VALUE CAPTURE: HOW TO GET A RETURN ON THE INVESTMENT IN TRANSIT AND TOD

By Gloria Ohland

The maxim is that when looking for a new home or business the three most important considerations are: location, location, location. As traffic makes it increasingly difficult to drive in downtowns, as downtowns become increasingly popular with both residents and businesses, and as new transit systems open up in downtowns across the U.S., an address near transit is proving to be a good one. Empirical evidence that transit and TOD create significant value is mounting. It has to do with economies of agglomeration and the efficiencies created: Some things work better when clustered together. And with “killer commutes” tying up 10 million drivers two hours a day in traffic, it works best when they’re clustered around transit.

The fact that condo sales have outpaced the sale of single family homes is proof the market is changing. Smaller, non-traditional households without children want to live in convenient neighborhoods. In cities, the road network has reached a level of connectivity best described as “saturated,” and returns on that investment are diminishing. But transit still offers net benefits, in part because it concentrates development -- and the tax base – allowing for more focused value capture strategies. And in this era of shrinking public funding and expansive demand, value capture strategies are needed to help pay for construction and operation of transit and expensive TOD components like structured parking.

This country’s first privately funded rail line – a 4-mile long monorail – opens shortly in Las Vegas, and public-private partnerships have resulted in the extension of light rail to Portland’s airport, construction of stations in Washington D.C. and California, and in streetcar projects across the U.S. Meanwhile, tax increment financing and assessment districts are being used to invest in TOD projects incrementally -- so the value created pays for further improvements. During the last half century the federal largesse available for transportation projects, especially highways, has caused us to forget that historically -- and even today in Hong Kong and Japan – transit was built by the private sector. Transit wasn’t viewed as a subsidized service for the poor but as an investment that returned a profit because it increased land values. Now that the real estate market has come back to the city, it’s time to think more about value capture strategies.

“Las Vegas was going to put a sales tax increase on the ballot and get in the very long line for federal funding when business leaders said, ‘There has to be a better way,’” says attorney Geoff Yarema, who arranged the sale of $650 million in non-recourse tax-exempt bonds. The first segment of the monorail connects casinos and the convention center; the second segment, which heads downtown, will combine public and private funding. Las Vegas is
a specialized market and this experiment may not be replicable, but other cities are trying other experiments.

The proposed Atlanta Beltline, for example, is a 22-mile light rail line and greenway to be built on existing freight corridors through 50 historic neighborhoods encircling downtown. It would intersect with five MARTA stations, open 4,000 acres for development, and accommodate 100,000 residents. “Developers are knocking on our door saying they’ll pay for the right of way and other improvements because they know the value it will add to their land,” says a staff person for Atlanta City Council President Cathy Woolard. MARTA, the Atlanta Redevelopment Authority and the city are determining how tax increment financing and developer contributions can be used to help finance the line.

**TRIED AND TRUE TOOLS FOR VALUE CAPTURE**

Tried and true value capture strategies include property and sales taxes, real-estate lease and sales revenues, farebox revenues, and fees on everything from parking to business licenses. Two recent studies suggest that when the market is active, the effect of rail on property values is considerable: Robert Cervero’s 2001 study showed the value of commercial property in California’s Santa Clara County was 23 percent higher near light rail and 120 percent higher near commuter rail. A 2003 study by the University of North Texas showed the value of office properties near suburban DART rail stations increased 53 percent more than comparable properties not served by rail, and the value of residential properties was 39 percent greater.

The Rosslyn-Ballston Corridor in Arlington County outside Washington D.C. offers the most potent example of the tax revenues that can be generated over time. In 2002 the assessed value of land and property in the corridor was $8.88 billion, an 81 percent increase over 1992. Because high-density development is clustered around five closely-spaced Metro stations, the corridor comprises just 8 percent of county land but generates 33 percent of county revenues, producing property taxes, hotel taxes, meal taxes, and business and household personal property taxes (on cars, for example). As a result, Arlington has one of the lowest real estate tax rates in Northern Virginia, and because development is channeled around stations, existing single-family neighborhoods and affordable housing have been preserved. The sale last year of the Clarendon Market Common for a record $166 million proves TOD’s market value.

There is additional value in the fact that Arlington residents ride transit: 47 percent use modes of travel other than the automobile to get to work, and 73 percent arrive at rail stations on foot, providing a cost savings because neither the county nor WMATA have to provide long-term commuter parking: Parcels devoted to parking early on have all been converted to high-density mixed-use development. In California, a brand new study by Cervero and others shows that people living in transit-oriented development are five times
as likely to ride transit, and people who work in TOD are 3.5 times as likely. The study showed that while 45 percent of residents living near BART stations used the train in 1990, by 2000 the number had risen to 60 percent.

Parking and other fees on increased activity around TOD – such as business license fees -- provide another means to capture value. Half the cost of construction of the Portland streetcar was paid for with parking bonds and revenues; the streetcar is credited with engendering $1.3 billion in investment in two blocks on either side of the line in the city’s vibrant, high-density Pearl District. Moreover, because the market has placed such a high value on structured parking – ranging from $20,000 per space to $75,000 in some cities -- the fact that transit and TOD make it possible to build less parking frees up considerable public and private resources that can be invested in higher quality development and place-making amenities.

An ad hoc benefit is the development of strong transit constituencies. Residents attending recent forums on projected growth in Arlington agreed more transit and TOD are the solution. Similarly, residents and property owners around three MARTA stations in Midtown Atlanta, who sought to accommodate cars, transit and pedestrians in a 1999 master plan, were interested only in funding alternatives to the car in an update underway in 2004.

MORE SPECIALIZED TOOLS FOR VALUE CAPTURE
Joint development, tax increment financing, special assessment districts, equity participation, and public-private partnerships provide a more direct and focused approach to capturing value. WMATA has aggressively purchased vacant land near planned rail stations, often at bargain rates, to ensure development of transit-supportive projects. The agency has mounted 66 joint development projects since 1976 – half in just the past five years – which had generated $129 million in revenue by 2002, an amount expected to double by 2007. Stations had attracted $30 billion in private investment by 2000: Between 1980 and 1990 40 percent of the region’s office and retail space was built within walking distance, and between 1990 and 2000, another 20 percent was constructed. “When we talk about the great success of public transportation in this region we generally talk about ridership,” noted Metro Board Chairman Chris Zimmerman. “But transit-oriented development is the unsung hero of our operation.”

BART entered the market more slowly. Governed by a board of locally elected representatives, many representing the suburbs, BART surrounded its many suburban stations with parking and instituted a one-for-one parking replacement policy, making joint development extraordinarily expensive. This has worked to BART’s advantage, however, with the parking lots serving as land banks in an overheated real estate market that has only recently made structured parking more feasible. By 2004 a dozen ambitious joint development projects were coming on line, including projects in Hayward, Castro Valley, at Fruitvale in Oakland, in Richmond, Walnut Creek, West
Oakland, Dublin-Pleasanton and at Pleasant Hill – all viewed as a revitalizing force and many provided much-needed affordable housing.

The Valley Transportation Authority, working closely with the City of San Jose, was using joint development to introduce multi-family and affordable housing into single-family suburban neighborhoods. Other agencies, including Tri-Met in Portland and the Metropolitan Transit Development Board in San Diego, purchase sites for resale, taking less than market value or delaying payment to improve the economics of the deal.

Transit agencies and local governments are also experimenting with equity participation to help secure financing and share in upside returns. The City of Albuquerque became an equity partner with the Arcadia Land Company by contributing land, building a parking structure and providing tax abatements for a 500,000 square foot commercial and residential development near the Amtrak station downtown. The city is receiving 25 percent of the cash flow after expenses and debt service in years 6 to 12, and 50 percent in years 12 to 20, in addition to other revenues. And in the Bay Area, the Contra Costa County Redevelopment Agency became an equity partner in BART’s joint development project in Pleasant Hill, assembling the land, and helping finance infrastructure, amenities and affordable housing.

TOD projects often require place-making infrastructure – streetscapes, sidewalks and parks – which makes them cost more than other projects in the short term but provides more value in the mid and long term. Tax increment financing is often used, and developers with expertise in TOD gravitate to municipalities providing this support. The Chicago suburb of Arlington Heights used two TIF districts to rebuild its downtown with very high residential densities around the commuter rail station, funding infrastructure and providing gap financing as an incentive to developers. The village committed $45 million over 15 years, building parking garages, expanding green space, improving streetscapes and facades. Since 1985 the number of residences has increased from 150 to 1,500, the assessed value of property from $10.7 million to $72 million, and gross sales receipts from downtown restaurants from $7 million to $17 million. The developer’s agreement includes a provision reducing the city’s investment if the developer’s rate of return exceeds a targeted amount.

Tax increment financing is used widely in Chicago, where 129 TIF districts cover 30 percent of city land. TIF can be used for public transit infrastructure -- though not operations -- and TOD, and half the city’s TIF districts include stations. Tax increment was used to improve three stations in the Loop, where 85 percent of workers use transit. But given the importance of transit in Chicago, where the overall mode split is almost 60 percent and the need to reinvest in aging transit infrastructure is great, advocates are urging that more TIF be used for transit and TOD.
The assessment district is another specialized value capture tool. Property owners within 200 feet of a new infill station at New York Avenue on WMATA’s busy Red Line will pay annual assessments for 20 years to retire $25 million in general obligation bonds. Benefit assessment districts around five subway stations in Los Angeles have generated $130 million a year to retire bonds sold to help fund the first segment of the line. The Valley Transportation Authority in Santa Clara County used an assessment district to fund construction of a station in Sunnyvale; and has indicated it will use assessment districts to help pay for stations on the BART extension to San Jose.

Contra Costa County created three separate assessment districts at the Pleasant Hill BART station to fund improvements ranging from extensive road work and the under-grounding of utilities to a sheriff’s substation, plaza, streetscape, a bike parking station and trails. Developers prepaid annual assessments for 20 years to fund two-thirds of the $40 million cost. Tax increment provided additional funding as properties around the station increased in value, and TIF is being used for a $30 million BART parking structure. The Redevelopment Agency also helped by assembling land, and in exchange BART is giving the agency 75 percent of ground lease revenues. Once the joint development project next to the station gets built, the county will get another huge chunk of tax increment, which will be spent on more place-making amenities.

Pleasant Hill, like Arlington Heights, shows how the layering on of development and investment over time builds up value that can be tapped and reinvested. Because the Redevelopment Agency helped assemble land for developers, a critical mass of housing and jobs has been built – providing a 40 percent mode split for transit – even though the joint development project at the station has not. Neighborhood opposition kept that component from moving forward until recently, and the enormous cost of building a parking structure for 1500 cars made it economically unfeasible. These final pieces are only possible because the value of the project built up incrementally.

In Portland, funding from two assessment districts was cobbled together with tax increment financing, parking fees, a parking bond, and federal and local transportation dollars to pay for the streetcar, which has leveraged an explosion of development. The Pearl District had been a mostly vacant, low-density neighborhood in the early ‘90s when the city reached agreement with the owner of one 40-acre parcel: The city would build the $56 million streetcar line connecting his property to downtown if he’d upzone from 15 dwelling units per acre to 125 dua – an outrageous density at the time. The result was a critical mass of housing showcasing an urbane new lifestyle that became so popular new units couldn’t be built fast enough.

The Pearl illustrates the best kind of economy of agglomeration: By 2004 4,600 new residential units and 2.2 million square feet of commercial
development had been built. Because of the streetcar – which connects to the regional rail system – a network of bicycle paths and active car-sharing program, as well as a good mix of uses on the street and connectivity to jobs downtown, it’s possible to go car-free in the Pearl. And because there’s little automobile infrastructure there’s an intensity of uses that has created an animated and intimate neighborhood.

Streetcar projects across the U.S. illustrate the public-private partnerships forming to mine the value of transit and TOD. These projects have had to leverage private investment because there is no dedicated source of streetcar funding; streetcars don’t fare well in the fierce competition with light rail and bus for New Starts money, designed for bigger, faster systems. The private sector is a willing investor because streetcar systems clearly promote business activity and because – at half the per-mile cost of light rail and averaging only 2.5 miles in length – they’re inexpensive.

Private investment was also key to the extension of MAX light rail to Portland’s Airport. In 1997 Bechtel offered to help extend MAX in exchange for development rights and a long-term lease on 120 acres at the airport’s entrance. The Port of Portland, Bechtel and the Portland Development Commission shared the $125 million cost of the extension -- with Bechtel contributing $28 million. Unfortunately, the project missed the market, opening with the economic downturn in 2001, and it has not been built. But both the streetcar and MAX extension inspired the Oregon Innovative Partnerships Program, which is establishing protocols for encouraging, evaluating and managing private sector proposals for transportation projects.

**NEW IDEAS FOR VALUE CAPTURE**

Project partners in this country can also look to the London Docklands Development Corporation, a quasi-public holding company created by the British government to oversee a large redevelopment project outside the central business district. LDDC built and operated the Docklands Light Railway and facilitated the sale of land for development. The project is interesting because of the extent and success of development, which built enormous support for more transit, and permitted the use of increased land values and profits from land sales for improvements and extensions to the rail line. The fact that LDDC was the largest landowner and light rail investor eliminated the need for taxing schemes and lengthy negotiations, suggesting another way to facilitate joint development.

Value capture schemes can require extensive negotiations. "Deals must always be structured carefully," explains Peter Benjamin of WMATA, "because there are two sets of tensions: First, does the increase in value go to the local jurisdiction or to the transit agency? And second, since the most support you'll get for a project comes from those who stand to make the most profit from it, how much of the increased value can you take before you lose the interest of your development partners? This balance is struck jurisdiction by jurisdiction, site by site, project by project."
Funding constraints are sure to increase interest in innovative financing arrangements. “It’s being proven that access creates value, but we still don’t really think in terms of value capture – yet,” says Todd Litman of the Victoria Transport Policy Institute in Canada. “People will argue value is captured because taxes go up. But property and sales taxes are simply not focused enough to capture the value of the public investment.” Other innovative strategies suggested in a paper entitled “Can Rail Pay?” by Peter Newman, Jeff Kenworthy and Jan Scheurer include:

- Grant density bonuses to developers who contribute to rail implementation.
- Assess property values over time and tax windfall changes at a higher marginal rate to fund infrastructure and put redevelopment pressure on underused properties.
- Devote parking fees (and cash-in-lieu payments from developers undersupplying parking) to a rail trust fund; create a corridor-wide parking assessment district.
- Give government priority purchase rights to acquire and bank land to resell after its value increases due to rail service. Feed proceeds back into infrastructure.
- Establish a public-private consortium responsible for both rail infrastructure and station district real estate.