THE CITY OF NEW YORK
INDEPENDENT BUDGET OFFICE
110 WILLIAM STREET, 14TH FLOOR
NEW YORK, NEW YORK 10038
(212) 442-0632 •EMAIL: iboenews@ibo.nyc.ny.us
http://www.ibo.nyc.ny.us

Testimony of Sarah Stefanski
Assistant Director, New York City Independent Budget Office
To the New York State Senate Standing Committee on Corporations, Authorities, and Commissions and Senate Standing Committee on Finance
Regarding the Pennsylvania Station Area Civic and Land Use Improvement Project
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Good morning, Chair Comrie, Chair Krueger, and committee members. My name is Sarah Stefanski, and I am the assistant director for housing, environment, and infrastructure at the New York City Independent Budget Office (IBO). I appreciate the opportunity to testify before this joint committee hearing today on the Empire State Development's plan to redevelop Penn Station.

IBO is a New York City agency created to provide nonpartisan information on the city's budget and economic outlook to elected officials and the public. Last month, IBO issued a report examining ESD's proposed General Project Plan (GPP) for Penn Station. Overall, IBO found that the plan, as it stands, lacks many of the basic and important details needed for a robust analysis and leaves many open questions about its impact on state and city finances. In my testimony today, I will highlight some of what we believe are the most important open questions and what in the plan might have the greatest impact on the city's fiscal condition.

Revenue from Development. ESD proposes to use value capture financing, where payments in lieu of property taxes (PILOTs) and fees from eight development sites surrounding the train station are used to pay for project costs. The GPP did not include any forecasts of revenue from these sources or details on how the PILOTs or development fees would be structured. We understand that ESD is currently working with the city to formulate an agreement that sets parameters for this value capture framework, including more details on property tax discounts included in the PILOTS and PILOT terms. As we highlighted in our report, any discounts granted for PILOTs reduce funds available to support project costs. Therefore, if discounts are given, they must be set at a level that creates an incentive for the development, but not so steep as to give away revenue unnecessarily, or to give developments an advantage over other similar office buildings elsewhere in the city.

Furthermore, it remains unclear the extent to which discounts are even necessary to spur the new development outlined in the GPP. Unlike Hudson Yards, one of the city's most prominent examples of value capture financing—where the city determined that development in an almost entirely new neighborhood as far west as 11th Avenue would not be economically feasible without some level of public subsidy—the location of the eight sites close to a renovated Penn Station may be sufficient to attract developers and future tenants. In the case of the several Vornado-owned sites, the company has already indicated its intention to redevelop, further signaling that little, if any, additional incentive may be needed.

Development Timing Considerations. The station reconstruction is expected to be completed by 2032, but the development sites whose PILOT revenue is slated to help pay for that work are not expected to be fully complete until 2044. Additional funding will be required to both boost the project's credit rating and to cover debt service costs until PILOT revenue can sustain the payments. Anticipating a similar timing gap for the Hudson Yards development, the mayor and the City Council agreed to make interest support payments until the development revenue would be enough to support the annual debt service. For Hudson Yards, the city paid $395 million from fiscal years 2010 through 2015 for interest support payments tied to $3 billion in bond financing, in addition to the city paying for some of the project's costs through its own capital budget. The Hudson Yards Infrastructure Corporation, however, is also required to remit surplus revenue back to the city, and in recent years, the city has received $663 million in surplus payments. Again, IBO looks to ESD to provide more details on how any revenue gaps or surpluses would be addressed in the case of Penn Station.

Current Property Taxes for Development Sites and Other City Tax Revenue Considerations. Currently there are 55 property tax lots on the eight proposed development sites. This fiscal year, the city collected $60 million in property taxes on these sites, a very small share of the city's more than $29 billion in total property tax revenue. Under the plan, as I've mentioned, property owners would pay PILOTs to ESD, not property taxes to the city. ESD has indicated that it intends to reimburse the city for this lost tax revenue based on current collections from the sites, with annual escalations. While such an arrangement would help keep the city financially whole, it reduces the amount of revenue ESD then has to pay back the project's cost. Without details on how revenue shortfalls would be resolved, and by which level of government, the impact on the city's finances is far from certain. The GPP also did not specify if the state intends to provide the city with any part of the Payments in Lieu of Sales Tax or Payments in Lieu of Mortgage Recording Tax that ESD also includes as revenue sources to cover the project cost.

Madison Square Garden. ESD's Penn Station plan does not propose any changes to Madison Square Garden, which sits directly atop the existing Penn Station train complex. The arena is exempt from paying property taxes, a value of $43 million annually. Since the exemption was granted in 1982, IBO estimates the collective tax expenditure has exceeded $875 million dollars, adjusted for inflation. IBO views this as a conservative estimate of the foregone revenue since, knowing the property has a full tax exemption, the Department of Finance does not have a strong incentive to accurately estimate the fair market value of the arena, which is the first step in determining the tax liability for the property. This exemption is granted through state law and remains in effect unless the state amends the section of the law or the arena is no longer home to professional major league basketball and hockey teams. If the state were to repeal this exemption, the city could then collect Madison Square Garden's property taxes, offsetting any potential loss of tax revenue under the ESD plan, or the arena could enter into a PILOT agreement as an additional source of revenue for the Penn Station project; however, neither of these options are discussed in the state's plan.

Potential Positive City Revenue Impacts from Personal Income and Sales Taxes. Presently, the eight development sites contain around 4.7 million square feet of real estate—underbuilt relative to even what current city zoning allows in terms of square footage. The creation of new, attractive retail spaces may have positive impacts on the city's sales tax receipts. Multiplier effects of induced economic activity may also produce potential benefits to the city beyond income and sales tax directly tied to the Penn Station Area Project. Because so little is known about project construction and future tenants, however, IBO is unable to estimate these ancillary impacts.

Future Demand for Proposed Real Estate Development. The majority of proposed new development under the plan is new Class A office space. Pandemic-related changes in work arrangements have raised questions whether there would be sufficient demand for such space in the future. IBO has found that Class A office space has fared favorably in the near term, and the number of direct transit commutes straight to these buildings may make the area particularly attractive to employers. There certainly is a risk of a larger shift in work arrangements, however, in the longer term when these buildings are expected to be complete.

There is also the potential that the introduction of new Class A office space near a newly improved Penn Station may erode demand for nearby Hudson Yards and other office districts. Several major office tenants at Hudson Yards relocated from other parts of the city, primarily the Financial District downtown and central and east Midtown, indicating that new office districts in the city can draw from existing office areas elsewhere within the city. Any downward pressure new commercial office space may have on other existing commercial office space, could in turn negatively impact the city's property tax collections, as the Department of Finance uses building income (consisting mainly of rents) as one of the components for calculating the tax base for commercial office buildings.

While few would argue about the need for improvements at Penn Station, many key questions remain unanswered under the state's current proposal, particularly around the PILOT structure, the projected value capture revenues, the timing, and the risk management around funding shortfalls. This information is critical for the plan to be fairly evaluated in terms of both potential benefits and risks to the state and city—a necessary step before approving a plan that could impact the city and state for years to come.