Value Capture: Capitalizing on the Value Created by Transportation

Value Capture Frequently Asked Questions: Joint Development

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What is joint development?
Joint development is a process by which public agencies partner with private developers for the purpose of a real estate development project. Common joint development arrangements include air-rights development, ground leases, right-of-way use agreements, station interface or connection improvements, cost-sharing arrangements, and incentive agreements. Joint development agreements have been used for a wide variety of public facilities and services including transit, highways, parking facilities, and schools.

Joint development is a type of public-private partnership related to the development of real estate. The real estate development project might include commercial space, residential space, or infrastructure facilities. In a joint development project, both the public agency and the private developer contribute resources. The parties may share costs, revenues, or both. This contrasts with many public projects in which public agencies direct and pay for the projects, and the private contractors are merely paid for providing specified products and services.

Typically, publicly provided resources include land or air rights that are associated with an existing or proposed infrastructure facility. Public resources might also include grant funding, loans, or loan guarantees. Private developers provide real estate design expertise and construction capabilities. They may also provide equity capital and access to debt financing. The ability to provide public resources in conjunction with a real estate development project will be governed by State and local law. If Federal funds are being used, Federal-aid or other Federal requirements will also be applicable.

In many cases, a public agency will sell or lease public land (or air rights) to a developer as part of the deal. In exchange for providing land or air rights for private development, a public agency may seek some or all of the following:

- Fair market value return for the public resources provided.
- A private development designed to complement an existing or proposed public facility (e.g., transit station, highway interchange, parking garage, or school). In the case of joint development adjacent to a transit station, the development is intended to enhance ridership and reduce the amount of automobile traffic (and pollution) that would be generated by a similar development that does not have transit access.
  - In some cases, the private development is directed to satisfy other public objectives such as below-market-price housing, accessible dwelling units, environmental mitigation in excess of what is required by the building code, landscaping, or enhanced public space amenities.
  - To the extent that accomplishing these public objectives reduces the profitability of the private development, the public agency may need to increase the resources that it

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provides or accept discounted returns from them. For example, a site zoned for 100,000 square feet of residential space above a transit station might command a price per square foot based on the sale or rent of market-rate units. However, if a jurisdiction mandates the inclusion of below-market-rate units (thereby reducing developer profit), the jurisdiction may need to increase the allowable development density or reduce the price per square foot for the site (or provide some combination of these two options).

In some cases, a public agency enlists a private developer to construct or improve a public facility as well. For example, a developer might be directed to construct a publicly owned transit station within a privately owned commercial or residential building.

How does joint development relate to value capture?
In many joint development projects, the primary resource that a public agency provides is real estate. To the extent that public land or air rights (and access to nearby public infrastructure) provides value to a private development, obtaining a fair return for that publicly provided resource represents value capture.

What are the primary opportunities and challenges of joint development?
Joint development projects are intended to benefit both public and private parties and may lead to: increased revenue for real estate owners, decreased costs for operating or constructing transportation facilities and services, complementary infrastructure, increased transit ridership, or enhanced amenities for transit riders, motorists, cyclists, or pedestrians.

Opportunities for the public sector to use joint development include:

- Integrating private development with public infrastructure to enhance the efficacy and efficiency of public infrastructure.
- Obtaining economic returns in exchange for providing access to infrastructure.
- Ensuring long-term returns for public resources through the use of long-term leases for public land or air rights.
- Leveraging public resources to obtain additional public benefits such as:
  - Affordable housing;
  - Environmental enhancements (e.g., parks and stormwater mitigation);
  - Public space amenities.
- Private-sector design and construction expertise.
- Private-sector capital.
- Risk sharing.
- Performance-based contracting.

Challenges for the public sector include:

- Contractual complexity: Joint development projects are a type of public-private partnership. In some cases, public agency contracting abilities might be limited to soliciting bids for defined products and services or selecting the “best value” proposal submitted pursuant to a request for proposals. Joint development projects entail contributions from both the public and private sector in exchange for contractually allocated risks and rewards. This level of contractual complexity may require enactment of State public-private partnership enabling legislation and retention of experts to negotiate and draft the contracts.
- Project management complexity: Compared to traditional government projects for which a public agency hires a contractor to construct a project, joint development entails more nuanced boundaries between public and private control over the project. This leads to more a complicated project management process that requires enhanced levels of communication and coordination.
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- The mingling of public and private resources, combined with the allocation of risks and rewards among the parties, requires detailed record-keeping and sophisticated accounting.\textsuperscript{xv}
- Transparency: Contractual complexity and weighing the value of publicly contributed resources against the cost of extraordinary private development requirements (e.g., contractual requirements for affordable housing or public realm amenities) may make it difficult for the public to understand whether the deal is fair to the taxpayers. Some members of the public may be suspicious of (or opposed to) any project that results in profits for private-sector real-estate developers. Thus, compared to traditional development projects, joint development may merit enhanced public outreach and education efforts as part of the project.\textsuperscript{xvi}
- Valuing the public resources provided and determining the cost to a developer for achieving specified public policy objectives are critical to the fairness and success of the deal from a public perspective but may be outside the expertise of the sponsoring public agency.\textsuperscript{xvii}
- Complexity of project funding and risk allocation increase the chance of misallocating responsibilities, risks, and rewards.\textsuperscript{xviii}
- Value capture can be truncated as a result of a real estate sale in lieu of a long-term lease.\textsuperscript{xix}

Under what circumstances is joint development useful?

If a public agency controls land or air rights adjacent or near to valuable public infrastructure (e.g., highway interchange, transit station, central business district), and if there is a demand for private commercial or residential development there, then there might be an opportunity to facilitate the development of the land or air rights in a way that is complementary to (or at least not in conflict with) the existing or proposed infrastructure facility. Similarly, companies seeking routes for cable conduits might find value in utilizing transportation rights-of-way such as roadways, transit tunnels, or sewers.

In some cases, there might be an opportunity for a private developer to build or improve the public infrastructure facilities as part of the private real estate development project. Yet another opportunity might entail the utilization of public land or rights-of-way for solar power generation.

Does it matter whether projects are urban, suburban, or rural?

No.

What types of infrastructure projects can be supported by joint development?

Almost anything. However, if a public facility has negative externalities (e.g., sewage treatment plant or trash transfer station), it might be difficult to find a demand for private space (commercial or residential) that would want to co-locate there. Even though airports have significant negative noise externalities, they can be excellent locations for warehouses, intermodal freight facilities, and perhaps other industrial facilities. In addition, the airport terminals themselves provide opportunities for a variety of retailers and food vendors.

The economic vitality and character of a jurisdiction, as well as the imagination of its public officials and private developers, will ultimately determine what combinations of public facilities and private development make sense.

Is the use of joint development dependent on market conditions?

Absolutely. Market conditions will determine the value of the public real estate and other resources that a public agency brings to a joint development deal. Market conditions will also determine the necessity for and utility of a public infrastructure facility. And market conditions will determine the character and economic viability of the private development to co-locate within public land or air rights near a particular public facility.
What is the scale at which joint development might be viable?

Depending on market conditions and the size and nature of the adjacent public infrastructure, the scale can range from having a private developer pay for the entire cost of a public facility to no deal whatsoever. This range of possibilities is illustrated by the following single example.\textsuperscript{xx}

In 1995, the private owner of a defunct, 235-acre railroad yard (Potomac Yards) in Alexandria, Virginia, offered to pay for the entire cost of a new Metrorail transit station adjacent to the yard. This offer was made because the landowner was unable to obtain a development permit for a mixed-use development unless the site provided rail transit access. (The only road providing access to the project was already over capacity during rush hour, thereby causing the host jurisdictions to deny development permits without transit access.) Designing and constructing the station, estimated at approximately $20 million in 1995, was deemed to be a worthwhile expenditure in light of the revenues to be generated from the completed development.

However, when residents on the opposite side of the congested road reviewed the mixed-use development proposal, they feared that it would still generate too much auto traffic. The residents lobbied their local representatives to down-zone the site, and they succeeded. Due to the reduced development density, allowable development could no longer generate enough revenue to pay for the cost of the transit station. Consistent with the new zoning, the landowner then developed a complex of big-box retail stores with acres of parking – generating much more auto traffic than the original mixed-use development proposal.

Now, more than 25 years later, the landowner and the City of Alexandria are seeking to intensify the development of the site in conjunction with the creation of a new Metrorail transit station. The station, now estimated to cost about $320 million, will be paid for by a combination of special assessments, tax-increment financing, and Federal and State grants and loans.\textsuperscript{xix}

Is joint development subject to voter approval?

Typically, joint development is not subject to voter approval. The ability of a public agency to engage in a joint development project depends upon its property management powers under the State and local laws and regulations governing the agency’s authority to acquire, manage, and dispose of real estate. In some cases, such laws and regulations may require legislative review or approval of the disposition of public lands. Additionally, if public land or air rights were acquired with Federal funds, Federal review and approval may also be required as specified in the relevant Federal regulations.\textsuperscript{xxii}

What analysis is needed to implement joint development?

Joint development is subject to the laws and regulations governing an agency’s authority to acquire, manage, and dispose of real estate. In addition to State laws and regulations, requirements that may apply to joint development of land acquired with Federal highway funds can be found in 23 U.S.C. §§ 129(b), 137(a), 142(a), 142(f), and 156. See also 23 CFR part 710 and 49 CFR §§ 18.25 and 18.31. Joint development of land acquired with funds administered by the Federal Transit Administration (FTA) is addressed in FTA guidance updated on August 14, 2020.\textsuperscript{xxiii}

At a minimum, it is important that a public agency determine the value of the resources that it is contributing to the project. Aside from simply being necessary as a duty to taxpayers, where federally acquired land or air rights are in play, this is required pursuant to 23 USC §156, as mentioned above. Where federally acquired property is not in play, State and local law may have similar provisions. Also, if the agency will impose unusual requirements on the private developer that will reduce the net income of the project, the developer will seek a commensurate reduction in payment for the public resources. To determine a fair and reasonable price for public resources, the agency will need to evaluate the extent to which such requirements will reduce the net income to the developer.
What is the time frame for joint development?
The time frame depends on the size, complexity and duration of the project. If there’s a lot of land or air rights to be developed, the project might be accomplished in phases over many years.

In terms of the receipt of public revenues, the disposition of public land or air rights can be accomplished in two ways, subject to applicable laws and regulations. Public land or air rights can be sold to a developer or they can be leased. Private developers will not develop real estate if a project is subject to a short-term lease. Therefore, leases for this purpose are typically for terms lasting between 50 and 99 years. These two approaches to public real estate disposition have the following consequences:

- **Sale:** The sale of public land or air rights can result in a significant one-time infusion of revenue. However, once that revenue is received, that completes and terminates the most significant value capture aspect of the deal. If the value of the disposed land or air rights increases in the future, that enhanced value becomes a windfall to the landowner at that time.

- **Long-term lease:** The lease of public land or air rights for 50 to 99 years will provide a steady stream of revenue over the duration of the lease. When the lease expires, either the land (and improvements) revert to the public, or the lease can be re-negotiated and extended. In either event, the public is able to retain any future enhancement to the value of the land or air rights.

Are joint development projects included in a jurisdiction’s capital improvement plan?
A capital improvement plan (CIP) is a State or local planning document containing all the individual capital projects, financial plans, and major studies for a State or local government. A CIP looks beyond a federally required fiscally constrained plan and includes projects outside of the fiscally constrained Plan. Construction and completion schedules can also be included. The plan provides a working blueprint for sustaining and improving the community’s infrastructures. It coordinates strategic planning, financial capacity, and physical development.

A transportation improvement program (TIP) is a four-year, fiscally constrained document required for metropolitan planning organizations (MPOs). The TIP lists all transportation projects in an MPO’s metropolitan planning area that use Federal transportation funding. Detailed requirements for TIPs and the MPO transportation planning process are located in 23 CFR part 450. There are similar requirements for State Transportation Improvement Programs (STIPs) in 23 CFR part 450.

In the event that a public agency provides land or air rights solely for a private development, such a project would probably not appear in the capital improvement plan. However, if a project entails construction of or improvement to a public facility, then that aspect of the project and its source of funding would be included in the capital improvement program.

What are some examples of joint development projects?
I-395 Air Rights (Washington, DC): In 2012, a private developer obtained air rights over a portion of a depressed freeway (I-395) in the heart of downtown Washington, DC. As part of the deal:

- The developer paid $120 million for the air rights
- The developer paid for improvements to I-395 worth $270 million including:
  - New access and exit ramps
  - The construction of a deck on top of I-395 with ventilation systems
  - Two east-west streets (F and G Streets, NW), which had been interrupted by the freeway’s construction in the 1950s, were re-established on the new deck – one as a street for auto traffic and one for pedestrians only – improving connectivity and accessibility in this part of the downtown
- The District’s traffic signal computer operations center was relocated
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- New LEED-certified buildings (commercial and residential) are being constructed atop the deck.

High Street Cap (Columbus, Ohio): This joint development air rights project entailed creating a retail development featuring “main street” design on air rights above I-670. Federal funds were used to acquire the real estate as part of the original I-670 construction. Therefore, FHWA regulations governed the disposition of this right of way and the amount and utilization of any revenues obtained from it. Restrictions on the use of the air rights platform made determining fair market value complex. FHWA agreed to an unconventional base rent with a profit-sharing component.

Reconstruction of the Navy Yard Metrorail Station Entrance: In the early 2000s, the District of Columbia was building a new baseball stadium about one mile south of the Capitol. There was already a Metrorail Station entrance one block away. The station entrance, of standard design, was not capable of handling the volume of passengers who would use this entrance to attend ballgames and other stadium events. This entrance was located in an open, undeveloped area adjacent to the sidewalk on one side and to a bus parking lot and bus garage on the other side. This entire area was owned by the Washington Metropolitan Area Transit Authority (WMATA). A private developer entered into an agreement with WMATA to expand the Metrorail station entrance and to construct an office building adjacent to and on top of the expanded station entrance. The developer purchased the land and air rights adjacent to and above the station entrance from WMATA.

For additional examples, see the National Cooperative Highway Research Program’s Report 873, Guidebook to Funding Transportation through Land Value Return and Recycling.

What types of financing tools support joint development?
Public agencies and private developers have different types of financing tools available to them. If the project generates revenues, then the party entitled to the revenue can use that revenue (or a portion of it) to support any type of loan or financing instrument that this party is eligible to receive. Of course, public agencies do not necessarily require project revenues to be eligible for various financing mechanisms. Some public financing tools are based on the anticipated receipt of formula grants or on the dedication of a portion of general revenue for debt service. Depending on the nature of the project, a public agency might be eligible for Federal loans or loan guarantees such as Transportation Infrastructure Finance and Innovation Act (TIFIA) or allocation of Transportation Private Activity Bonds.

For more information about U.S. DOT’s financing programs, visit: https://www.transportation.gov/buildamerica/financing.

RESOURCES

FHWA EDC-5 Value Capture: Capitalizing on the Value Created by Transportation
https://www fhwa dot gov innovation everyday counts/edc_5/value_capture.cfm

FHWA Center for Innovative Finance Support (CIFS) – Value Capture
https://www.fhwa.dot.gov/ipd/value_capture

FHWA CIFS – Joint Development Resources
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4 Id., at Section 8.1.3.

5 Id., at Section 8.1.3.

6 Id., at Sections 8.1.6 and 8.1.7.

7 Id., at Section 8.1.7.

8 Id., at Section 8.1.7.

9 Id., at Section 8.1.3.

10 Id., at Section 8.1.3.

11 Id., at Section 8.1.3.

12 Id., at Section 8.1.3.


16 See 23 U.S. Code 156 and 23 CFR 710.


xxvi 23 CFR part 710.