

Federal Highway Administration Webinar on Assessing Value Capture Risks

Webinar Date: September 15, 2021

Answers to Questions Posed During the Webinar

What are some of the risks that municipalities typically do not identify or under-evaluate as a risk?

The most common trip-ups are with the feasibility study up front. If a locality does a realistic feasibility study that includes a solid “but-for” analysis early in the process, then it is setting itself up for success. A locality needs to understand how much development the project may potentially generate (over and above expected growth without the project), how much of this value it could potentially capture, the expected cash flow, and how the expected cash flow will influence possible debt issuance. Will the financials work for the project? In conjunction, how will the implementation of value capture affect the locality’s budget? Doing that homework can help not just the project, but also collaborations with your local stakeholders, because you are being honest about what they are signing up for.

Taxpayer concentration is another consideration. On the surface, it can look like there is not much concentration within a special-purpose district. However, a locality sometimes discovers that a single developer owns multiple properties in the district.

How does the city address over- and under-investment risks?

A city can assess this type of risk by conducting a very rigorous “but for” test. That test examines whether the investment would happen in the absence of local government contributions such as tax districts, financial districts, or other developer incentives. The but-for analysis helps to ensure that the right amount of government support is being provided.

Should the risk assessment consider business dislocation resulting from the new development?

Yes.

Given the Administration's emphasis on equity, there are concerns about housing displacement and value capture. Does the primer cover this topic enough to respond to concerns?

The primer will present examples of what locations have done to address equity concerns. Individual techniques can address equity, such as Utah's use of Transportation Reinvestment Zones (TRZs)

requiring low-income housing.¹ * Similar requirements are found in the legal framework for Tax Increment Financing districts in California and Oregon.²

In one sense, value capture has equity “baked into it,” because it is based on the economic “beneficiary pays” principle. That principle indicates that those who benefit from a transportation investment should pay in proportion to the benefit that they receive.

Value capture techniques that are used as part of projects that receive Federal funding are subject to the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970, as amended.³ That law seeks to provide uniform, fair, and equitable treatment to persons whose property is acquired or who are displaced in connection with a federally funded project.

Will the primer have a recommended template or set of standards for financial feasibility tests and/or forecasts of expected revenues?

The primer needs to be a reasonable length to make it a useful reference, so it will not include any templates. However, it will include references and links to resources that should be helpful to the reader.

How can local governments know that the consultant they hire for a feasibility study has used an adequately rigorous method?

Texas DOT (TxDOT) has been asked this question by some of its local government partners. In some cases, a locality has paid for a study, but the study did not necessarily look at the right things that would mitigate the financial risks. Oftentimes, some things are left out or are only looked at from an economic impact perspective instead of looking at the revenue forecasts. In some cases, the forecasts are too rosy. A local government needs realistic estimates, particularly if it plans to issue debt.

The following are items that TxDOT recommends including and considering in the preparation a TRZ capacity analysis:

- Clear overview of the zone, map, zone delineation, and parcel listing (if available)
- List of participating local governments considering a TRZ for the project (city, multiple cities, etc.)
- Assumptions underlying the study:

¹ For more information on TRZs in Utah, watch the recording of the FHWA [value capture webinar on TRZs](#) (recorded July 14, 2021).

² Sources:

- California Health and Safety Code Division 24, §§ 33000 – 37964
- Portland HOU-1.06.
- For more information, please see: Tax Increment Financing Frequently Asked Questions: https://www.fhwa.dot.gov/ipd/pdfs/value_capture/value_cap_faq_tif_march_2021.pdf

³ 42 U.S.C. 4601-4655.

- The percentage of the property tax value increment in the TRZ that is under consideration by the local government
- Number of years included in the analysis
- Assumed base year for establishment of the TRZ
- Parcel analysis, including zoning types considered and current breakdown of zoning included in the potential TRZ (e.g., residential, commercial, etc.)
- The netting-out of existing properties that would not contribute to the revenues (i.e., other TIRZ, TIF, abatement agreements, or tax-exempt property)
- 30 years of revenue estimates, including a cash-flow table in both nominal and net-present-value figures
- Trend analysis of historical property value growth, based on Central Appraisal District data
- Multiple economic growth models, i.e. pessimistic, base, and optimistic scenarios for revenues

Would you please review the calculation of the volatility ratio?

[Note: This question relates to slide 16 of slide deck for S&P Global Ratings.]

The scale for the volatility ratio is one to zero — the lower the number, the less volatile. The calculation is the ratio of the base value to the total assessed value. In the case of Project Area B, the base value is \$400 million, and the total assessed value is \$500 million. Therefore, the volatility ratio is 0.8.

Volatility Example

Examples of Different Base to Total Project Area Assessed Valuations		
	Low volatility Project Area A	High volatility Project Area B
Base value	\$100 million	\$400 million
Total assessed value	\$500 million	\$500 million
Incremental assessed value	\$400 million	\$100 million
Tax rate	1.00%	1.00%
Pledged revenues	\$4 million	\$1 million
Maximum annual DS	\$2 million	\$500,000
Coverage	2.0x	2.0x
<i>But if project assessed value fall 10%</i>		
Base Value	\$100 million	\$400 million
Project assessed valuation	\$450 million	\$450 million
Incremental assessed value	\$350 million	\$50 million
Pledged revenues	\$3.5 million	\$500,000
Coverage	1.75x	1.00x
Base assessed value to total value volatility ratio	0.2	0.8

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Source: S&P Special Purpose Districts' Criteria

What type of transportation infrastructure was funded with bond funds that raised property values within the districts?

[Note: This question relates to slide 17 of slide deck for S&P Global Ratings.]

Often, the transportation infrastructure improvements are meant to make the project area more accessible or more appealing for development (e.g., streetscaping). On Gulfgate, it was an older shopping mall. They came in and put in new infrastructure to support

Real Examples

Comparing 2 Houston Area Projects		
	Houston - Gulfgate	Houston - Midtown
Project Area	Shopping Center & Hobby Airport	Just outside of downtown
Rating	BBB	A
Debt authorization	City of Houston approves borrowing; no debt plans	
Acreage	835	770
Base AV	\$1.06 billion	\$212 million
Total AV	\$1.75 billion	\$2.24 billion
Incremental AV	\$638 million	\$2.03 billion
Taxpayer Concentration (top 10)	~40%	~30%
Volatility Ratio	0.64	0.09
MADS	2.13	3.16
ABT	1.25x annual DS	1.40x annual DS
Debt Service Reserve Fund	Lesser of MADS or 10% of par	MADS

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retail projects. For Midtown, it was to support mixed-use development (i.e., apartments above restaurants and offices).

Using Value Capture Techniques in California

Do Proposition 13's limitations on property taxes in California apply to special assessments?

In California, Proposition 13 applies to property taxes but not to special assessments, which are considered fees, not taxes. This distinction has been affirmed by court cases such as *County of Fresno v. Malmstrom* (1979).⁴ In fact, the passage of Proposition 13 in 1978 spurred California cities to create special assessment districts to raise funds for public capital improvements.⁵ Proposition 218, passed in 1996, established new procedural and substantive requirements for special assessments in California.⁶ For more information on special assessments, please see FHWA's [special assessments primer](#) and its [Frequently Asked Questions](#).

How do Proposition 13's limitations on property taxes in California apply to tax increment financing (TIF)?

Two changes introduced by California's Proposition 13 in the State's property tax system may impact a local governments decision to use create a TIF district. First, Proposition 13 capped the *ad valorem* property tax to a total of one percent of assessed value. Second, property taxes are not based on the market value of a property, but rather on the purchase price. In the year a property is purchased, it is taxed at the purchase price. In subsequent years, the property's taxable value may only increase by the lowest of the rate of inflation, or 2% (until the property is sold and taxed again at the purchase price)⁷.

The impact from the limit on growth of taxable values growth is direct because it means that taxable values in any given year are no reflective of market values for as long as the property does not change ownership. In other words, the growth in annual property tax incremental revenue is limited to 2% (or the rate of inflation), regardless of what a market value appraisal indicates.

⁴ *County of Fresno v. Malmstrom*, 94 Cal. App. 3d 974 (1979). See also Dean Misczynski, "Special Assessments in California: 35 Years of Expansion and Restriction," in *Value Capture and Land Policies*, Proceedings of the 2011 Land Policy Conference, Lincoln Institute of Land Policy, https://www.lincolnst.edu/sites/default/files/pubfiles/special-assessment-california_0.pdf.

⁵ California Debt and Investment Advisory Commission, *Funding and Financing of Maintenance and Public Infrastructure Using Special Assessments: Approaches for Achieving Successful Outcomes*, September 18, 2014, <https://www.treasurer.ca.gov/cdiac/seminars/2014/20140918/presentation.pdf>.

⁶ Michael Colantuono, "A History of Local Government Revenues under California Law: Proposition 13 through Proposition 26," presented to the League of California Cities, City Attorneys Department, May 9, 2013, pp. 22-29, https://chwlaw.us/papers/History_of_Props_13_%202018_26.pdf.

⁷ California Legislative Analyst's Office. <https://lao.ca.gov/Publications/Report/3497>

The impact from the from the one percent tax rate limit is more indirect. State laws control the allocation of property tax revenue from the one-percent rate to local governments, including counties, cities, school districts, and special districts. The distribution of property tax revenue varies significantly by locality due to historical factors built into the allocation formulas. As a result, it does have an indirect impact on where TIF is used in the State. A common rule-of-thumb states that a locality should receive at least 15 percent of the general one-percent property tax to make TIF worth the effort, and the majority of California cities receive a lower share. The median share is approximately 10 percent. All of the TIF districts implemented to date are in jurisdictions with shares higher than the median.⁸ Given the low property tax share received by many cities, in many cases, TIF districts may not be feasible without voluntary contributions from other taxing entities.

⁸ Housing Financing Tools and Equitable, Location-Efficient Development in California: Report on the Use of Tax Increment Financing, prepared for the California Governor’s Office of Planning and Research, December 29, 2020, pp. 31-32, https://www.opr.ca.gov/docs/20210203-TIF_Tools_Final_Report.pdf.