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THE USE OF PILOT FINANCING TO DEVELOP MANHATTAN'S FAR WEST SIDE

Amy F. Cerciello*

INTRODUCTION

On January 19, 2005, the Bloomberg Administration revealed the details of a plan to transform Manhattan's Far West Side.¹ The plan authorizes the extension of the Number Seven subway line and the construction of new office space, housing, streets, and parks.² The Bloomberg Administration intends to finance these public improvements outside of New York City's capital budget. A newly created local development corporation called the Hudson Yards Infrastructure Corporation will issue bonds backed by revenues that the new development is expected to generate.³ The largest

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1. Press Release, N.Y. City Council, Miller and Council Members Announce Details of Far West Side Plan (Jan. 10, 2005), at http://www.nycouncil.info/pdf_files/newswire/1_10_05_west_side.pdf [hereinafter Miller and Council Members]. Manhattan's Far West Side (also called the Hudson Yards) consists of "the area bounded by the south side of West Forty-third Street on the north, the east side of Eleventh Avenue on the west, generally, the north side of West Twenty-seventh Street and West Thirtieth Street on the south, and the west side of Seventh and Eighth Avenues on the east." Press Release, City of N.Y. Office of Mgmt. & Budget, New York City Announces Lead Underwriters for Hudson Yards Infrastructure Corporation (Feb. 11, 2004), at www.ci.nyc.ny.us/html/omb/pdf/press02_04a.pdf [hereinafter New York City Announces Lead Underwriters].

2. New York City Announces Lead Underwriters, *supra* note 1. The Bloomberg Administration concurrently planned to expand the Jacob K. Javits Center ("Javits Center") and construct a new stadium for the New York Jets. *Id.* After New York City lost its bid to host the 2012 Olympic Games, however, the stadium project was tabled. *See, e.g.,* Charles V. Bagli, *Schumer Calls for Action on Two West Side Development Plans*, N.Y. TIMES, June 21, 2005, at B4 (citing "the collapse of the stadium project in Manhattan"). The City may still go ahead with the Javits expansion, but that project would be financed separately from the Hudson Yards development, and therefore I do not discuss it. *See id.* (noting that U.S. Senator Charles Schumer called "for New York City to move ahead swiftly" on the Javits Center expansion); *see also* THERESA J. DEVINE, N.Y. CITY INDEP. BUDGET OFFICE, WEST SIDE FINANCING'S COMPLEX, \$1.3BN STORY 13 n.2 (2004), at <http://www.ibo.nyc.ny.us> [hereinafter DEVINE, COMPLEX STORY].

3. *See infra* notes 175-179 and accompanying text.

anticipated revenue source for bond repayment is commercial payments in lieu of taxes (“PILOTs”) made by private developers who build within the development zone.⁴

PILOT-backed bonds are a unique and little used mode of financing. New York City has never issued PILOT-backed bonds before,⁵ and they are a rare structure in the municipal debt markets.⁶ Yet, PILOT financing has a close analog: tax increment financing (“TIF”). TIF is a popular local redevelopment financing mechanism.⁷ Since its inception in California in 1952, all fifty states have implemented legislation authorizing the use of TIF.⁸ This Comment discusses TIF and its legal and financial drawbacks, and then applies the lessons learned from TIF to PILOT financing. Part I describes TIF’s general structure and underlying rationale and then examines New York State’s TIF statute. Part II considers the legal challenges that have been raised against TIF and predicts their likely outcome in a New York court. Part III explores the risks and policy considerations surrounding the use of TIF. It also considers whether TIF really is a self-financing redevelopment mechanism, as its proponents argue. Finally, Part IV examines the limited use of TIF in New York and proposes an explanation for its scarcity. It also outlines the similarities between TIF and PILOT financing, and explains how the legal issues, risks, and policy considerations surrounding the use of TIF apply with equal force to PILOTs. It concludes by recommending some changes to the Far West Side’s PILOT financing plan, based on the lessons learned from TIF.

I. TAX INCREMENT FINANCING: THE BASICS

This section begins by explaining the basic structure of TIF—in particular, how tax revenues get allocated during the life of a TIF project. It then describes TIF’s basic assumptions and underlying rationale. Finally, it examines New York State’s TIF statute.

4. See *infra* note 180 and accompanying text.

5. Michael McDonald, *N.Y.C. Sees \$2.7B in West Side Bonds*, BOND BUYER, Feb. 12, 2004, at 44 [hereinafter McDonald, *West Side Bonds*].

6. *Id.*

7. See, e.g., Joyce A. Man, *Introduction*, in TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACT 1 (Craig L. Johnson & Joyce Y. Man eds., 2001). By 1992, over 5,400 municipalities in forty-four states had used TIF. Jeffrey Chapman, *Tax Increment Financing as a Tool of Redevelopment*, in LOCAL GOVERNMENT TAX AND LAND USE POLICIES IN THE UNITED STATES 183 (Helen F. Ladd ed., 1998). As of 2001, fifty-six percent of cities with populations over 100,000 had used TIF. J. Drew Klacik & Samuel Nunn, *A Primer on Tax Increment Financing*, in TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACT 15, 18 (Craig L. Johnson & Joyce Y. Man eds., 2001).

8. See *infra* notes 20-21 and accompanying text.

A. Tax Increment Financing's Structure and Rationale

TIF allows local governments to finance development projects with the increased tax revenue generated by the redeveloped property.⁹ The initial property tax base of the redevelopment zone (the "TIF district") is "frozen" on the tax roll.¹⁰ As the redevelopment progresses, property values and property tax collections should increase.¹¹ The taxing authorities continue to receive tax revenue based on the frozen base value,¹² while the excess tax collections (the "tax increment") flow into a special fund that is used to make interest and principal payments on the TIF bonds.¹³ The original taxing authorities do not get any of the tax increment until the TIF bonds are repaid.¹⁴

Two central assumptions underlie the use of TIF. The first assumption is that property values would remain constant without the stimulation provided by TIF.¹⁵ The second assumption is that the redevelopment causes the increase in property values and the corresponding increase in tax revenue.¹⁶

Because TIF projects are financed from the incremental tax revenue generated by the redevelopment, TIF proponents argue that TIF is a self-

9. See, e.g., Sam Casella, *What is TIF?*, in *TAX INCREMENT FINANCING 1* (James Hecimovich ed., 1985); Todd A. Rogers, *A Dubious Development: Tax Increment Financing and Economically Motivated Condemnation*, 17 REV. LITIG. 145, 162 (1998) ("The driving force behind tax increment financing is the premise that the public will benefit from the increases in tax revenue created by the redeveloped property."); Gary P. Winter, *Tax Increment Financing: A Potential Redevelopment Financing Mechanism for NY Municipalities*, 18 FORDHAM URB. L.J. 655, 655 (1991) (noting that TIF "exploits the rise in economic value and hence the increase in tax receipts which accompanies urban redevelopment"); Catherine Michel, Note, *Brother, Can You Spare a Dime: Tax Increment Financing in Indiana*, 71 IND. L.J. 457, 458 (1996).

10. See, e.g., Chapman, *supra* note 7, at 183; Jonathan M. Davidson, *Tax Increment Financing as a Tool for Community Redevelopment*, 56 U. DET. J. URB. L. 405, 410 (1978-79); Randall V. Reece & M. Duane Coyle, *Urban Redevelopment: Utilization of Tax Increment Financing*, 19 WASHBURN L.J. 536, 538 (1979-80).

11. See, e.g., Chapman, *supra* note 7, at 183.

12. See, e.g., *id.*; Davidson, *supra* note 10, at 410; Reece & Coyle, *supra* note 10, at 538.

13. E.g., Reece & Coyle, *supra* note 10, at 538. The "tax increment" represents the difference between "the assessment based on the frozen base value and the amount of tax levied on the current value of the improved property." *Id.*

14. See, e.g., Rogers, *supra* note 9, at 163-64 ("Until the costs incurred by the redevelopment agency are repaid through the tax increment, all public entities that normally receive tax revenue from the property within the project area are limited to revenue based on the frozen valuation.").

15. See Davidson, *supra* note 10, at 410.

16. *Id.*

financing mechanism.¹⁷ In theory, the municipality does not have to pledge funds from its capital budget or increase taxes to fund the development.¹⁸ This characteristic of TIF helps explain its increasing popularity.¹⁹

B. New York State's Tax Increment Financing Statute

TIF originated in California in 1952 as a way to provide local matching funds for federal urban renewal grants.²⁰ Now all fifty states have legislation authorizing the use of TIF.²¹ New York authorized the use of TIF in 1984 with the passage of the Municipal Redevelopment Law ("TIF statute").²²

17. See, e.g., Chapman, *supra* note 7, at 184 ("What seemingly has occurred is that the redevelopment activities have become self-financing: the increment in land value generates the revenue to pay for the debt that was used to finance the expenditures that helped to cause the increment in land value."); Neil deMause, *Scrounging Up \$3 Billion in 'New' Tax Money? Hey, No Problem*, VILLAGE VOICE, Jan. 22, 2003 [hereinafter deMause, *Scrounging*] ("The promise of TIFs is no less than magical: to generate millions of dollars in subsidies for private developers, without costing the local government a dime."). See *infra* Part III.E for an analysis of whether TIF really is a self-financing mechanism as its proponents argue.

18. See, e.g., Joyce Y. Man, *Determinants of the Municipal Decision to Adopt Tax Increment Financing*, in TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACT 93 (Craig L. Johnson & Joyce Y. Man eds., 2001); Reece & Coyle, *supra* note 10, at 540.

19. See, e.g., Casella, *supra* note 9, at 1; deMause, *Scrounging*, *supra* note 17 ("TIFs are the fastest-growing development subsidy . . . [because] they supposedly neither require new taxes nor the use of existing ones.").

20. See, e.g., Klacik & Nunn, *supra* note 7, at 17.

21. By 1997, forty-eight states had passed laws authorizing the use of TIF; only Delaware and North Carolina did not have TIF statutes. Craig L. Johnson & Kenneth A. Kriz, *A Review of State Tax Increment Financing Laws*, in TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACT 31 (Craig L. Johnson & Joyce Y. Man eds., 2001). Delaware's TIF statute (called the Municipal Tax Increment Financing Act), codified at DEL. CODE ANN. tit. 22, §§ 1701-1715, became effective in 2003. North Carolina finally followed suit in November 2004, when voters approved a constitutional amendment authorizing the use of TIF and the issuance of TIF debt. See Richard Rubin, *Amendment 1: A New Tool*, CHARLOTTE OBSERVER, Dec. 13, 2004, at B1. North Carolina's TIF statute (called the Project Development Financing Act) is codified at N.C. GEN. STAT. §§ 159-101 to 159-113. For a discussion of North Carolina's TIF legislation, see P. Michael Juby, *Tax Increment Financing in North Carolina: The Myth of the Countermajoritarian Difficulty*, 83 N.C. L. REV. 1526 (2005).

22. In November 1983, the New York Constitution was amended to authorize the use of TIF. N.Y. CONST. art. XVI, § 6. New York's TIF statute is codified at N.Y. GEN. MUN. LAW §§ 970-a to 970-q (McKinney 2005).

1. The Blight and “Cannot be Accomplished by Private Enterprise Alone” Requirements

Under New York’s TIF statute, two criteria must be met before a municipality can implement a TIF project. First, TIF can only be used to redevelop “blighted areas.”²³ Second, TIF can only be used when “the redevelopment of such areas cannot be accomplished by private enterprise alone.”²⁴ Most states’ TIF statutes contain similar requirements.²⁵

2. The Planning Phase

After the local legislature identifies a blighted area, it must conduct a study to determine the feasibility of the proposed redevelopment.²⁶ If the legislative body concludes that the project is feasible, the next step is to prepare a preliminary plan that justifies the project.²⁷ The plan must describe the project and its likely impact on the surrounding neighborhoods and the environment.²⁸ It also must explain why redevelopment would not occur without TIF.²⁹

If the legislative body approves the preliminary plan, it then must prepare a redevelopment plan.³⁰ In addition to confirming the information

23. § 970-b. Section 970-c(a) defines a “blighted area” as:

an area within a municipality in which one or more of the following conditions exist: (i) a predominance of buildings and structures which are deteriorated or unfit or unsafe for use or occupancy; or (ii) a predominance of economically unproductive lands, buildings or structures, the redevelopment of which is needed to prevent further deterioration which would jeopardize the economic well being of the people.

This vague definition gives local officials considerable discretion in identifying “blighted areas.” THERESA J. DEVINE, N.Y. CITY INDEP. BUDGET OFFICE, *LEARNING FROM EXPERIENCE: A PRIMER ON TAX INCREMENT FINANCING 2* (2002), at <http://www.ibo.nyc.ny.us> [hereinafter DEVINE, PRIMER]. New York’s TIF statute is not unique; most states’ TIF statutes lack any quantifiable criteria for identifying blight. See Colin Gordon, *Blighting the Way: Urban Renewal, Economic Development, and the Elusive Definition of Blight*, 31 FORDHAM URB. L.J. 305, 320 (2004). As a result, municipalities and redevelopment agencies “have enjoyed wide latitude in defining or determining blight.” *Id.*

24. § 970-b.

25. *E.g.*, Josh Reinert, Comment, *Tax Increment Financing in Missouri: Is It Time for Blight and But-For To Go?*, 45 ST. LOUIS U. L.J. 1019, 1020 (2001) (these two requirements are “the principal tests required of any municipality to proceed with the use of TIF on a redevelopment initiative”).

26. § 970-d. Although the legislative body ultimately designates the survey area by resolution, any person, group, association or corporation may request the designation of a particular area. *Id.*

27. § 970-e.

28. *Id.*

29. *Id.*

30. § 970-f.

provided in the preliminary plan, the redevelopment plan must describe the proposed method of financing.³¹ If the redevelopment will be funded with TIF bonds, then the plan must indicate the amount and term of the bonds that will be issued.³² The legislature then must submit the redevelopment plan to the planning agency for review.³³ The planning agency is expected to file its comments within thirty days of receiving the plan.³⁴

3. Public Hearing Requirement

Before adopting the redevelopment plan, the legislative body must present the plan at a public hearing.³⁵ It must post notice of the hearing in a local newspaper and in at least four prominent public locations in the affected area at least three weeks prior to the hearing.³⁶ The notice must include a legal description of the boundaries of the project area and a summary of the plan.³⁷

Anyone who objects to the proposed plan may challenge it at the public hearing.³⁸ The TIF statute requires the legislative body to “hear and consider” all objections.³⁹ After the hearing, the legislative body may officially adopt the redevelopment plan.⁴⁰

The legislative body may amend the redevelopment plan at any time after it is adopted.⁴¹ But the amendments must go through the aforementioned public notice and hearing process before the legislature can adopt them.⁴²

4. Implementation

After the legislature adopts the redevelopment plan, the municipality has the authority to acquire property, relocate displaced individuals, demolish or move buildings, and prepare the site for redevelopment.⁴³ The statute

31. *Id.*

32. *Id.*

33. § 970-g.

34. *Id.*

35. § 970-h(a). The legislative body must hold additional public hearings on a biennial basis to review and evaluate the progress of the TIF project. *Id.*

36. § 970-h(b).

37. *Id.*

38. § 970-h(c).

39. § 970-h(d).

40. § 970-h(f).

41. § 970-m.

42. *Id.*

43. §§ 970-i to 970-l.

permits the municipality to assign these administrative powers to a local government agency.⁴⁴

5. Tax Increment Bonds

To carry out the redevelopment plan, the TIF statute authorizes the municipality to issue bonds payable from and secured by real property taxes (“TIF bonds”).⁴⁵ The municipality can only issue TIF bonds for certain public purposes, however, including the acquisition of land, the demolition and removal of structures, and the construction of streets, walkways, public utilities, parks, and playgrounds.⁴⁶ The statute expressly provides that TIF bonds may not be secured by the “faith and credit” of the local government⁴⁷ and that they will not count toward the issuing municipality’s constitutional debt limitation.⁴⁸

II. SUCCESSFUL LEGAL CHALLENGES TO TIF STATUTES

Although no one has challenged New York’s TIF statute thus far, a number of constitutional arguments have been raised against other states’ TIF statutes.⁴⁹ Of those, three have prevailed.⁵⁰ This section examines

44. *Id.* Most TIF statutes permit a municipality to exercise redevelopment powers either directly or through a redevelopment agency. *See Casella, supra* note 9, at 3.

45. § 970-o(a).

46. § 970-o(i).

47. § 970-o(b).

48. § 970-o(g).

49. The majority of courts considering TIF have found the TIF statutes constitutional against a variety of challenges. *See, e.g., Denver Urban Renewal Auth. v. Byrne*, 618 P.2d 1374 (Colo. 1980) (TIF does not violate constitutional debt limitations, constitutional prohibition against pledging of credit, or state constitutional prohibitions of nonuniform taxation); *City of Canton v. Crouch*, 403 N.E.2d 242 (Ill. 1980) (TIF does not violate public purpose doctrine or uniformity clause); *S. Bend Pub. Transp. Corp. v. City of S. Bend*, 428 N.E.2d 217 (Ind. 1981) (TIF does not violate equal protection, due process, uniform and equal taxation requirement, constitutional debt limitations, or constitutional provision prohibiting laws that impair contracts); *Richards v. City of Muscatine*, 237 N.W.2d 48 (Iowa 1975) (TIF upheld against attacks relating to due process, equal protection, constitutional debt limitations, and delegation of legislative authority); *State ex rel. Tomasic v. Unified Gov’t of Wyandotte County*, 962 P.2d 543 (Kan. 1998) (TIF does not violate public purpose doctrine, equal protection, or constitutional debt limitations); *State ex rel. Schneider v. City of Topeka*, 605 P.2d 556 (Kan. 1980) (TIF does not violate uniform and equal taxation requirement and is not an unlawful delegation of legislative power); *Delogu v. Maine*, 720 A.2d 1153 (Me. 1998) (TIF does not violate public purpose doctrine or equal taxation requirement); *Request for Advisory Opinion on the Constitutionality of 1986 PA 281*, 422 N.W.2d 186 (Mich. 1988) (TIF does not unconstitutionally lend the credit of the state or municipality); *R.E. Short Co. v. City of Minneapolis*, 269 N.W.2d 331 (Minn. 1978) (TIF does not violate public purpose doctrine); *City of Sparks v. Best*, 605 P.2d 638 (Nev. 1980) (TIF does not constitute unconstitutional delegation of legislative power); *Meierhenry*

those three arguments and predicts the likely outcome if they are ever raised in a New York court.

A. TIF Bonds and Constitutional Debt Limits

1. Generally

All state constitutions limit the amount of public debt that municipalities can incur.⁵¹ Courts are divided over whether TIF debt counts toward these limits.

Courts in the following states have considered the issue and concluded that TIF debt is subject to constitutional debt limitations: Arizona, Iowa, Kentucky, Oklahoma, South Dakota, West Virginia, and Wisconsin.⁵² With the exception of South Dakota, each of these states' TIF statutes expressly provides that TIF debt does not count toward constitutional debt limitations.⁵³ Yet such provisions are not controlling. According to the

v. *City of Huron*, 354 N.W.2d 171 (S.D. 1984) (TIF does not violate equal protection or due process guarantees, public purpose doctrine, state constitutional prohibition of nonuniform taxation, or constitutional provision prohibiting laws that impair contracts); *Metro. Dev. & Hous. Agency v. Leech*, 591 S.W.2d 427 (Tenn. 1979) (TIF does not constitute an unconstitutional diversion of taxes and does not amount to an unconstitutional taking of property); *Tribe v. Salt Lake City Corp.*, 540 P.2d 499 (Utah 1975) (TIF upheld against constitutional challenges regarding debt limitations).

50. See *infra* Parts II.A-C.

51. DANIEL R. MANDELKER ET AL., *STATE AND LOCAL GOVERNMENT IN A FEDERAL SYSTEM* 389 (rev. 5th ed. 2003). For example, New York's Constitution imposes the following debt limits, measured as percentages of the average full valuation of taxable real estate in the municipality:

- (a) Nassau County, for county purposes, 10%;
- (b) any county, other than Nassau County, for county purposes, 7%;
- (c) New York City, for city purposes, 10%;
- (d) any city, other than New York City, with a population greater than 125,000 according to the latest federal census, for city purposes, 9%;
- (e) any city having with a population of less than 125,000 according to the latest federal census, for city purposes excluding education, 7%;
- (f) any town, for town purposes, 7%; and
- (g) any village for village purposes, 7%.

N.Y. CONST. art. VIII, § 4.

52. *City of Tucson v. Corbin*, 623 P.2d 1239, 1244-45 (Ariz. Ct. App. 1980); *Richards*, 237 N.W.2d 48 at 65-66; *Miller v. Covington Dev. Auth.*, 539 S.W.2d 1, 5 (Ky. 1976); *Okla. City Urban Renewal Auth. v. Med. Tech. & Research Auth. of Okla.*, 4 P.3d 677, 684 (Okla. 2000); *Meierhenry*, 354 N.W.2d at 179; *County Comm'n of Boone County v. Cooke*, 475 S.E.2d 483, 493 (W. Va. 1996); *City of Hartford v. Kirley*, 493 N.W.2d 45, 55 (Wis. 1992).

53. *Johnson & Kriz*, *supra* note 21, at 45-47. South Dakota's TIF statute does not address the issue. *Id.* at 47.

Oklahoma Supreme Court, “[s]tatutory declarations alone will not alter the nature of indebtedness when circumstances make it clear that an obligation has been incurred.”⁵⁴ Courts in the aforementioned states reasoned that, because TIF bonds are repaid from property tax revenue, they implicate the credit of the underlying municipality. For example, in *Richards v. Muscatine*,⁵⁵ the Iowa Supreme Court held that “ultimately the ‘credit’ of a city is its power to levy general taxes. When it pledges all or part of that power, it pledges its credit and in a realistic sense incurs an obligation.”⁵⁶ Similarly, the Supreme Court of Wisconsin determined that TIF bonds count against constitutional debt limits because “they are payable solely from general property tax revenue.”⁵⁷ The court noted that it did not matter that the tax increment might not have existed without the use of TIF.⁵⁸

Courts in the following states have taken the opposite view, instead finding that TIF debt is not subject to constitutional debt limitations: Colorado, Florida, Indiana, Missouri, South Carolina, and Utah.⁵⁹ In making this determination, these courts relied on the special fund doctrine.⁶⁰ Under the special fund doctrine, when bonds are repaid from “special funds” rather than from a municipality’s general fund, those bonds do not count toward the municipality’s constitutional debt limitation.⁶¹ With TIF projects, the special funds contain the increased tax revenue generated by the projects. In *Wolper v. City Council of Charleston*, the South Carolina Supreme Court noted that TIF debt is repaid from a special fund containing the incremental property tax revenue from the TIF district.⁶² The court reasoned that, since TIF bondholders cannot look

54. *Okla. City Urban Renewal Auth.*, 4 P.3d at 686; *accord Kirley*, 493 N.W.2d at 50 (“The legislature’s characterization of the bonds is not controlling on this court’s determination of the constitutional issue.”); *Meierhenry*, 354 N.W.2d at 178 (“[N]otwithstanding the legislature’s characterization of the bonds, we must determine the nature of the bonding transaction from what it is, and not from what it is called.”).

55. 237 N.W.2d 48 (Iowa 1975).

56. *Id.* at 64.

57. *Kirley*, 493 N.W.2d at 54.

58. *Id.*

59. *See Denver Urban Renewal Auth. v. Byrne*, 618 P.2d 1374, 1382 (Colo. 1980); *State v. Miami Beach Redev. Agency*, 392 So. 2d 875, 899 (Fla. 1980); *S. Bend Pub. Transp. Corp. v. City of S. Bend*, 428 N.E.2d 217, 220 (Ind. 1981); *Tax Increment Fin. Comm’n v. J.E. Dunn Const.*, 781 S.W.2d 70, 77 (Mo. 1989); *Wolper v. City Council of Charleston*, 336 S.E.2d 871, 874 (S.C. 1985); *Tribe v. Salt Lake City Corp.*, 540 P.2d 499, 503 (Utah 1975).

60. *See Julie A Goshorn*, Note, *In a TIF: Why Missouri Needs Tax Increment Financing Reform*, 77 WASH. U. L.Q. 919, 937 n.94 (1999) (describing how the special fund doctrine is used to avoid counting TIF bonds toward constitutional debt limits).

61. *See MANDELKER ET AL.*, *supra* note 51, at 404.

62. 336 S.E.2d at 874.

beyond this special fund for repayment, TIF bonds do not count toward constitutional debt limitations.⁶³ The Supreme Court of Florida exercised similar reasoning in *State v. Miami Beach Redevelopment Agency*.⁶⁴ The court emphasized that if the special fund did not contain sufficient revenues to meet the bond obligations, TIF bondholders would have no recourse against the municipality.⁶⁵ The court thus concluded that TIF debt should not count toward the municipality's constitutional debt limitation.⁶⁶

The application of the special fund doctrine to TIF is problematic. The money funneled into these special funds is property tax revenue; "the character of [the] revenue does not change."⁶⁷ The Iowa Supreme Court best explained the conflict that arises when the special fund doctrine is used to exclude TIF debt from constitutional debt limitations:

Clearly the urban renewal bonds would constitute a constitutional debt if they were payable from the general revenues of the city without limitation. We think the result is not different because [the TIF statute] carves out a certain portion of a city's general revenues and limits the liability of the city to those revenues. If the result were otherwise, a city could divide its general revenues into several special funds, each with a bond issue restricted to recourse against its own fund—and thus commit large portions of the city's revenues without regard to [the constitutional debt limitation, which] could thus be virtually nullified.⁶⁸

The court realized that allowing the special fund argument to prevail would perpetuate the creation of other special funds, resulting in the ongoing circumvention of constitutional debt limits. It is true that counting TIF debt toward the underlying municipality's debt limit may preclude valuable redevelopment projects. But the purpose of constitutional debt limitations is "to prevent the creation of excessive municipal debt and to protect taxpayers from the consequent oppression of burdensome, if not ruinous, taxation."⁶⁹ Thus, although some redevelopment may not get accomplished, TIF debt should count toward constitutional debt limitations. This best serves the long-term interests of the taxpayers.

2. Likely Outcome in New York

New York's TIF statute expressly states that TIF debt does not count

63. *Id.*

64. 392 So. 2d 875 (Fla. 1980).

65. *Id.* at 898.

66. *Id.* at 898-99.

67. Goshorn, *supra* note 60, at 943.

68. *Richards v. City of Muscatine*, 237 N.W.2d 48, 64 (Iowa 1975).

69. *City of Hartford v. Kirley*, 493 N.W.2d 45, 51 (Wis. 1992).

toward the issuing municipality's constitutional debt limit.⁷⁰ As shown above, such provisions are not controlling.⁷¹ But New York's TIF statute was enacted pursuant to an amendment to the New York Constitution that also expressly provides that TIF debt does not count toward constitutional debt limits.⁷² This has been the deciding factor for courts in other states. For example, in finding that TIF bonds do not count toward constitutional debt limits, the South Carolina Supreme Court emphasized that the state constitution explicitly authorizes the issuance of such bonds.⁷³ Conversely, the Oklahoma Supreme Court found that TIF bonds do count toward Oklahoma's constitutional debt limits, reasoning that Oklahoma's enabling amendment "contains no language impacting or altering" these limits.⁷⁴ Given the express language of New York's enabling amendment, a New York court is not likely to find that TIF debt is subject to the constitutional debt limitations.

B. Unlawful Diversion of School Tax Revenues

1. Generally

The diversion of property tax revenue to a TIF project can have a detrimental financial impact on overlapping jurisdictions. In particular, school districts are often affected because they generally receive large amounts of property tax revenue.⁷⁵ As such, several state courts have considered whether TIF unconstitutionally diverts tax revenue from school districts.⁷⁶ Thus far, only courts in Kentucky and Washington have

70. N.Y. GEN. MUN. LAW § 970-o(g) (McKinney 2005).

71. See *supra* notes 53-54 and accompanying text.

72. N.Y. CONST. art. XVI, § 6. The amendment provides that "the amount of any indebtedness contracted under this section may be excluded in ascertaining the power of such county, city, town or village to contract indebtedness within the provisions of this constitution relating thereto." *Id.*

73. *Wolper v. City Council of Charleston*, 336 S.E.2d 871, 874 (S.C. 1985). South Carolina's enabling amendment authorizes the issuance of TIF bonds but does not address whether they will be subject to constitutional debt limits. S.C. CONST. art. X, §14(10). In contrast, New York's enabling amendment specifically provides that TIF debt will not be subject to those limits. N.Y. CONST. art. XVI, § 6.

74. *Okla. City Urban Renewal Auth. v. Med. Tech. & Research Auth. of Okla.*, 4 P.3d 677, 685 (Okla. 2000). Cf. *County Comm'n of Boone County v. Cooke*, 475 S.E.2d 483, 492 n.16 (W. Va. 1996) (reaching a similar conclusion).

75. *Johnson & Kriz*, *supra* note 21, at 49.

76. See, e.g., *City of Canton v. Crouch*, 403 N.E.2d 242, 248-49 (Ill. 1980); *Miller v. Covington Dev. Auth.*, 539 S.W.2d 1, 5 (Ky. 1976); *Request for Advisory Opinion on the Constitutionality of 1986 PA 281*, 422 N.W.2d 186, 195 (Mich. 1988); *City of El Paso v. El Paso Cmty. Coll.*, 729 S.W.2d 296, 298 (Tex. 1986); *Leonard v. City of Spokane*, 897 P.2d

endorsed this argument.⁷⁷ Unlike other states, Kentucky and Washington have special constitutional provisions that expressly prohibit the use of school tax revenue for non-school purposes.⁷⁸ In *Miller v. Covington Development Authority*, the Kentucky Supreme Court held that Kentucky's TIF statute violated this provision of the Kentucky Constitution.⁷⁹ The court rejected the argument that, because the incremental revenue would not have been raised without TIF, TIF was not diverting revenue that belonged to the school district.⁸⁰ The court was equally unmoved by the argument that the use of TIF would eventually increase the school district's tax revenue by increasing its tax base.⁸¹ The Washington Supreme Court, citing *Miller*, reached the same conclusion in *Leonard v. City of Spokane*.⁸²

The specificity of Kentucky's and Washington's constitutional provisions regarding the use of school tax revenue limits *Miller's* and *Leonard's* applicability to other jurisdictions.⁸³ Such provisions are not common features of most states' constitutions. For example, in *City of Canton v. Crouch*, the Illinois Supreme Court held that "[t]he fact that our constitution provides for no such limitation on education revenues, and in fact encourages intergovernmental cooperation, compels us to reach the

358, 361-62 (Wash. 1995).

77. *Miller*, 539 S.W.2d at 5; *Leonard*, 897 P.2d at 361-62.

78. See KY. CONST. § 186; WASH. CONST. art 9, § 2. Section 186 of the Kentucky Constitution states:

All funds accruing to the school fund shall be used for the maintenance of the public schools of the Commonwealth, and for no other purpose, and the General Assembly shall by general law prescribe the manner of the distribution of the public school fund among the school districts and its use for public school purposes.

KY. CONST. § 186. Washington's Constitution contains a similar provision: "the entire revenue derived from the common school fund and the state tax for common schools shall be exclusively applied to the support of the common schools." WASH. CONST. art. 9, § 2.

79. *Miller*, 539 S.W.2d at 5.

80. *Id.*

81. *Id.* The Kentucky legislature subsequently repealed Kentucky's TIF statute in 1986. KY. REV. STAT. ANN. §§ 99.750-.765. It was replaced by the Kentucky Increment Financing Act in July 2000. KY. REV. STAT. ANN. §§ 65.680-.699. The new statute remedies the constitutional problem identified in *Miller* by expressly prohibiting the use of tax revenue that would otherwise go to school districts. KY. REV. STAT. ANN. § 65.680.

82. 897 P.2d at 361 (holding that Washington's TIF statute unconstitutionally diverted tax revenues from schools in violation of the state constitution).

83. See, e.g., Reece & Coyle, *supra* note 10, at 547 ("In light of the unique character of the constitutional provision responsible for the demise of tax increment financing in Kentucky, the case should be of limited precedential value."); Joseph F. Luther, Comment, *Tax Increment Financing: Municipalities Avoiding Voter Accountability*, 1987 DET. C.L. REV. 89, 106-07 (1987) ("[T]he specificity of [Kentucky's] constitutional provision may have the effect of limiting the applicability of this case to other jurisdictions.").

conclusion that the decision in *Miller* has no application in this case.”⁸⁴ The Michigan Supreme Court reached the same conclusion in *Request for Advisory Opinion on the Constitutionality of 1986 PA 281*, holding that *Miller* did not apply because the Michigan Constitution does not contain a similar restriction on education revenues.⁸⁵

2. Likely Outcome in New York

School district taxes are not eligible for TIF bond repayment in New York.⁸⁶ The constitutional amendment authorizing TIF legislation provides that only the municipality that initiates the TIF project can allocate its incremental tax revenue to a TIF fund.⁸⁷ The enabling amendment does not authorize school districts to initiate TIF projects, which means that school districts cannot allocate their tax revenue to a TIF fund.⁸⁸ Therefore, the unlawful diversion of school tax revenue argument should not arise in New York.

C. Unlawful Delegation of Legislative Power

1. Generally

Several courts have considered the legality of granting redevelopment agencies power over the tax revenue of other taxing jurisdictions. Thus far, only one court has found that TIF permits an unlawful delegation of legislative authority.⁸⁹ In *Miller v. Covington Development Authority*, the Kentucky Supreme Court invalidated Kentucky’s TIF statute⁹⁰ because it

84. 403 N.E.2d 242, 248-49 (Ill. 1980) (upholding the constitutionality of Illinois’ TIF statute).

85. 422 N.W.2d 186, 195 (Mich. 1988).

86. See Winter, *supra* note 9, at 671-72.

87. N.Y. CONST. art. XVI, § 6 provides:

[a]ny county, city, town or village contracting indebtedness pursuant to this section for redevelopment of an economically unproductive, blighted or deteriorated area shall pledge to the payment thereof that portion of the taxes raised by it on real estate in such area which, in any year, is attributed to the increase in value of taxable real estate resulting from such redevelopment.

88. *Id.* New York’s TIF statute also prohibits the use of school district taxes. The statute authorizes the use of “real property taxes levied upon taxable real property in the project area each year by or for the benefit of the municipality or municipalities” that approved the redevelopment plan. N.Y. GEN. MUN. LAW § 970-p(a) (McKinney 2005). Section 970-c(e) defines a municipality as “a city, village, town or a county other than a county located wholly within a city.” Since the definition of “municipality” does not include school districts, school district taxes cannot be allocated to the TIF fund.

89. *Miller v. Covington Dev. Auth.*, 539 S.W.2d 1, 5 (Ky. 1976).

90. KY. REV. STAT. ANN. §§ 99.750-.770 (repealed 1986).

granted too much authority to independent redevelopment agencies.⁹¹ The court reasoned that legislative power should be exercised by elected representatives and not by administrative agencies.⁹² The court concluded that Kentucky's TIF statute improperly delegated legislative power by permitting redevelopment agencies to create TIF districts without prior approval from the local governing body.⁹³

Despite its success in Kentucky, all other courts that have heard the unlawful delegation argument have rejected it.⁹⁴ For example, in *Tribe v. Salt Lake City Corp.*, the Utah Supreme Court determined that a redevelopment agency only offends the constitution when the agency has powers that "intrude into areas of purely municipal concern."⁹⁵ The court found that the state legislature has the authority "to grant [such an agency] any powers, not expressly prohibited by the constitution, to further such [state] purposes, including the power of taxation."⁹⁶ After characterizing the elimination of blight as a state concern, the court held that Utah's TIF statute did not improperly delegate legislative power to a redevelopment agency.⁹⁷ Similarly, in *Bunker Hill Urban Renewal Project 1B v. Goldman*,⁹⁸ the California Supreme Court determined that a redevelopment agency is "entitled to exercise the powers delegated to it when functioning under the state law to fulfill the specifically enunciated state purposes."⁹⁹

91. *Miller*, 539 S.W.2d at 4-5. The *Miller* Court invalidated Kentucky's Tax Increment Act for two reasons, the first of which is discussed above. See *supra* notes 77-81 and accompanying text.

92. *Miller*, 539 S.W.2d at 4 ("If there is one essential characteristic inherent in legislative power, it is that such power must be exercised by an elected representative or representatives of the people, and not by a person, persons or agency created or designated by those representatives.").

93. *Id.* at 2.

94. See *Bunker Hill Urban Renewal Project 1B v. Goldman*, 389 P.2d 538, 573 (Cal. 1964); *Redevelopment Agency of San Francisco v. Hayes*, 266 P.2d 105, 124 (Cal. Dist. Ct. App. 1954); *Denver Urban Renewal Auth. v. Byrne*, 618 P.2d 1374, 1386 (Colo. 1980); *S. Bend Pub. Transp. Corp. v. City of S. Bend*, 428 N.E.2d 217, 224-25 (Ind. 1981); *Richards v. City of Muscatine*, 237 N.W.2d 48, 56-57 (Iowa 1975); *State ex rel. Schneider v. City of Topeka*, 605 P.2d 556, 563 (Kan. 1980); *City of Sparks v. Best*, 605 P.2d 638, 640 (Nev. 1980); *Meierhenry v. City of Huron*, 354 N.W.2d 171, 183 (S.D. 1984); *Metro. Dev. & Hous. Agency v. Leech*, 591 S.W.2d 427, 430 (Tenn. 1979); *Tribe v. Salt Lake City Corp.*, 540 P.2d 499, 507 (Utah 1975).

95. *Tribe*, 540 P.2d at 503.

96. *Id.*

97. *Id.*

98. 389 P.2d 538 (Cal. 1964).

99. *Id.* at 571; accord *Redevelopment Agency of San Francisco v. Hayes*, 266 P.2d 105, 124 (Cal. Dist. Ct. App. 1954) (noting that the state legislature "may, where necessary, confer authority and discretion in connection with the execution of the law; it may establish primary standards and impose upon others the duty to carry out the declared legislative

The court concluded that, because elimination of blight is a specifically declared state purpose, California's TIF statute did not unconstitutionally delegate legislative power to redevelopment agencies.¹⁰⁰

2. Likely Outcome in New York

New York's TIF statute expressly defines the elimination of blight as a state goal: "it is declared to be the policy of the state to protect and promote the sound development and redevelopment of blighted areas."¹⁰¹ The powers granted to redevelopment agencies by New York's TIF statute are inexorably connected to this state objective. Because a redevelopment agency that operates pursuant to New York's TIF statute is furthering a state purpose, a New York court is likely to reject the unlawful delegation argument. Moreover, the New York Court of Appeals has stated that, "[p]articularly [when a] statute concerns public financing programs, courts are required to exercise restraint and give deference to the legislative enactment."¹⁰² Thus, a New York court is likely to defer to the legislature and uphold the TIF statute in the face of an unlawful delegation of authority challenge.

III. RISKS OF TIF

Although many TIF projects have been successful, there are several potential risks that a municipality should consider before implementing a TIF project. This section describes these risks and then considers whether TIF really is a self-financing mechanism, as its proponents argue.

A. Impact of TIF Debt on the Underlying Municipality

TIF bonds are more expensive than general obligation bonds.¹⁰³ Unlike general obligation debt, TIF debt is not backed by the "faith and credit" of the underlying municipality.¹⁰⁴ Therefore, TIF debt is riskier than general

policy in accordance with the general provisions of the act") (quoting *Belovsky v. Redevelopment Auth.*, 54 A.2d 277, 283 (Pa. 1947)).

100. *Bunker Hill*, 389 P.2d at 573.

101. N.Y. GEN. MUN. LAW § 970-b (McKinney 2005).

102. *Local Gov't Assistance Corp. v. Sales Tax Asset Receivable Corp.*, 813 N.E.2d 587, 594 (N.Y. 2004).

103. See Craig L. Johnson, *The Use of Debt in Tax Increment Financing*, in *TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACT* 71, 77 (Craig L. Johnson & Joyce Y. Man eds., 2001); George Lefcoe, *When Governments Become Land Developers: Notes on the Public-Sector Experience in The Netherlands and California*, 51 S. CAL. L. REV. 165, 253 (1978).

104. See DEVINE, PRIMER, *supra* note 23, at 2. New York's TIF statute expressly

obligation debt and thus generally warrants a higher interest rate.¹⁰⁵

Although TIF debt requires a higher interest rate than general obligation debt specifically because it is not backed by the underlying municipalities' faith and credit,¹⁰⁶ underlying municipalities almost always prefer to bail out TIF bonds rather than allow them to default.¹⁰⁷ Generally, when implementing a TIF project, the underlying municipality will create a redevelopment agency that is a "legally separate and distinct entit[y]" to issue TIF debt.¹⁰⁸ The municipality is not legally required to make debt service payments if the agency fails to pay.¹⁰⁹ If the municipality does not cure the agency's default, however, the rating agencies may downgrade the municipality's general obligation debt.¹¹⁰ For example, when the Englewood Urban Renewal Authority of Englewood, Colorado defaulted on a twenty-seven million dollar TIF bond issue, Moody's downgraded Englewood's general obligation debt rating.¹¹¹ In its explanatory report, Moody's cited the "inextricable financial links among the city, the authority and the city's unwillingness to follow through on its capital projects, regardless of how the debt that financed the project is ultimately secured."¹¹² Because of the risk to the municipality's credit rating, the municipality has tremendous incentive to bail out TIF bonds.¹¹³ According to Economic Research Associates, when TIF bonds have come close to default, most local governments have provided the needed funds.¹¹⁴

provides that TIF bonds may not be secured by the "faith and credit" of the local government. § 970-o(b).

105. See, e.g., Johnson, *supra* note 103, at 77.

106. See *supra* notes 104-105 and accompanying text.

107. See *infra* notes 113-115 and accompanying text.

108. Johnson, *supra* note 103, at 81.

109. *Id.*

110. See *id.* ("Nevertheless, the nonrepayment of TIF debt can have an adverse impact on the general government's general obligation debt.")

111. *Id.*

112. *Id.*

113. See, e.g., GARY L. SULLIVAN ET AL., INSTIT. FOR POLICY & ECON. DEV., UNIV. OF TEX. AT EL PASO, TAX INCREMENT FINANCING BEST PRACTICES STUDY FOR GREATER EL PASO CHAMBER OF COMMERCE 3 (2002), available at <http://iped.utep.edu/IPED%20Reports/tr2002-10/tr2002-10.pdf>.

114. DAVID A. WILCOX & DAVID E. VERSEL, ECON. RES. ASS'N, REVIEW OF BEST PRACTICES FOR TAX-INCREMENT FINANCING IN THE UNITED STATES 5 (1999), available at http://www.econres.com/documents/issue_papers/issue_era_6_TIF_bestpractices.pdf; see also deMause, *Scrounging*, *supra* note 17 ("TIF bonds traditionally use a city's general fund as a backup revenue source."). For example, in 1984 when two of Minneapolis' TIF districts failed to generate sufficient revenue to repay their TIF debt, the city made up the difference. See John Kemanski, *Using Tax Increment Financing for Urban Development Projects*, 4 ECON. DEV. Q. 23, 26 (1990).

Default generally is “the option of last resort.”¹¹⁵

B. Revenue Shortfalls and Cost Overruns

Before implementing a TIF project, a municipality needs to consider how difficult it is to estimate accurately project revenues and costs. Various factors can cause revenue shortfalls and cost overruns, and inaccurate predictions may, in turn, jeopardize the TIF debt. First, the TIF project might not attract the projected level of private development.¹¹⁶ In addition, labor strikes, changes in market conditions, interest rate increases, and harsh weather conditions can halt or delay development.¹¹⁷ Second, assessed property values in a TIF district may decline rather than increase.¹¹⁸ In a TIF district in St. Petersburg, Florida, the taxable property value declined roughly twenty-five percent below its pre-TIF assessment due to recession.¹¹⁹ The city used existing taxes to bailout the project.¹²⁰ Third, tax abatements can reduce the tax base.¹²¹ When a municipality uses property tax abatements to attract developers, it risks lower-than-anticipated tax increments if the abatements are not properly factored into the TIF projections.¹²² For example, taxable property values in some Michigan TIF districts declined from their base values because of the concurrent granting of tax abatements in those districts.¹²³ Finally, some project costs are difficult to foresee.¹²⁴ For example, Greenburgh, New York used eminent domain to displace some residents in its TIF district, and one of these residents sued over the price he received for his property.¹²⁵ As a result of this unexpected litigation, Greenburgh accumulated sizeable legal costs that it had not factored into its projections.¹²⁶

115. Reinert, *supra* note 25, at 1028.

116. DEVINE, PRIMER, *supra* note 23, at 4.

117. See, e.g., Klacik & Nunn, *supra* note 7, at 25; STANDARD & POOR’S, PUBLIC FINANCE CRITERIA 54 (2000) (on file with author).

118. DEVINE, PRIMER, *supra* note 23, at 4.

119. *Id.*

120. See deMause, *Scrounging*, *supra* note 17.

121. See Klacik & Nunn, *supra* note 7, at 25.

122. *Id.* For more information on the relationship between TIF and tax abatement, see *infra* notes 162-166 and accompanying text.

123. DEVINE, PRIMER, *supra* note 23, at 4.

124. See *id.*

125. See *id.*

126. See *id.*

C. Cost Spillovers

The development associated with a TIF project is likely to generate increased demand for government services (such as education, fire, police, sanitation, and transportation) in the TIF district.¹²⁷ The property taxes paid to the municipality by property owners in the TIF district likely will not cover the cost of these new services.¹²⁸ And, the incremental tax revenue generated by the new development cannot be used to cover these costs.¹²⁹ The redevelopment agency will continue to funnel the increment into a special fund until all the TIF bonds are retired—even if the increment is higher than expected.¹³⁰ The local taxing bodies may wait many years before that portion of the tax base becomes available. In the meantime, the municipality may have to increase taxes or dip into its general fund to pay for these services.¹³¹ As a result, taxpayers outside the TIF district often wind up subsidizing TIF projects.¹³²

Some commentators argue that increased sales tax revenue from the new commercial growth in the TIF district will offset any indirect subsidies.¹³³ This argument is flawed. Although the development may increase the supply of retail stores, it does not follow that the demand for retail goods will also increase.¹³⁴ As such, there is no guarantee that sales tax revenue will increase to a point where it offsets contributions made by taxpayers outside the TIF district. Commentators have also argued that as property values increase in the TIF district, adjacent landowners will experience a corresponding increase in property values that compensates them for their contributions to the TIF project.¹³⁵ But it is almost impossible to determine when, where, and even whether such increase will occur.¹³⁶ Moreover, if

127. *E.g.*, Frank S. London, *The Use of Tax Increment Financing to Attract Private Investment and Generate Redevelopment in Virginia*, 20 VA. TAX REV. 777, 809 (2001).

128. Recall that, for the life of the TIF project, the original taxing authorities only receive taxes on the base assessed value of properties in the TIF district. *See supra* notes 10-14 and accompanying text.

129. *See supra* note 14 and accompanying text (noting that the original taxing authorities do not get any of the tax increment until the TIF bonds are repaid).

130. *See supra* note 14 and accompanying text. New York's TIF statute provides that the tax increment does not revert to the municipality until all the TIF debt has been repaid. N.Y. GEN. MUN. LAW § 970-p(a)(ii) (McKinney 2005).

131. *See, e.g.*, Michel, *supra* note 9, at 469.

132. DONALD G. HAGMAN, PUBLIC PLANNING AND CONTROL OF URBAN AND LAND DEVELOPMENT: CASES AND MATERIALS 187 (Supp. 1976).

133. *See, e.g.*, Reece & Coyle, *supra* note 10, at 542.

134. *See* Lefcoe, *supra* note 103, at 259.

135. *See* Reece & Coyle, *supra* note 10, at 542.

136. *See* David A. Hegg, *Tax-Increment Financing of Urban Renewal – Redevelopment Incentive Without Federal Assistance*, 2 REAL EST. L.J. 575, 578 (1973).

the use of TIF is not limited, it can extend indefinitely and thus never return the benefits to the taxpayers who subsidized the redevelopment.¹³⁷

D. Lack of Voter Accountability

TIF allows local governments to act without accountability to voters.¹³⁸ Most TIF statutes do not require voter approval prior to the adoption of the redevelopment plan or prior to the issuance of TIF bonds.¹³⁹ Local governments essentially have free reign over TIF projects, which increases the likelihood of abuse.¹⁴⁰ Chief Justice Henriod of the Utah Supreme Court best articulated the lack of voter accountability argument in his dissent in *Tribe v. Salt Lake City Corp.*:

Powerful interests are now free to inveigh upon politically sensitive and possibly over-sold public officials to induce the expenditure of public funds in all sorts of development schemes, with no voter control but with voter liability if the development fails to produce the needed revenues and/or taxes to repay the bonds¹⁴¹

Henriod points out that this freedom from voter approval may entice local officials to abuse TIF. Because voter approval is not required, local officials can use taxpayers' money for TIF "under almost any circumstance."¹⁴² Moreover, because TIF funds do not originate from the municipality's capital budget, local officials have less incentive to review TIF expenditures as closely as they review budgetary items.¹⁴³ Taxpayers are disadvantaged by the lack of voting power because, as Henriod indicates, they are the ultimate repayers of the TIF debt if the project fails to produce the anticipated tax revenue.

TIF proponents argue that TIF statutes generally contain adequate safeguards to protect taxpayers from abuse.¹⁴⁴ In particular, some

137. See HAGMAN, *supra* note 132, at 187.

138. *E.g.*, Luther, *supra* note 83, at 117 (arguing that "[e]limination of voter accountability is the inherent defect in tax increment financing").

139. *See, e.g.*, Man, *supra* note 18, at 93. For example, under New York's TIF statute, the municipality must file an annual progress report with the State Comptroller, but voter approval is not required for project plans or bond issues. N.Y. GEN. MUN. LAW § 970-q (McKinney 2005). In contrast, most states have public referendum requirements for traditional general obligation debt. *See* MANDELKER ET AL., *supra* note 51, at 389.

140. *See* Luther, *supra* note 83, at 117.

141. 540 P.2d 499, 515 (Utah 1975) (Henriod, C.J., dissenting). Chief Justice Henriod also determined that "the taxpayers no longer have referendum control over the decisions of municipal bodies to extend money for capital improvements in any area which arbitrarily is labeled 'blighted,' whether it is blighted or not." *Id.* at 514.

142. London, *supra* note 127, at 810.

143. *See* Winter, *supra* note 9, at 682.

144. *E.g.*, Reece & Coyle, *supra* note 10, at 541.

commentators argue that the public notice and hearing requirements contained in most TIF statutes ensure that the public has a voice in the TIF decision.¹⁴⁵ In response, one critic rightly argues that “[p]ublic notice in a newspaper that a municipality is considering the implementation of tax increment financing is unlikely to raise the eyebrow of an attorney or accountant, much less the average public.”¹⁴⁶ And even if taxpayers do take notice, the hearings themselves do not provide taxpayers with any real decision-making authority.¹⁴⁷ Although taxpayers may challenge a TIF plan at a public hearing, the legislative body is not required to respond. For example, New York’s TIF statute just requires the legislative body to “hear and consider” the public comments; the legislature does not have to make any changes to the redevelopment plan in response to public objection.¹⁴⁸ Another TIF proponent contends that the public hearings at least enable voters to make informed decisions about their elected officials at upcoming elections.¹⁴⁹ But this overlooks the fact that many TIF projects are administered by redevelopment agencies consisting of officials who are appointed rather than elected.¹⁵⁰ Elected officials effectively are protected against negative voter reaction to TIF projects.¹⁵¹ Thus, taxpayers essentially are left without a voice in the process. Such a result seems unfair, given that taxpayers are the ultimate repayers of TIF debt.¹⁵²

145. See, e.g., Davidson, *supra* note 10, at 439; London, *supra* note 127, at 812. Only seven states (Alaska, Delaware, Kentucky, Massachusetts, Maryland, Ohio and Rhode Island) do not require public hearings prior to either plan approval or district creation. Of the forty-eight states that had enacted TIF statutes by 1997, only six did not have public hearing requirements. Johnson & Kriz, *supra* note 21, at 42. Subsequently, the remaining two states, North Carolina and Delaware, passed TIF statutes. See *supra* note 21. North Carolina’s TIF statute requires the issuing municipality’s governing body to hold a public hearing before adopting the redevelopment plan. N.C. GEN. STAT. § 158-7.3 (2005). Delaware’s Municipal Tax Increment Financing Act, however, does not appear to require a public hearing. DEL. CODE tit. 22, §§ 1701-1715 (2005).

For a discussion of New York’s public hearing requirement, see *supra* notes 35-37 and accompanying text.

146. Luther, *supra* note 83, at 118.

147. See, e.g., Davidson, *supra* note 10, at 440 (“If an issue does arise at this stage, it is likely to be treated as an administrative matter that does not require the same level of formalized citizen input.”).

148. N.Y. GEN. MUN. LAW § 970-h(d) (McKinney 2005).

149. London, *supra* note 127, at 812.

150. See HAGMAN, *supra* note 132, at 187; Kemanski, *supra* note 114, at 25 (noting that the creation of redevelopment agencies “raises the problem of accountability . . . in which decisions concerning millions of dollars are made by individuals who most often are not elected by voters”).

151. See Kemanski, *supra* note 114, at 25.

152. See Johnson, *supra* note 103, at 78.

E. Are TIF Projects Really Self-Financing?

The argument that TIF is a self-financing redevelopment mechanism, often advanced by TIF supporters, is misleading.¹⁵³ In reality, TIF projects often impose considerable costs on taxpayers. If the anticipated tax revenue does not materialize, the underlying municipality likely will raise taxes or dip into its general fund to service and repay the TIF debt.¹⁵⁴ Moreover, an increased demand for city services often accompanies the redevelopment; thus, taxpayers outside the TIF district may be forced to pay higher taxes to cover the cost of these services.¹⁵⁵ Finally, there is always some possibility that the development would have occurred without the use of TIF.¹⁵⁶ If this is the case, then the tax increment also would have occurred—meaning that the original taxing authorities unnecessarily subsidized the redevelopment.¹⁵⁷

Because many of TIF's costs are "hidden and may occur years later," taxpayers likely will not be able to discern the true costs of TIF projects.¹⁵⁸ When local officials praise TIF projects as self-financing, they mislead their constituents, giving them a false impression of TIF and its associated costs. When a city's general fund is ultimately responsible for the debt should the project fail, it is improper to assert otherwise. Thus, local officials should stop billing TIF projects as self-financing. Instead, they should provide accurate explanations of the pros and cons of TIF, so that their constituents can develop accurate opinions about its merits.

IV. FINANCING DEVELOPMENT IN NEW YORK

This section considers TIF's scarcity in New York and proposes a potential explanation. It then describes the intended use of PILOT financing to develop Manhattan's Far West Side. It examines the structural and conceptual similarities between PILOT financing and TIF and explains how the legal issues and policy considerations surrounding the use of TIF apply with equal force to PILOT financing. Finally, it applies the lessons learned from TIF to PILOT financing and, based on those lessons, recommends some changes to the PILOT financing of the Far West Side development.

153. See *supra* notes 17-18 and accompanying text.

154. See *supra* Parts III.A-B.

155. For further discussion of these cost spillovers, see *supra* Part III.C.

156. See Chapman, *supra* note 7, at 188.

157. *Id.* Yet "it is impossible to know what level of development would have occurred in the absence of TIF." *Id.*

158. Michel, *supra* note 9, at 469.

A. The Use of TIF in New York

There are only two reported uses of TIF in all of New York thus far.¹⁵⁹ The town of Victor in Ontario County issued approximately eight million dollars in TIF bonds in 1994 to help finance the renovation and expansion of a local shopping mall,¹⁶⁰ while the town of Greenburgh in Westchester County issued roughly \$770,000 in TIF debt between 1990 and 1993 to fund road improvements.¹⁶¹

New York's heavy reliance on tax abatement may explain its scant use of TIF.¹⁶² Tax abatement programs attempt to attract private development by exempting developers from paying real property taxes for a certain number of years.¹⁶³ In New York State, municipalities are authorized to grant tax abatements for up to twenty-five years for residential property.¹⁶⁴

159. Under section 970-q of New York's TIF statute, a municipality employing TIF must submit an annual progress report to the State Comptroller. N.Y. GEN. MUN. LAW § 970-q (McKinney 2005). According to the Office of the State Comptroller, their records do not indicate that any other local government, besides Victor and Greenburgh, has filed a report pursuant to section 970-q. Telephone Interview with Office of the State Comptroller (Feb. 10, 2005).

160. Telephone Interview with Michael J. Dollard, Town Manager of Victor (Feb. 4, 2005). According to Dollard, the redevelopment boosted Victor's economy; Victor's sales tax revenue increased almost 270% in the wake of the mall project. *Id.*

161. Telephone Interview with Doreen Muentener, Deputy Comptroller of Greenburgh (Feb. 10, 2005). Greenburgh issued \$660,500 in 1990, \$135,000 in 1992, and \$95,000 in 1993. *Id.* For more information on Greenburgh's TIF project, see *supra* notes 125-126 and accompanying text.

162. See Winter, *supra* note 9, at 693 (noting that "the traditionally indiscriminate use of tax abatements in New York may discourage municipalities and developers from even bothering with tax increment financing").

163. *E.g.*, Winter, *supra* note 9, at 691.

164. Section 421-a of New York's Real Property Tax Law provides graded exemptions for newly constructed residential multiple dwellings (defined as three or more families living independently of one another). N.Y. REAL PROP. TAX LAW § 421-a (McKinney 2005). The duration of the exemption ranges from ten to twenty-five years, based on project location and affordability. *Id.* Section 421-b provides an eight-year graded exemption for newly constructed or reconstructed one- and two-family homes. § 421-b. Section 421-c provides a graded exemption of up to ten years for new residential multiple dwellings in towns, villages, and cities with less than one million residents. § 421-c. Section 421-e provides a twenty-year graded exemption on cooperatives, condominiums, homesteading or rental projects that receive payments pursuant to Article 18 of the private housing finance law. § 421-e. New York City in particular runs an extensive tax abatement program. *E.g.*, Michael J. Wolkoff, *The Nature of Property Tax Abatement Awards*, 49 J. AM. PLAN. ASS'N 77, 80 (1983). According to the New York City Independent Budget Office (IBO), over the last five years approximately 1,200 units with ten-year exemptions and 1,300 units with twenty-year exemptions have been added annually. N.Y. CITY INDEP. BUDGET OFFICE, BUDGET OPTIONS FOR NEW YORK CITY 56 (2005), at <http://www.ibo.nyc.ny.us>. The IBO estimates that the full cost in foregone property tax revenues is roughly \$22,000 per unit with a ten-year exemption and \$91,000 per unit with a twenty-year exemption. *Id.* at 56.

Similar abatement schemes exist for non-residential property.¹⁶⁵ Because TIF depends on new property tax revenue, it essentially precludes the use of tax abatement programs as incentives to attract private development.¹⁶⁶ If developers are given tax breaks, there will be less incremental tax revenue to collect.¹⁶⁷

B. The Use of PILOT Financing in New York

New York's limited use of TIF is somewhat misleading, because the Bloomberg Administration recently initiated a substantial development project in New York City ("the City") that uses PILOT financing, a close variant of TIF.

1. Description of the Far West Side Development

The development of Manhattan's Far West Side will occur in two phases.¹⁶⁸ Phase I calls for the extension of the Number Seven subway line from Times Square west to Eleventh Avenue; the construction of a platform over the Eastern Rail Yards; the formation of a new street system, including "Hudson Boulevard," a mid-block street running north-south

Between 1971 and 2002, the 421-a exemption helped finance the construction of 87,000 apartments in New York City. N.Y. CITY INDEP. BUDGET OFFICE, WORTH THE COST? EVALUATING THE 421-A PROPERTY TAX EXEMPTION I (2003), at <http://www.ibo.nyc.ny.us>. The Department of Finance estimates that the use of the 421-a program in New York City resulted in \$130 million in foregone tax revenue in 2002 alone. *Id.*

165. Section 485-a of New York's Real Property Tax Law provides for a twelve-year graded exemption for non-residential property converted to mixed-use property in a municipality with less than one million inhabitants. § 485-a. Section 485-b provides for a ten-year graded exemption on real property "constructed, altered, installed or improved . . . for the purpose of commercial, business or industrial activity." § 485-b.

166. HAGMAN, *supra* note 132, at 187.

167. TIF and property tax abatement programs have different benefits, which may explain why some municipalities prefer TIF and others prefer tax abatements. One benefit of tax abatement programs is that the cost of the abatement is borne solely by the particular jurisdiction that gives the subsidy. *See* Chapman, *supra* note 7, at 189. In contrast, overlapping jurisdictions often bear some of the costs associated with TIF. *See supra* Part III.C. Tax abatement is also less complicated than TIF. Winter, *supra* note 9, at 692. The municipality does not have to designate a specific TIF district and divert incremental tax revenues to a special fund. Some municipalities prefer TIF over tax abatement programs, however, because they believe that TIF is a self-financing mechanism that stimulates development without direct subsidies. *See* Man, *supra* note 18, at 94.

168. *See* CITY OF N.Y. OFFICE OF MGMT. & BUDGET, PRESENTATION OF HUDSON YARDS INFRASTRUCTURE CORPORATION FINANCING PLAN TO CITY PLANNING COMMISSION (July 12, 2004), at http://www.nyc.gov/html/dcp/pdf/hyards/financing_for_cpc.pdf [hereinafter HUDSON YARDS PRESENTATION]; *see also* COMM. ON FIN., N.Y. CITY COUNCIL, REPORT OF THE FINANCE DIVISION: PRECONSIDERED RESOLUTION No. 760-2005 (Jan. 19, 2005) (on file with author) [hereinafter PRECONSIDERED RESOLUTION No. 760-2005].

between Tenth and Eleventh Avenues from West Thirty-third Street to West Thirty-ninth Street; and the creation of a six-acre park over the Eastern Rail Yards Platform and a network of parks along the new Hudson Boulevard.¹⁶⁹ Phase II consists of the construction of a subway station at Forty-first Street for the Number Seven line and the construction of the northern blocks of Hudson Boulevard.¹⁷⁰ According to a report by the City Council's Finance Division, Phase I will cost approximately \$2.8 billion and Phase II will cost roughly \$775 million.¹⁷¹

2. Financing the Far West Side Development

The City initially considered using traditional TIF to finance the Far West Side development. In 2001, the Department of City Planning published a report that outlined a comprehensive development plan and proposed the use of TIF.¹⁷² Subsequently, many groups, including the NYC2012 Olympic Committee, submitted proposals advocating the use of TIF.¹⁷³ Although the City ultimately decided not to use "a classic TIF," it is using a close variant that shares many of TIF's conceptually important features.¹⁷⁴

To finance Phase I, the Bloomberg Administration created the Hudson Yards Infrastructure Corporation ("HYIC"), a non-profit local development corporation.¹⁷⁵ The HYIC will issue thirty-year bonds backed by revenue

169. See HUDSON YARDS PRESENTATION, *supra* note 168.

170. *See id.*

171. PRECONSIDERED RESOLUTION No. 760-2005, *supra* note 168. According to the report, Phase II can be deferred until future development produces the need and financial resources for the infrastructure. *Id.*

172. DEP'T OF CITY PLANNING, CITY OF N.Y., FAR WEST MIDTOWN: A FRAMEWORK FOR DEVELOPMENT 61 (2001), at <http://www.nyc.gov/html/dcp/pdf/pub/fwmt.pdf>.

173. DEVINE, PRIMER, *supra* note 23, at 2; *see also* Michael McDonald, *IBO Leery of N.Y. City TIF District*, BOND BUYER, Mar. 13, 2003, at 1 [hereinafter McDonald, *IBO Leery*] (describing how the City initially planned to use TIF to pay for the Far West Side development).

174. McDonald, *IBO Leery*, *supra* note 173, at 1; *see also* Neil deMause, *The Jets' End Run*, VILLAGE VOICE, Nov. 16, 2004, at 20 (remarking that "[t]he effect [of the Far West Side financing] would be exactly the same [as TIF]"); Matthew Strozier, *How to Pay for the Far West Side*, REAL DEAL, May 2004 (referring to the Far West Side financing as a "TIF-style arrangement").

175. The HYIC was created pursuant to section 1411 of New York's Not-for-Profit Corporation Law, which authorizes the creation of local development corporations. Section 1411-a provides:

Corporations may be incorporated or reincorporated under this section as not-for-profit local development corporations operated for the exclusively charitable or public purposes of relieving and reducing unemployment, promoting and providing for additional and maximum employment, bettering and maintaining job opportunities, instructing or training individuals to improve or develop their

expected to be generated by the development.¹⁷⁶ Payments in lieu of taxes (“PILOTs”) from new commercial buildings and residential property taxes together will provide more than eighty-five percent of the revenues.¹⁷⁷ Payments received from the sale of development rights over the Eastern Rail Yard and contributions to the District Improvement Fund (in exchange for development bonuses) will contribute roughly ten to twelve percent.¹⁷⁸ The remaining money will come from the sale of publicly-owned land and payments in lieu of sales taxes on construction materials.¹⁷⁹

3. PILOT Financing: A TIF-Like Arrangement

PILOTs made by private developers represent the primary source of expected revenue for the Far West Side development. By 2015, PILOTs will contribute over forty percent of total revenue, and more than half of the total revenue is expected to come from PILOTs after 2020.¹⁸⁰

The City has never issued bonds backed by payments in lieu of taxes before,¹⁸¹ and they are a rare structure in the municipal debt markets.¹⁸² But, PILOT financing is conceptually and structurally similar to TIF. As a result, the legal issues, risks, and policy considerations surrounding the use of TIF apply with equal force to PILOT financing.

a. How Does PILOT Financing Work?

Under the Far West Side plan, private developers planning to develop in

capabilities for such jobs, carrying on scientific research for the purpose of aiding a community or geographic area by attracting new industry to the community or area or by encouraging the development of, or retention of, an industry in the community or area, and lessening the burdens of government and acting in the public interest.

N.Y. NOT-FOR-PROFIT CORP. LAW § 1411-a (McKinney 2005). Section 1411-c authorizes local development corporations to borrow money and issue bonds. §1411-c. According to the IBO, “[a]lthough there are no explicit plans for financing Phase 2, the anticipated revenues are intended to ultimately cover all project costs, including Phase 2 financing.” DEVINE, COMPLEX STORY, *supra* note 2, at 2.

176. See PRECONSIDERED RESOLUTION NO. 760-2005, *supra* note 168. The bonds will be issued from 2005 to 2011. *Id.*

177. *See id.*

178. *See id.*; HUDSON YARDS PRESENTATION, *supra* note 168.

179. *See* HUDSON YARDS PRESENTATION, *supra* note 168.

180. DEVINE, COMPLEX STORY, *supra* note 2, at 4.

181. *See* McDonald, *West Side Bonds*, *supra* note 5. But PILOTs (as opposed to PILOT-backed bonds) are not a new phenomenon. New York City received roughly \$209 million in PILOTs in 2004. *See* COMM. ON FIN., N.Y. CITY COUNCIL, REPORT OF THE FINANCE DIVISION: PROPOSED INTRODUCTION NO. 584-2005 (Mar. 22, 2005) (on file with author) [hereinafter PROPOSED INTRODUCTION NO. 584-2005].

182. *Id.*

the Hudson Yards will have the option of entering into PILOT agreements with the City's Industrial Development Agency ("IDA").¹⁸³ Under these agreements, the IDA will purchase the land from the developers.¹⁸⁴ This removes the land from the property tax rolls, because the IDA is a tax-exempt entity.¹⁸⁵ The developers will then make payments in lieu of regular property taxes to the IDA for the duration of the agreement.¹⁸⁶ These payments are generally less than the amount of real property taxes that would otherwise be due.¹⁸⁷ Presumably, the IDA will funnel these payments into a special fund overseen by the HYIC. The HYIC will then use the special fund to make interest and principal payments on the project bonds. At the end of the contract period, the IDA will return the land to the developers and the developers thereafter will pay taxes to the City rather than making payments to the IDA.¹⁸⁸

b. Structural Similarities Between PILOT Financing and TIF

TIF and PILOT financing have the same basic structure. Under both, a redevelopment agency issues bonds and uses the proceeds to finance public improvements. The public improvements are expected to increase property values and generate new property tax revenue.¹⁸⁹ Instead of going into the

183. The IDA is a public benefit corporation created under section 917 of the New York General Municipal Law. N.Y. GEN. MUN. LAW § 917 (McKinney 2005). Section 917 provides:

[i]t is the policy and intent of the City of New York to promote the economic welfare of its inhabitants and to actively promote, attract, encourage and develop economically sound commerce and industry through governmental action for the purpose of preventing unemployment and economic deterioration by the creation of a New York City Industrial Development Agency.

Id.

184. DEVINE, COMPLEX STORY, *supra* note 2, at 3.

185. *E.g.*, Joshua P. Rubin, *Take the Money and Stay: Industrial Location Incentives and Relational Contracting*, 70 N.Y.U. L. REV. 1277, 1303 n.162 (1995).

186. *Id.* Section 854 (17) of New York's General Municipal Law defines payments in lieu of taxes as "any payment made to an agency, or affected tax jurisdiction equal to the amount, or a portion of, real property taxes, or other taxes, which would have been levied by or on behalf of an affected jurisdiction if the project was not tax exempt by reason of agency involvement." § 854(17). Section 858 authorizes the IDA to enter into PILOT agreements. § 858. The IBO believes that the PILOT agreements will have a thirty-year term. DEVINE, COMPLEX STORY, *supra* note 2, at 3.

187. PROPOSED INTRODUCTION NO. 584-2005, *supra* note 181.

188. *Id.*

189. *See* DEVINE, COMPLEX STORY, *supra* note 2, at 6 (PILOT financing uses "property tax revenue and the proceeds from the sale of new development rights that result from public investment in infrastructure to pay for the infrastructure"); *see also supra* note 11 and accompanying text (noting that public improvements should increase property values and property taxes).

municipality's general fund, this new tax revenue goes into a special fund.¹⁹⁰ The redevelopment agency then uses the money in the special fund to service and repay the project debt. In theory, neither TIF nor PILOT projects take money from the municipality's general fund.¹⁹¹

Although similar, TIF and PILOT financing are not identical. Under TIF, private developers own the project land, whereas under the West Side plan the IDA will own the land until the PILOT agreements expire.¹⁹² Moreover, with TIF, all incremental tax revenue from the TIF district flows into a special fund maintained by a redevelopment agency.¹⁹³ In contrast, with the West Side's PILOT financing, only payments made under PILOT agreements will go into a special fund. All taxes collected on non-PILOT properties will continue to go to the City's general fund.¹⁹⁴

c. Potential Legal Challenges to PILOT Financing

Given the similarities between TIF and PILOT financing, the PILOT financing of the Far West Side development could face some of the same legal challenges that TIF has already faced.

i. PILOT Bonds and Constitutional Debt Limits

The Bloomberg Administration does not intend to count the PILOT-backed debt toward the City's constitutional debt limit.¹⁹⁵ As explained above, the PILOT bonds will be issued by the HYIC, a local development corporation created pursuant to section 1411 of New York's Not-for-Profit Corporation Law.¹⁹⁶ Section 1411 authorizes not-for-profit local development corporations like the HYIC to borrow money and issue

190. See *supra* note 13 and accompanying text (explaining that the tax increment collected from TIF projects flows into a special fund).

191. See *supra* notes 17-18 and accompanying text for a discussion of how TIF proponents argue that TIF projects are self-financing. Similarly, proponents of the Far West Side financing plan argue that the project will pay for itself. See, e.g., DIVINE, COMPLEX STORY, *supra* note 2, at 6 (noting that PILOT financing does not draw directly on general fund revenue); Charles V. Bagli, *West Side Plan is Risky Effort, Forecasters Say*, N.Y. TIMES, Dec. 21, 2004, at B1 [hereinafter Bagli, *Risky Effort*] (quoting Deputy Mayor Daniel Doctoroff as saying that the West Side development "pays for itself with new revenues it will generate—not with capital budget money"); Strozier, *supra* note 174 (describing the West Side project as "financially self-supporting").

192. See *supra* notes 184-188 and accompanying text (explaining how PILOT financing works).

193. See *supra* note 13 and accompanying text.

194. DEVINE, COMPLEX STORY, *supra* note 2, at 12.

195. *Id.* at 6. Under New York's Constitution, New York City can only issue debt up to 10% of its average full valuation of taxable real estate property. N.Y. CONST. art VIII, § 4.

196. See *supra* note 175-176 and accompanying text.

bonds,¹⁹⁷ but it does not address whether such bonds will be considered a debt of the underlying municipality. The Far West Side plan, however, provides that interest payments on the HYIC debt may come from the City's general fund.¹⁹⁸ Given that the City has express authority to pay the interest on the debt, the debt should count toward the City's constitutional debt limitation.

The Administration likely will rely on the special fund doctrine to support its position that the PILOT bonds do not count toward that limit.¹⁹⁹ The application of the special fund doctrine to PILOT-backed bonds is problematic, just as it is with TIF bonds.²⁰⁰ If the IDA did not purchase the land from the developers (which removes the land from the property tax rolls), then the developers would still be paying property taxes to the City. Thus, even though the PILOTs will be funneled into a special fund, the fund will contain property tax revenue. Because the special fund contains tax revenue, it implicates the City's credit.

Given that the PILOT bonds will be repaid from tax revenue, they should count toward the City's constitutional debt limit.

ii. Unlawful Diversion of School Tax Revenues

As with TIF projects,²⁰¹ PILOT financing projects may divert tax revenue from school districts. The City's school district is not an independent taxing jurisdiction. Rather, it is fiscally dependent, meaning that it depends on tax revenue from the City's general fund for support.²⁰² Because the HYIC bonds will be repaid out of tax revenue that otherwise would go to the City's general fund, the Far West Side's PILOT financing has the potential to draw revenue away from City schools.

iii. Unlawful Delegation of Authority

The significant delegation issue under the Far West Side's PILOT

197. N.Y. NOT-FOR-PROFIT CORP. LAW § 1411 (McKinney 2005).

198. *See infra* note 214.

199. For an explanation of the special fund doctrine, see *supra* note 61 and accompanying text.

200. *See supra* notes 68-69 and accompanying text (discussing the problem with using the special fund doctrine to avoid counting TIF debt toward constitutional debt limits).

201. *See supra* notes 75-82 and accompanying text.

202. OFFICE OF MGMT. SERVS., N.Y. STATE EDUC. DEP'T, SCHOOL FINANCE IN NEW YORK STATE (1999), at <http://www.oms.nysed.gov/faru/Primer/primeintro.htm>. In New York State, all but five school districts are separate from municipal governments. *Id.* The exceptions are the five cities whose populations exceed 125,000: New York City, Buffalo, Rochester, Syracuse, and Yonkers. *Id.* In these five cities, education is part of the municipal budget. *Id.*

financing plan concerns the Mayor's intention to appropriate PILOTs without prior approval from the City Council.²⁰³ The Mayor unilaterally authorized the IDA to transfer the PILOTs to the HYIC . This violates the City Charter, which requires the Mayor to seek legislative approval before appropriating public funds.²⁰⁴ This also violates New York State's General Municipal Law, which requires the IDA to remit PILOTs to the affected tax jurisdictions within thirty days of receipt.²⁰⁵ Therefore, an unlawful delegation of authority challenge to the Mayor's appropriation of PILOTs could arise in a New York court.²⁰⁶

d. Risks Shared by PILOT Financing and TIF

The Far West Side's PILOT financing and TIF are both billed as self-financing development mechanisms.²⁰⁷ As shown above (in relation to TIF), several risks accompany projects that claim to be self-financing.²⁰⁸ These risks apply with equal force to projects backed by PILOT financing.²⁰⁹

203. See, e.g., PROPOSED INTRODUCTION NO. 584-2005, *supra* note 181.

204. Press Release, N.Y. City Council, Speaker Miller Introduces Legislation to Stop Mayor's Slush Fund Financing of Stadium (Mar. 2, 2005) (on file with author) [hereinafter Speaker Miller Introduces Legislation]. Section 227 of the City Charter specifically provides that:

[n]o money, except for grants or gifts from private entities, shall be paid from any fund under the management of the city, or any fund under the management of any agency or officer of the city, or any other entity, the majority of the members of whose board are city officials or are appointed directly or indirectly by city officials, except in pursuance of an appropriation by the council or other specific legal authorization.

N.Y. CITY CHARTER § 227. The Administration has not pointed to any "specific legal authorization" for the Mayor's claimed power to spend PILOT funds. Bonnie Brower, Testimony at the Public Hearing of the N.Y. City Council Comm. on Finance on Proposed Introduction No. 584-2005 (March 22, 2005) (on file with author). Brower is the Executive Director of City Project, a non-partisan public policy organization whose mission is to advocate for fair fiscal policies in New York City.

205. N.Y. GEN. MUN. LAW § 874 (McKinney 2005).

206. In an attempt to rectify the situation, the City Council approved new legislation on May 11, 2005 that requires City Council approval for all future PILOT appropriations. See PROPOSED INTRODUCTION NO. 584-2005, *supra* note 181; Frank Lombardi, *Council Bars Mayor from Stadium Aid*, N.Y. DAILY NEWS, May 12, 2005. The new law also requires the Mayor to file monthly reports with the City Council on the collection and use of PILOTs. See PROPOSED INTRODUCTION NO. 584-2005, *supra* note 181.

207. See *supra* note 191.

208. See *supra* Part III (describing the risks of TIF).

209. Neil deMause, Remarks at Tax Increment Financing Coming to the Big Apple? (Mar. 12, 2003), at <http://www.goodjobsny.org/tif.htm> [hereinafter deMause, Remarks].

i. Impact of PILOT Debt on the Underlying Municipality

PILOT debt, like TIF debt, is not backed by the faith and credit of the underlying municipality.²¹⁰ Rather, PILOT bonds are secured by an uncertain future revenue stream. To compensate bondholders for accepting this uncertainty, PILOT bonds, like TIF bonds, are likely to carry a higher interest rate than general obligation bonds.²¹¹

Although the HYIC will incur debt service costs on the PILOT debt beginning in 2005, the West Side development is not expected to generate sufficient revenue to cover these costs until approximately 2018.²¹² The Far West Side plan, acknowledging this discrepancy, authorizes the City Council to appropriate money from the City's capital budget to make interest payments.²¹³ But, the City Council is not obligated to appropriate City funds, and "bondholders will have no claim against the City should the City Council choose not to make these payments."²¹⁴

Even though bondholders will have no legal claim against the City,²¹⁵ the rating agencies may regard the HYIC's PILOT debt as City debt. As shown above, the rating agencies often see a link between a municipality

210. See DEVINE, PRIMER, *supra* note 23, at 2 (noting that TIF debt is not backed by the faith and credit of the underlying municipality); PRECONSIDERED RESOLUTION No. 760-2005, *supra* note 168 (noting that, with the PILOT-backed bonds issued by the HYIC, "bondholders will have no claim against the City").

211. See DEVINE, COMPLEX STORY, *supra* note 2, at 7 (noting that that West Side's PILOT-backed bonds will carry an interest rate 0.5% above the City's general obligation debt); see also *supra* note 105 and accompanying text (noting that TIF debt generally warrants a higher interest rate than general obligation debt).

212. HUDSON YARDS PRESENTATION, *supra* note 168.

213. PRECONSIDERED RESOLUTION No. 760-2005, *supra* note 168. This use of City funds is subject to annual City Council approval. *Id.*

214. Under the Bloomberg Administration's original plan, introduced in February 2004, early interest payments would not be paid out of the City's general fund. Instead, the HYIC would repeatedly issue commercial paper (CP) to provide the needed revenue. HUDSON YARDS PRESENTATION, *supra* note 168. The HYIC would borrow \$4.1 billion, which exceeds the anticipated project costs by \$1.3 billion. PRECONSIDERED RESOLUTION No. 760-2005, *supra* note 168. Of the \$1.3 billion in additional borrowing, \$948 million consisted of the additional borrowing (in the form of CP) needed to make the interest payments on the long-term debt. *Id.* In 2020, when project revenues were sufficient to cover the debt service on the long-term bonds, the HYIC would issue roughly \$1 billion in twenty-five-year bonds and use the proceeds to repurchase the outstanding CP. *Id.* In response to the City Council's concerns about the costs of the original proposal, the Bloomberg Administration agreed to alter the plan. Now, early interest payments may come from the City's general fund, subject to appropriation by the City Council. *Id.* By eliminating the ongoing issuance of CP and instead using the City's general fund to pay the interest, the HYIC will only need to borrow approximately \$3 billion rather than the originally proposed \$4.1 billion. *Id.* Moreover, the City Council anticipates that the revised plan will result in a more favorable credit rating for the debt. Miller and Council Members, *supra* note 1.

215. See *supra* note 214.

and its redevelopment agencies.²¹⁶ As such, non-repayment of the HYIC's PILOT bonds could endanger the City's credit rating and its strong borrowing position.²¹⁷ The Office of the State Comptroller warned that the HYIC debt "may be perceived by the financial community as a moral obligation of the City of New York and could adversely affect the city's credit rating."²¹⁸ To preserve its own debt rating, the City likely would bail out the PILOT bonds to prevent a default. According to California TIF expert Howard Greenwich, if the HYIC defaults on the bonds, "the city will have a hard time ever selling bonds again, so they'll do whatever they can to prevent that from happening."²¹⁹

ii. Revenue Shortfalls and Cost Overruns

As with TIF, if the anticipated revenues do not materialize in the magnitude or timeframe projected by the City then the City likely will do whatever it can to prevent a default.²²⁰

According to the Far West Side plan, private developers will construct 24 million square feet of office space, 12.6 million square feet of residential space, 960,000 square feet of hotel space, and 680,000 square feet of retail space in the Hudson Yards by 2035.²²¹ The Office of the State Comptroller described this plan as "ambitious."²²² If the Far West Side project does not attract the anticipated level of private development, then PILOT revenues could fall short of projections. Critics of the Far West Side project warn that the Bloomberg Administration is "overly optimistic" about the need for new office buildings.²²³ Similarly, the New York City

216. See *supra* notes 110-112 and accompanying text.

217. See DEVINE, COMPLEX STORY, *supra* note 2, at 9; Bagli, *Risky Effort*, *supra* note 191 (quoting Richard Ravitch, former chairman of the Metropolitan Transportation Authority, as saying "to suggest that a default wouldn't affect the credit of the city is silly").

218. OFFICE OF THE STATE COMPTROLLER, REVIEW OF NEW YORK CITY'S FINANCIAL PLAN FOR FISCAL YEARS 2005 THROUGH 2008 51 (July 2004), at <http://www.osc.state.ny.us/osdc/rpt5-2005.pdf> [hereinafter FINANCIAL PLAN].

219. deMause, *Scrounging*, *supra* note 17.

220. See *supra* notes 215-219 and accompanying text.

221. New York City Announces Lead Underwriters, *supra* note 1. The development plan initially called for twenty-six million square feet of office space, but on January 11, 2005, the Bloomberg Administration agreed to reduce it to twenty-four million square feet. See, e.g., Charles V. Bagli & Mike McIntire, *Mayor and Council Reach Deal on West Side Development*, N.Y. TIMES, Jan. 11, 2005, at B1; Jill Gardiner, *Deal is Struck on West Side Development*, N.Y. SUN, Jan. 11, 2005, at 1.

222. FINANCIAL PLAN, *supra* note 218, at 49.

223. Bagli, *Risky Effort*, *supra* note 191; see also THERESA J. DEVINE, N.Y. CITY INDEP. BUDGET OFFICE, SUPPLY AND DEMAND: CITY & STATE MAY BE PLANNING TOO MUCH OFFICE SPACE 1 (2004), at <http://www.ibo.nyc.ny.us> [hereinafter DEVINE, TOO MUCH]. According to Betsy Gotbaum, Public Advocate for the City of New York, "[i]f 26 million

Independent Budget Office (“IBO”) determined that the City currently has a surplus of office space.²²⁴ In addition to existing space, an additional 14 million square feet is currently under construction.²²⁵ This includes 7.4 million in Midtown, 1.7 million in Lower Manhattan, 2.2 million in the other boroughs, and 2.5 million in Northern New Jersey.²²⁶ These locations could absorb demand for private development in the Far West Side.²²⁷ With substantial space already available and even more space on the way, private developers may choose not to build in the Far West Side, or to build more slowly than anticipated.²²⁸

Other factors besides the current surplus of office space could cause private development to fall short of projected levels. For example, a private developer may not want to commit to developing in the Far West Side until future tenants have signed leases for the new space. In turn, potential tenants may wait to make a commitment until the Javits Center expansion is complete, to determine how that project will impact the neighborhood.²²⁹ Potential tenants also may wait until the Number Seven subway line is fully operational.²³⁰ Thus, construction delays could significantly impact the level of private development.

As with TIF projects, the success of the Far West Side development will depend largely on the accuracy of the projections used.²³¹ Inaccurate projections could leave the HYIC with insufficient revenue to service and repay the project debt, which likely would prompt the City to raise taxes or take money from its general fund to cover any shortfall.

iii. Cost Spillovers

PILOT projects, like TIF projects, are likely to generate increased

square feet of office space are not filled, the financing for the plan will collapse like a house of cards.” Betsy Gotbaum, Remarks at the New York City Council Hearing on the West Side Financing Plan (Dec. 15, 2004), at http://pubadvocate.nyc.gov/news/releases_12_15_04.html.

224. DEVINE, TOO MUCH, *supra* note 223, at 4. The IBO concluded that the Far West Side plan provides for more office space than the City needs. *Id.*

225. See REG’L PLAN ASS’N, THE FAR WEST SIDE & THE REGION’S FUTURE DEVELOPMENT NEEDS 5 (2004), at http://www.rpa.org/pdf/RPA_FWS_PAPER.pdf.

226. *Id.*

227. DEVINE, COMPLEX STORY, *supra* note 2, at 10.

228. DEVINE, TOO MUCH, *supra* note 223, at 1.

229. DEVINE, COMPLEX STORY, *supra* note 2, at 11; see also *supra* note 2 for a discussion of the proposed Javits Center expansion.

230. DEVINE, COMPLEX STORY, *supra* note 2, at 11.

231. *Id.* at 9 (“The success of the proposed revenue plan will hinge critically on the accuracy of the development projections used as its basis.”).

demand for city services.²³² The new development on the Far West Side will bring more employees, residents, and visitors to the area.²³³ To accommodate these newcomers, the Department of City Planning and the Metropolitan Transportation Authority have determined that, at a minimum, the City will require a new firehouse, a new school, and possibly a new daycare center.²³⁴ Yet, the funding plan does not take the cost of these new facilities into account.²³⁵ And even if the project generates revenue in excess of what is needed to service the debt, the excess may not be available to pay for these facilities, because the HYIC is not obligated to transfer the excess to the City's general fund.²³⁶ Thus, to pay for these new facilities, the City likely will have to increase taxes or withdraw existing taxes. As a result, taxpayers may wind up subsidizing the development.

iv. Lack of Voter Accountability

The Far West Side project, like many TIF projects, allows the local government to act without any meaningful accountability to voters. Some accountability does exist, in that Mayor Bloomberg plans to run for re-election and thus has some incentive to act in voters' best interests.²³⁷ This accountability, however, is very limited. Mayor Bloomberg unilaterally determined that the HYIC debt will be repaid from PILOT revenue rather than from the City's budget.²³⁸ In so doing, the Mayor sidestepped the normal budget approval process, as the City Council (which is composed of elected officials) is supposed to have final budget approval powers. According to New York City Council Member Joel Rivera, "[t]he Mayor has successfully circumvented the formal budget process, which denies people the right to a transparent government."²³⁹

Furthermore, as is often the case with TIF agencies,²⁴⁰ the HYIC officials will be appointed rather than elected by voters.²⁴¹ This means that

232. For a discussion of the cost spillovers that may arise with TIF projects, see *supra* notes 127-132 and accompanying text.

233. DEVINE, COMPLEX STORY, *supra* note 2, at 11.

234. *See id.*

235. *See id.*

236. *See id.*

237. *E.g.*, Andrew Jacobs, *Bloomberg Claims a Victory in Battling Homelessness*, N.Y. TIMES, July 1, 2005, at B4 (noting that Mayor Bloomberg is campaigning for re-election).

238. *See supra* notes 203-205 and accompanying text.

239. Speaker Miller Introduces Legislation, *supra* note 204.

240. *See supra* note 150 and accompanying text.

241. *See* Miller and Council Members, *supra* note 1. Some officials will be appointed solely by the Mayor, while others will be appointed by the City Council Speaker, City Comptroller, Manhattan Borough President, local Council Members and the local

voters cannot even express their disapproval of the financing plan by voting against HYIC officials in future elections.

4. Critique and Recommendations

The Far West Side development is billed as a self-financing project,²⁴² but, as with TIF, revenue shortfalls and cost overruns may occur, prompting the City to raise taxes or divert money from its general fund. The sheer magnitude of the Far West Side development increases the likelihood that something will go wrong and the City will have to step in. Most TIF bond issues are small, with an average issue size of roughly \$6 million.²⁴³ The two uses of TIF in New York involved bond issues of \$8 million and \$770,000.²⁴⁴ In contrast, the HYIC plans to issue almost \$3 billion in TIF-like debt, which is ten times the size of the largest preexisting TIF bond issue on record.²⁴⁵

The Far West Side financing plan has raised controversy because of its lack of transparency and accountability. The Mayor should not have unilateral discretion over the use of PILOT funds. Instead, determining how PILOT funds will be used should be part of the City's budget process. This would give taxpayers more of a voice in how their tax dollars are used.²⁴⁶ When describing the Mayor's use of PILOTs for the Far West Side project, Council Member Oliver Koppell remarked that, "[t]he expenditure of hundreds of millions of taxpayer dollars without the approval of the legislature is a violation of basic democratic principals and assertion of an imperial mayoralty."²⁴⁷ On May 11, 2005, however, the City Council passed a law that requires Council approval for all future PILOT appropriations.²⁴⁸ The new law also requires the Mayor to file monthly reports regarding the collection and use of PILOTs.²⁴⁹ This law is a step in the right direction.

If, as the Bloomberg Administration argues, the development of the Far West Side is so critical to the City's economic future, then perhaps the public improvements should be funded out of the City's capital budget.

Community Board. *Id.*

242. *See supra* note 191.

243. Johnson, *supra* note 103, at 4. No TIF issue has exceeded \$1 billion thus far. McDonald, *IBO Leery*, *supra* note 173, at 1.

244. *See supra* notes 159-161 and accompanying text.

245. deMause, Remarks, *supra* note 209.

246. Speaker Miller Introduces Legislation, *supra* note 204. Taxpayers do already have some voice, in that they elect the mayor.

247. *Id.*

248. *See supra* note 206.

249. *See supra* note 206.

Funding a project through the capital budget gives taxpayers indirect power, because the City Council has final budget approval powers (and City Council members are elected by the voting public). The City likely could find room in its budget to finance the Far West Side development. In a March 2005 report, the IBO indicated that the City will end fiscal year 2005 with the largest budget surplus since 2001.²⁵⁰ According to IBO Director Ronnie Lowenstein, this means that “there are some additional resources to work with.”²⁵¹

Another alternative would be for the City to use the pay-as-you-go approach. Under this approach, private developers obtain their own funding and front the costs.²⁵² The City would then repay the developers out of the incremental tax revenue generated if and when the development occurs.²⁵³ The developer, rather than the municipality, bears the risk that the development will not generate enough revenue to cover the project costs.²⁵⁴ This approach better protects taxpayers from local tax increases.²⁵⁵ At the very least, the City should negotiate firm commitments with private developers before making the public improvements.²⁵⁶

CONCLUSION

The use of PILOT financing, like the use of TIF, raises the question of who pays for the development. Although on their face both TIF and PILOT financing may seem like self-funding mechanisms, in reality this designation is misplaced. If the tax revenue does not materialize as planned, then the underlying municipality likely will increase taxes or take money from its general fund to prevent a debt rating downgrade. Moreover, taxpayers directly subsidize these projects by paying for the municipal services required by the new development. Because taxpayers are the ultimate repayers of the debt should the project fail, it does not seem right that the decision to use either TIF or PILOTs can be made without taxpayer input. Local officials should not be swayed by the argument that TIF and PILOT projects are self-financing. Instead, before implementing a project backed by either TIF or PILOT bonds, local officials must carefully

250. N.Y. CITY INDEP. BUDGET OFFICE, ANALYSIS OF THE MAYOR’S PRELIMINARY BUDGET FOR 2006 3 (2005), at <http://www.ibo.nyc.ny.us>.

251. Nicholas Confessore, *Larger Surplus in City’s Budget is Predicted*, N.Y. TIMES, Mar. 4, 2005, at B1.

252. See, e.g., Man, *supra* note 18, at 93; Reinert, *supra* note 25, at 1028.

253. Reinert, *supra* note 25, at 1028.

254. *Id.*

255. See Man, *supra* note 18, at 93.

256. See Kemanski, *supra* note 114, at 26.

consider whether such a project really is in the taxpayers' best interest.