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TOD Financing Toolkit

TOD projects typically require significant capital expenditures to provide the necessary buildings, facilities, and infrastructure to achieve mixed use, higher density and walkable developments. In pursuing smart growth in already-developed urban settings or in centers planned for growth, the major challenges are providing public infrastructure systems such as roads, sewer, drainage and water, which are often inadequate and require costly upgrades, or nonexistent in planned growth centers. This section reviews a range of financing tools available which may be applied and should be considered to facilitate the delivery of TOD, TRD, and infrastructure projects.

TOD financing can relate to a specific project at a particular site, and it can also relate to a neighborhood or larger district if improvements are needed at that level to address conditions such as off-site infrastructure inadequacies. The types of financing tools available can generally be categorized as debt, equity, and value capture.

1. Debt

Debt financing through government bonds is how most public projects undertake development. Debt financing includes general obligation bonds, revenue bonds (e.g., airport and harbor projects), and private activity bonds issued through capital improvement program (CIP) funding by the State or county. CIP projects include renovations and major maintenance to existing facilities, landscape improvements, new construction, land acquisition, and utility modification. Private activity bonds are tax-exempt and backed by the government for private business facilities that have a public benefit (e.g., rental housing, schools, and utilities). Two notable bond programs in Hawaii targeting affordable housing and infrastructure are the Dwelling Unit Revolving Fund and the Hawaii Regional Infrastructure Financing program recently established.

- **Dwelling Unit Revolving Fund (DURF)**. DURF was established in 1970 and authorized to issue $125 million of general obligation bonds to carry out the purposes of the Housing Development Program. Funds may be used for the acquisition of real property, development of residential, commercial and industrial properties, and interim and permanent loans to developers.

- **Hawaii Regional Infrastructure Financing**. A notable new regional infrastructure financing tool was enabled through Act 132, SLH 2016. Regional infrastructure subaccounts may now be established in each county to provide grants and loans to State agencies, or loans to county or private developers for improvements that increase the capacity of regional infrastructure systems such as sewer, water, drainage, roads and telecommunications. Revisions to Chapter 15-307, "State Assisted Land and Housing Development Program", Hawaii Administrative Rules for regional infrastructure financing were effective April 28, 2017. Subchapter 14 sets forth the rules relating to the use of the Dwelling Unit Revolving Fund (DURF) for grants or loans to finance regional infrastructure improvements.

  HHFDC is currently working with the Kauai County Housing Agency (KCHA) to help finance regional infrastructure improvements for Lima Ola, a 75-acre parcel master planned for 550 affordable and workforce housing units in Eleele, Kauai. In August 2017, the County Council adopted Resolution No. 2017-43 which authorized the KCHA to apply for a DURF loan to develop and construct infrastructure for Lima Ola.

2. Equity

Equity tools allow private entities to invest private funds or take an equity interest in the project in expectation of a return. Equity sources are typically available only for projects or infrastructure that generate a significant return, such as parking facilities, utilities, or airports. Three major equity tools used to finance TOD projects include public-private partnerships, joint development, and for affordable housing, the Low Income Housing Tax Credit.

- **Public-private partnerships**. A public-private partnership (P3) is a contractual agreement between a public agency and private sector entity to deliver a service or facility for the benefit of the general public. While there are different forms of P3s, the standard model is Design-Build-Finance-Operate-Maintain (DBFOM). In a DBFOM, the private entity designs, builds, and provides the capital cost to finance a public project, while the public sector partner guarantees payment to the private partner. Operations and maintenance are integrated into project design and delivery to enhance long term performance of the asset.

  Experience with P3s, globally and in North America, shows that using this approach delivers projects on-time and under budget, and exceeds quality expectations. A P3 contracting approach provides the public agency with cost certainty, and transfers the risks of cost, schedule and performance to the private sector while maintaining public ownership of the asset. In one model, the P3 concessionaire receives payments based on the asset's availability and performance. Candidate P3 projects are typically greater than $50 million, and undergo value-for-money and risk analyses to determine if P3 is viable for the project. There are higher procurement and transaction costs due to the need for legal, technical and financial advisers, and a longer lead time for procurement and contract execution, typically 12 to 18 months.

  In Hawaii, P3 has been successfully used for the Army and Navy family housing redevelopment projects on Oahu. The County of Kauai Housing Agency has used P3 to develop its Kanikoo Rice Camp senior housing in Lihue. The Mayor Wright Homes redevelopment is undergoing a P3 process and is finalizing a development agreement with the developer team.

  The major challenges to P3 in Hawaii are the lack of experience and expertise in its use and uncertainties relative to compliance with the State Procurement Code. Agencies need technical assistance to navigate the use of P3s.

- **Joint development and development agreements**. In general, a real estate development project involving multiple parties can take many forms, ranging from an agreement to develop publicly-owned land to jointly financing and developing a project that includes both public facilities and private development. The public agency and the private developer may agree to share project costs and revenue. The University of Hawaii has selected a master developer for its University Village at West Oahu to undertake private mixed use TOD development complementary of and with revenue generation to support the adjoining campus.

- **Low Income Housing Tax Credit (LIHTC)**. LIHTC is the major financing tool administered by the HHFDC that provides equity funding for the development of low-income rental housing. Affordable housing project owners who are awarded an allocation of tax credits from HHFDC find investors for the tax credits to generate equity financing. The 9% competitive LIHTC has a volume cap based on the State's population, $3.3 million in 2016. These funds can provide up to 55-60% of the equity needed for project development. The limited funding available for the popular 9% LIHTC is a challenge for affordable housing projects, which must compete with other projects and wait years to obtain this financing. The 4% non-competitive LIHTC is allocated based on the use of private activity bonds, for which the State has an annual cap of about $300 million. This can provide for about 40% of the project equity needs.

3. Value Capture

Value Capture refers to a set of strategies whereby the value generated by public investments are recovered by the public sector. Public infrastructure investments have the potential to positively impact nearby property values and associated development potential. Many studies show that rail transit investments have a positive effect on property values when it significantly improves residents' access to jobs, education, entertainment, and services. Proximity to rail stations that are frequented destinations are also likely to attract more new development. The Honolulu rail project is expected to connect more than 40% of the island's jobs, a striking number when compared to other rail transit systems which typically connect less than 20% of regional jobs. Value capture can include already well-used systems such as improvement districts (e.g., sewer, sidewalk improvements) and special improvement districts or business improvement districts (e.g., security services, landscape and streetscape maintenance such as on Fort Street Mall and Waikiki).

Two value capture strategies which are well-used on the Mainland but not in Hawaii deserve consideration in financing TOD and infrastructure projects:

- **Community Facilities District (CFD)** is a special taxing district to fund the acquisition or construction of public improvements including transit, roadway, water, wastewater, pedestrian, cultural and police and fire facilities. A CFD can be either a construction or acquisition district. In a construction district, the County uses bond proceeds to construct the improvement. In an acquisition district, the improvements are constructed by a developer in advance, then acquired by the county using the bond proceeds. Bonds are repaid via an additional, separate charge on semi-annual real property assessments. A CFD allows for the issuance of tax-exempt municipal bonds secured by land within the district. CFDs are widely used on the Mainland to fund infrastructure for new developments. In Hawaii, CFDs are statutorily enabled for all counties; however, to-date only one CFD has been established on Kauai for the Kukuiula resort-residential development.

- **Tax Increment Financing (TIF)** is a tool that captures growth in property tax revenues over time. Upon establishment of a TIF district, incremental tax revenues over a base year that would otherwise go to a county's general fund are made available to fund public improvements or pay debt service on bonds for public infrastructure. Assuming growth in assessed property values within the TIF district, the revenue generated escalates over time. Typically, TIF is used in locations where new development is anticipated, thus generating incremental property tax that can be captured by the district. The tax increment is collected for a set period, usually between 15 and 30 years, and the tax increment can be used to secure a bond for district infrastructure improvements.

  California's Enhanced Infrastructure Financing District (EIFD) is a TIF-based tool that uses the incremental increase in property tax revenues from redevelopment to enable local public authorities to build infrastructure, construct transit stations, and develop neighborhood improvements such as sidewalks, streets, bicycle lanes and new parking structures.

<u>Challenges:</u> Concerns have hampered the use of TIF for financing infrastructure in Hawaii. Counties have expressed concern regarding the diversion of future revenues that could restrict the county's ability to pay for basic services such as police, fire and parks. Any downturn in the real estate market could result in TIF revenues being insufficient to cover debt service on the bond, compromising the public issuer's overall bond rating. Concern has also been raised as to whether TIF bonding is allowed under State law.

One option which is being considered by the City & County of Honolulu is to pair a CFD with a TIF district. CFD revenues are more predictable, producing a steady revenue stream that is not reliant upon new development, and can generate funds in advance of tax increment receipts from a new TIF district.

<u>Proposed Recommendations:</u>

1. Create the institutional framework for the use of P3 in Hawaii. This would include the following actions:

    a. Support legislation and funding to establish a Public-Private Partnership Office within a State department or agency to advise and assist agencies, and facilitate and promote the use of P3 for large capital projects.

    b. Explore legislative options to clarify P3 procurement authorization and the establishment of standards for practice/best practices.

    c. Continue to support State agencies as needed in entering into P3 under existing agency authority.

2. TIF / CFD. Further work is needed to advance and support use of TIF and CFDs in Hawaii. This would include the following actions:

    a. Study and develop recommendations to overcome barriers to use of TIF and CFDs in Hawaii.

    b. Study and develop recommendations for hybrid models and mechanisms to enable value capture for projects on State lands.

    c. Enact legislation as needed to implement the recommendations from these studies.

3. Identify actions needed to expand on financing tools and facilitate access to finance for TOD and infrastructure projects.