Most of these companies are believed to have come from the Midtown area of Manhattan. They consist of not only leading industries, known as TAMI (Technology, Advertisement, Media, Information), but also include traditional FIRE (Finance, Insurance, Real Estate) industries. 27)

The price of rent seems to be comparable to those found in the conventional market of Midtown[1]. 35)

Consequently, Midtown's vacancy rates have largely increased, while vacancies on that of its West Side, which includes the new downtown of Hudson Yards, have decreased. 28) 29)

However, there is still strong demand for offices throughout Manhattan, with 2018 seeing an 18% increase in new leases over the previous year, consisting of 35.9 million square feet (approx. 3.3 million square meters) of space. 30)

6.4.2 55 Hudson Yards

55 Hudson Yards can be used as a real-world example of real estate within the Hudson Yards Project. The building is located on the corner of 11th Avenue and West 33rd Street, and is adjacent to the man-made grounds on the eastern part of West Side Rail Yard and the new Subway Line 7.

Mitsui Fudosan Co., Ltd. has acquired 90% of stakes in this building. The specifications of the building are as follows:

<u>Building Scale:</u> 51 floors above ground, 2 floors below ground

<u>Site Area:</u> approx. 40,000sf (approx. 3,700m2, approx.

[1] According to Cushman & Wakefield 35), the average offer rent for Class A offices in the Penn Station Submarket, including the Hudson Yard area, was $86.63 per square foot in the first quarter of 2019, higher than the averaging $82.04 for the entire midtown.

1,100 tsubo)
Total Floor Area: 1,265,700sf (approx. 117,600m2, 35,600 tsubo)
Intended Usage: offices, shops
Total Project Cost: approx.150 billion yen (1 dollar = 110 yen) 26)
According to a tax exemption application submitted to IDA by One Hudson Yards Owner LLC, a consortium of Related and Oxford, the building was originally scheduled to start construction in June 2014 and to be completed in April 2017. In actuality, construction started in January 2015 and was completed in October 2018, and so was delayed for about a year and a half.
According to the application, the total construction cost was planned to be 1,246 million dollars. 23% was designated for land costs, 51% to hard costs, and 25% to soft costs. The soft costs were expected to be used to purchase DIB and ERY TDR to increase the floor area ratio. IDA analyzed the data provided by the developer in the application, and estimated that it would create 800 net jobs during the construction. They also estimated that it would create approx. 1600 net jobs for the New York City economy after construction.
In respect to New York City's finances, the City received $77 million in tax reductions from the PILOT program, while also gaining $601 million in tax revenue, based on the present discounted tax value calculated at a rate of 6.25% for 25 years. The breakdown of the tax revenue includes $103 million from the sale of land, $6 million from construction, $487 million from building operations and $5 million from PILOT MRT. 90% of tenants were under contract for the 55 Hudson Yards building when it completed construction in October 2018. 26) 36)

6.4.3 HYIC 2017 Issuance of Second Indenture Revenue Bonds
In 2017, ten years after first issuing bonds, HYIC became able to voluntarily redeem them, and also began issuing refunding bonds (Second Indenture Revenue Bonds, Fiscal 2017 Series A (Tax-exempted), Fiscal 2017 Series B (Taxable)). They amortized the entirety of the 2007 bonds and a portion of the 2012 bonds. Demand and revenue forecasts were revised (with revisions also conducted in 2012), and the estimated total revenue by 2047 was amended to $2.8 billion. This was less than the 2007 forecast of $3.44 billion by 2050 estimated under an economic fluctuation scenario. As of 2017, current revenue only covered 47% of maximum debt costs. However, it is believed that they will be covered by 2022. 21) Credit ratings have been raised compared to previously, with scores including Moody's' Aa3, S & P's A+, and Fitch's A+.
Moody's stated that the reasons for the rating are "The one notch distinction reflects our determination of the essential nature of the transportation and other infrastructure projects financed by the bonds, the strong legal structure that obligates the mayor to include the TEPs and an amount sufficient to cover interest in the annual budget, the need for appropriation of those amounts, and potential real estate market volatility that could affect assessed values in the district. The ratings also reflect closure of the first indenture and the relatively small amount of debt left outstanding under it." 33)
Fitch described the reason for the rating is "(i.)The 'A+' rating on the series 2017 bonds, two notches below the city's Issuer Default Rating (IDR), is based on the support provided by New York City's obligation to pay interest on the bonds if project revenues are insufficient for this purpose, subject to appropriation. The two notch distinction from the IDR, wider than the standard one notch for appropriation-supported obligations, is based on the limitation of the city's support to interest payments on…
(ii.)Fitch believes the project benefits from the city's unique role as a national and international center for commerce and culture… (iii.) Recurring revenues are derived from a mix of commercial, residential and hotel properties… (iv.) Fitch believes growth prospects for revenues supporting the bonds over time are strong but dependent on continued development. " 32)

7．Assessment of the Hudson Yard Project's Status
Here, we introduce two case studies: one focused on the importance of coordination among parties in using development profit to maintain railroads, and another that verified whether costs of the projects were actually financially independent.

7.1 University of Illinois at Chicago (UIC) Urban Transportation Center
SE Schlickman and others studied cases where development profits were funneled back into urban railway development, including the Hudson Yards Project, a residential building in San Francisco's Parkmerced, a joint development and installment of No Ma-Gallaudet U station by Washington DC's Washington Metropolitan Transit Authority (WMATA), and the financing of the Chicago Transit Authority (CTA) using revenue acquired from tax increases (Tax Increment Financing, TIF).
This research was conducted in 2015, just before the opening of the extended Subway Line 7.
Regarding the Hudson Yard Project:

1. The high credit rating of HYIC's bonds indicates that the financing scheme was successful, and the market is willing to support this prime and self-sustaining, transit-dependent development.
2. The establishment of HYIC and HYDC by New York City provided an environment for developers to consider their own large-scale investments, and to finance infrastructure development through mechanisms created by the City. In particular, HYDC conveyed the City and

MTA's vision to potential developers, and coordination with them made the initial bond issuance successful.

3 From the developer's point of view, identification of the use and floor area ratio for all 45 blocks eliminated long and cumbersome procedures for construction permits, reduced uncertainty, and saved time. Also, early identification of the primary developers (Related Companies and Oxford Properties Group[2]) and their involvement in the development process reduced risks in project execution.

4 In summary, the Hudson Yard Project learned from rezoning failures in the early 1990s. Private developers, transportation planners, and city governments collaborated through HYDC and HYIC. They produced innovative market approaches to become the standard for how to gain a return from development profits. It is unclear for the time being whether the financing strategy implemented will be completely successful, but initial funding has led to early redevelopment. Such cooperation between public and private organizations was key for this achievement.

Also, from the cases of the four cities mentioned in the UIC study (NYC, San Francisco, Washington DC, and Chicago):

5 Here are important characteristics that must be realized for infrastructure development to successfully occur from returned development profits via coordination of related parties; i. Establishment of an organization that centrally manages the project and coordinates with related parties, ii. The existence of managers who are familiar with local administration, taxation, real estate development, railway construction and operation, etc., and iii. Determination of appropriate zoning and taxation for infrastructure development, in which public, private and administrative departments should have mutual interests. 2)

Table 6-2

HYIC Bonds Credit Rating Transition

	2007 Bond	2012 Bond	2017 Refunding Bond
Moody's	A3(A1)	A2(Aa2)	Aa3(Aa2)
S&P	A	A	A+
Fitch	A-	A	A+

Moody's brackets are New York City General Revenue Bonds

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[2] Related is a prominent developer in the US with a 40-year history. It has diverse areas of expertise in all aspects of development, with assets of $15 billion. Oxford is a global real estate investment, development, and management platform, with approximately $20 billion assets under management for itself and co-owners. Founded in 1960, it was taken over in 2001 by OMERS, Canada's largest pension fund. 36)

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