

## MUNICIPAL LAW

BY JEFFREY D. FRIEDLANDER

### *Developing the Hudson Yards*

The area of Manhattan now known as “Hudson Yards,” bounded generally by 42nd Street on the north, 11th Avenue on the west, 31st Street on the south and 8th Avenue on the east, currently consists primarily of railyards, industrial buildings and parking lots.

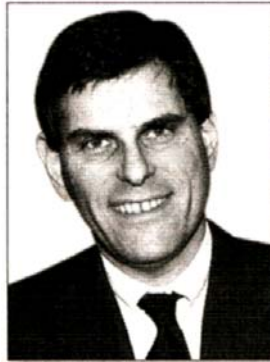
Under the leadership of Mayor Michael Bloomberg, Deputy Mayor Daniel L. Doctoroff and the City Council, recent rezoning of the area together with planned and now funded extension of subway service from Times Square to 11th Avenue and 34th Street will result not only in the westward expansion of Manhattan’s midtown office district but also in the creation of a new mixed-use community that includes significant residential development as well as a new park and boulevard.

This article focuses on the innovative financing of the infrastructure improvements necessitated or made possible by the rezoning of the Hudson Yards: the westward extension of the No. 7 subway line, the new park and the creation of a new midblock boulevard between 10th and 11th Avenues. In this effort, attorneys in the Municipal Finance, Economic Development and Legal Counsel divisions of the Law Department worked with a team of financial and urban planning experts from the office of Deputy Mayor Dan Doctoroff, the Hudson Yards Development Corp. (HYDC), the Department of City Planning and the bond counsel for the Hudson Yards project, Nixon Peabody LLP.

HYDC is a local development corporation created by the city under the laws of New York State to manage the Hudson Yards initiative and lead the Hudson Yards team. A second local development corporation, the Hudson Yards Infrastructure Corp. (HYIC), was created to issue bonds whose proceeds will finance the infrastructure improvements. The challenge was to create a mechanism pursuant to which funds attributable to the anticipated new development in the Hudson Yards area could be employed in support of the bonds issued by the HYIC to finance the subway extension and other public improvements. Law Department attorneys accomplished this by combining a set of previously employed devices to create a new framework for the issuance of bonds.

#### **Sources of Financial Support**

The zoning amendments approved by the City Council contain two of the financial supports for the Hudson Yards bonds: a district improvement fund and a provision allowing the sale of transferable development rights. The district improvement fund is a refinement of zoning bonuses permitted by the city’s Zoning Resolution. For example, a developer may be permitted to construct a larger building if the developer also constructs a related improvement to the transit infrastructure. This improvement helps make possible the increased density of the new zoning. However, no single developer could be expected to fund the No. 7 subway line extension and other infrastructure changes



made necessary by the development of the Hudson Yards, nor could they be done in stages. The public sector will therefore undertake these projects, based in part on revenues from the district improvement fund.

A second source of financial support for the Hudson Yards bonds is the sale of transferable development rights, which may be acquired by certain developers seeking to build above the new as-of-right floor area ratio (FAR) established for the Hudson Yards area by the Zoning Resolution.

Generally, floor area ratio is the number, established by the Zoning Resolution for each area of the city, that determines the development rights, in terms of total square feet of building, that are permitted on a parcel of land of a particular size. In most parts of the city, such development rights can be transferred among parcels within a city block.

In the case of the Hudson Yards area, through the use of a large scale plan, development rights may be transferred throughout the large scale plan area, generally the new commercial district between 10th and 11th avenues, from 30th Street to 36th Street east of the new park and boulevard and from 30th Street to 41st Street west of the new park and boulevard.

The source of the transferable development rights in the Hudson Yards area is the Eastern Rail Yards, consisting of the superblock between 10th Avenue and 11th Avenue and 33rd Street and 30th Street, which is controlled by the Metropolitan Transportation Authority (MTA). The placement of a park on the site limits development there to a floor area ratio below what is allowed by the rezoning. The additional development rights may, consistent with the overall zoning constraints of the district, be transferred to other sites in the commercial corridor in exchange for payments by the developers of those sites into a fund. The MTA has agreed to make those payments available to the HYIC, up to a certain limit, to be used for debt service on the bonds issued to pay for the subway extension and other infrastructure costs of the Hudson Yards project.

In addition to the zoning-based revenues, the largest revenue source for the funding of infrastructure improvements in the Hudson Yards area is expected to be real property taxes on new development. The Hudson Yards financing will capture real property-related revenues through PILOTs, short for “payments in lieu of taxes”. These are development incentives consisting of payments that substitute for real property taxes and are most commonly part of commercial development deals structured by the New York City Industrial Development Agency (IDA). Pursuant to its statutory authority, the IDA may enter into an agreement with a commercial developer which renders a site tax exempt in exchange for payment by the developer of a PILOT that is lower than the otherwise applicable real property tax for the site.

## *Developing the Hudson Yards*

In August 2006, the IDA adopted an amendment specifically for the Hudson Yards area to its Uniform Tax Exemption Policy, which sets forth the standards for its award of PILOTs. Pursuant to this amendment, deeper reductions are offered the sooner and the further west in the Hudson Yards area the development occurs.

PILOTs collected by the IDA are required to be paid to affected tax jurisdiction—in this case, the city. However, in order to benefit the Hudson Yards project, the city must be able to assign these payments to the HYIC to support the repayment of its bonds. An agreement between the Council and the mayor that was concluded in 2005 provides that PILOTs generated in the Hudson Yards area be assigned to the HYIC to pay the debt service on the Hudson Yards bonds, with any excess flowing back to the city.<sup>1</sup>

### **Delay in Realizing Revenues**

Although studies showed that revenues to be generated from new development in the Hudson Yards area will eventually be sufficient to cover the HYIC bonds, a sizable delay exists between the issuance date of the bonds and the projected receipt of sufficient revenues. Proceeds from PILOTs and from the transfer of development rights will become available when development of the Hudson Yards occurs.

However, the subway extension and other infrastructure improvements, which are preconditions of much of the expected development, must be funded now, before the development takes place.

This problem was addressed by the passage by the City Council of a Financing Resolution in connection with the Hudson Yards rezoning approval.<sup>2</sup> In the Financing Resolution, the Council approved a support agreement between the city and the HYIC which permits the city to make payments, on a subject to appropriation basis, of interest on HYIC bonds if the revenues of the HYIC are insufficient for debt service in any year.

In addition, the support agreement permits the city to pay annually to the HYIC, on a subject to appropriation basis, an amount equal to the property tax revenue from new development in the area to the extent not covered by PILOT arrangements. In this manner, taxes on new development not captured as PILOTs are available for debt service on the HYIC bonds.

In order to complete the credit structure for the bond transaction, final arrangements had to be made with regard to development of the Eastern Rail Yards, owned by a subsidiary of the MTA. To develop property that it owns, the MTA has authority to enter into an agreement with a developer obligating the developer to pay a PILOT to the MTA.

In September 2006, the MTA undertook to assign all PILOTs from development of the Eastern Rail Yards to the HYIC in support of its bonds, and to fix such PILOTs in amounts consistent with the IDA's amended Uniform Tax Exemption Policy for the Hudson Yards area. In addition, the HYIC acquired from the MTA, in exchange for a payment of \$200 million, a 50 percent interest in the proceeds from the transfer of development rights from sites within the Eastern Rail Yards to developers in other parts of the Hudson Yards. Such proceeds will first be paid to the HYIC in support of its bonds, and then to the MTA after the

HYIC's interest has been exhausted. The MTA has also agreed to plan with the city for development of the Western Rail Yards (owned by the MTA and located between 11th Avenue and West Street and 30th Street and 33rd Street), which have not been rezoned. Any developer retained by the MTA in this area will be required to pay a PILOT consistent with the IDA's Uniform Tax Exemption Policy for the Hudson Yards, and any such PILOT will be assigned by the MTA to the HYIC.

The final piece of the transaction was the expenditure of the bond proceeds. A further transaction in September 2006, structured as a memorandum of understanding among the MTA, the city, HYIC and HYDC, provides for the construction by MTA Capital Construction of the westward extension of the No. 7 subway. The city, through proceeds from the sale of HYIC bonds, will make available a capital commitment of \$2 billion, with a \$100 million contingency. The city has agreed to deliver the real estate sites and easements necessary for the extension. Such resulting condemnation work is being handled by the Law Department's condemnation unit and will be paid for from proceeds from the sale of Hudson Yards bonds.

The planning and the structure of the Hudson Yards program met with success in the bond market. In September 2006, with the necessary agreements in place for securing the revenues and for the expenditure of the proceeds the HYIC, with its advisers and bond counsel, brought the deal to the ratings agencies so that the bonds could be marketed. Two billion dollars in Hudson Yards Senior Revenue Bonds were sold in December 2006 at a true interest cost (which calculates the actual yield on the bonds, accounting for costs and proceeds) of 4.71 percent.

With the bond proceeds in hand, the Hudson Yards project now turns to implementation. Law Department attorneys and outside counsel are working to complete the necessary property acquisitions. The MTA is preparing the request for proposals for the first construction contract for the No. 7 subway line extension, and anticipates awarding the contract this summer. The city is working with the MTA on the planning principles for the Western Rail Yards and to prepare a request for proposals for development of that site. Change in the Hudson Yards is under way.

---

**Jeffrey D. Friedlander** is first assistant corporation counsel of the city of New York. **James McSpirtt**, deputy chief of the municipal finance division of the law department, assisted in the preparation of this article.

1. Council Resolution 1214 of 2005 approving the assignment of PILOTs from the Hudson Yards area to support the HYIC bonds. The resolution was further amended by Council Resolution 547 of 2006 on the expansion of the financing district.

2. Council Resolution 760 of 2005.