LINCOLN INSTITUTE
OF LAND POLICY

Future Directions in U.S. Municipal Infrastructure Finance

CEPAC VIABILITY IN THE U.S.

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Research Questions:

1. **What is CePAC and how does it work?**

2. **Where have CePACs been used and how effective were they? (P. Sandroni)**

3. **How does CePAC compare with existing land value capture tools in the U.S.?**

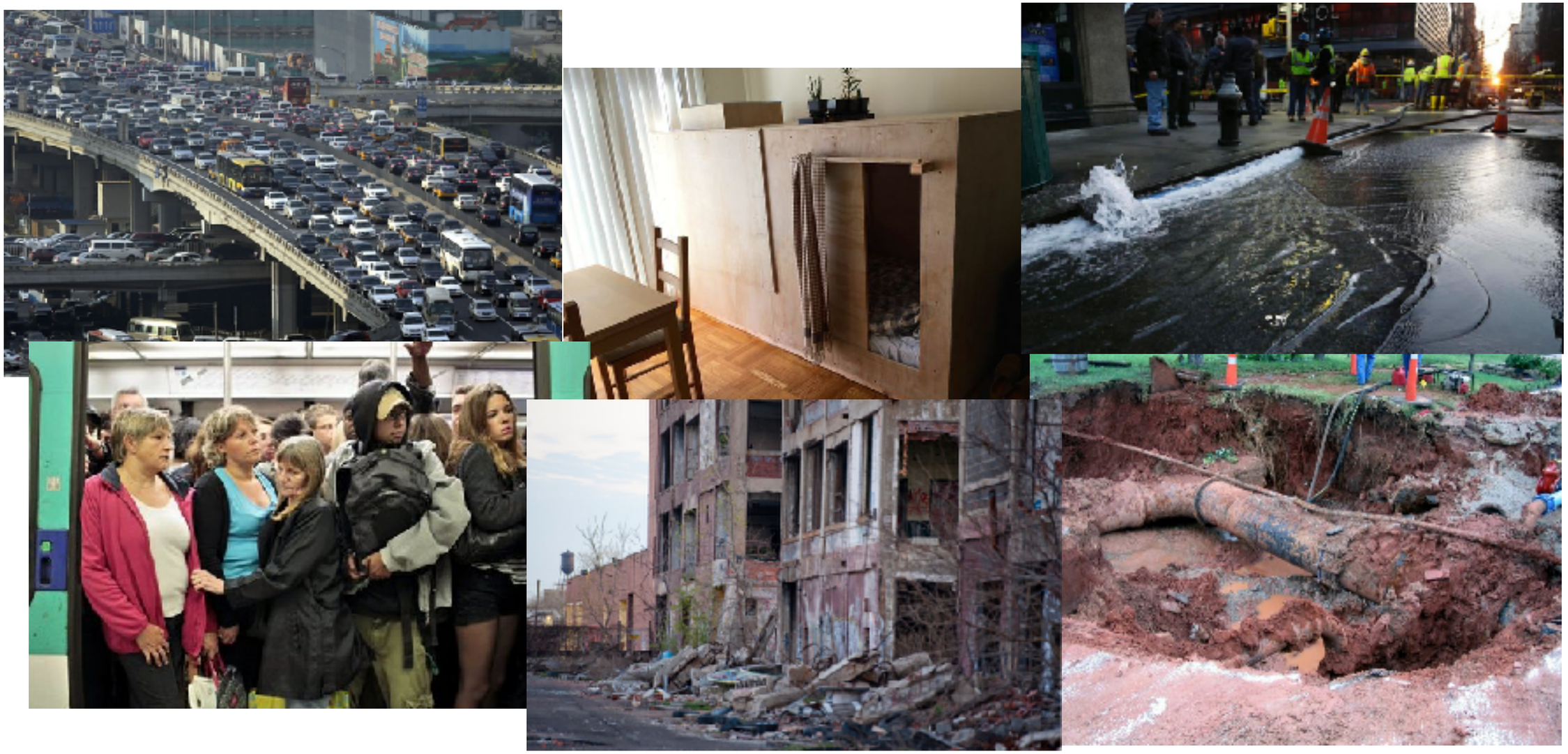
4. **What are potential opportunities and implmentation challenges for CePACs in the U.S.?**

CePAC—Certificate of Potential Additional Cnstruction

U.S. Infrastructure Context

U.S. Infrastructure Financing Challenges

Increased Burden on Local and Private Sector



Trump's $1.5T Plan leverages $200B federal for $800B local, $500B private sector funding

Local Governments

- 64 out of 75 largest U.S. cities operate in red
- Top 75 cities have $355B in total outstanding debt
  - 2/3 in UPL, rest mostly in OPEB
- "Kick the can"—Infrastructure spending most vulnerable

Private Sector

- Mostly in P3s
  - Not always cost effective, often political
  - Financing/delivery solution not funding/revenue solution

CePACs incur no additional public debt;
Engage private sector for revenues not financing

UPL—Unfunded pension liability; OPEB—Other post-employment benefits

CePAC—Quick Overview

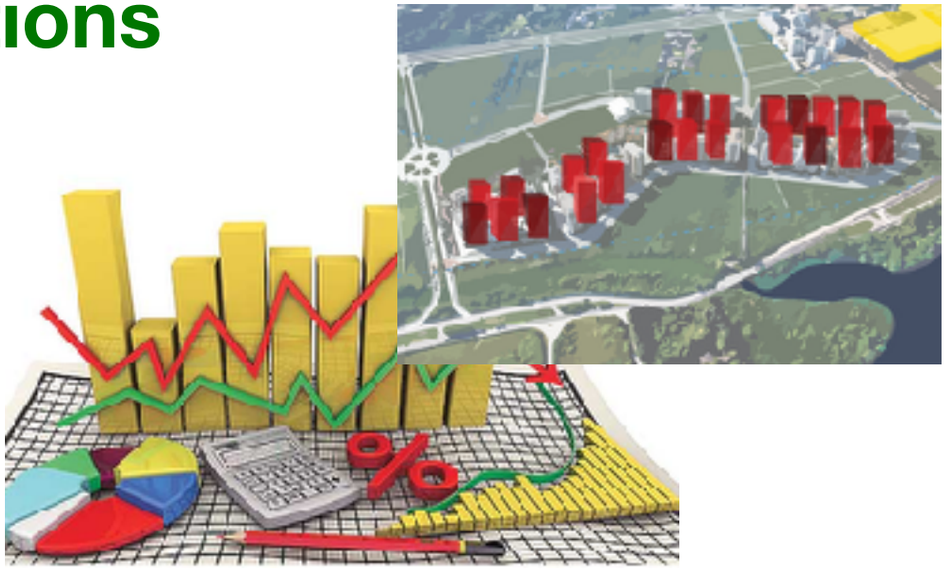
What is CePAC?

- Certificate of vested land use entitlement for a unit space (~10 sq.ft.)
- Created through upzoning above existing FAR
- Top-down, policy-driven to encourage smart growth, TODs
- Issued for designated areas only—prime locations that can attract private investments
- Monetized (value capture) by selling to property owners, developers, investors
- Sales proceeds used for public improvements early and within the designated area

FAR—Floor area ratio; TODs—Transit-oriented developments

How does CePAC work?

- Issued by municipalities, but not a debt instrument
- Designated local agency, typically RDA-like
- Commodity-like security similar to emission trading
- Sold and traded in stock market through open public auctions
- Also used as pseudo-currency to pay private contractors, sold in closed auctions
- Secondary trading, secondary market potential



RDA—Redevelopment agency

Comparing CePACs vs. Land Value Capture Tools in the U.S.

“Land Value Capture”

A policy tool that enables public sector to recover and reinvest land value increases generated by infrastructure investment and other government actions

Land Value Capture Tools in the U.S.

Taxpayer Pays

Property Tax/Tax Increment Financing (TIF)
• Property tax most basic LVC but need enabling framework • TIF enables capture of property value increases for public improvements by earmarking incremental tax revenues • No new taxes to property owners but incremental tax revenues not guaranteed • Taxpayers beholden to TIF liabilities if revenues fall short • TIF usage over-extended and over-leveraged
CePACs vs. Property Tax/TIF
• CePACs do not rely on taxpayers or local general fund • CePAC supply and demand controlled by local gov't • Revenue captured at the beginning ("concurrency" benefit)

LVC—Land value capture

Land Value Capture Tools in the U.S.

Property Owner Pays

Special (or Benefits) Assessments

- Public improvements paid by property owners through benefits assessments
- Wide usage—residential, BIDs, rail transitsystems, TODs
- Assessments can vary greatly, often politically driven
- Often contested, court rulings created more restrictions
- Benefits must be “unique, mesurable, and direct”, burden of proof on local governments

CePACs vs. Special Assessments

- CePACs apply only for designated areas
- CePAC purchases are voluntary and market-based, not mandated

BID—Business Improvement District

Land Value Capture Tools in the U.S.

Developer Pays

Developer Exactions

- Directly linked to conditions of land use approvals/permits
- (1) Land dedication, (2) in-kind contribution, and/or (3) in-lieu fees; impact fees most common but lack uniformity
- Voluntary and negotiated, not mandated
- Legal/constitutional per "regulatory takings"—essential nexus/rough proportionality test (*Nollan*/*Dolan*/*Koontz*)
- Developers pay in downcycle, property buyers in upcycle

CePACs vs. Dveloper Exactions

- Both entitlement focus, same legal/constitutional grounds
- CePACs value-based per market perception, not on cost of mitigating negative impacts
- Larger investor base to share early financial risks

Land Value Capture Tools in the U.S.

Contract Based

Development and Community Benefits Agreements

- DAs and CBAs voluntary contracts; more flexible, less litigious
- DA—large upfront contribution in exchange for vested rights; easier to secure financing, exempt from takings
- CBA—social amenities in exchange for project support/ acquiescence; often used in conjunction with DA
- Most effective for large, long-term, multi-phased projects
- Lack of transparency, untested legal/constitutional basis

CePACs vs. DAs/CBAs

- Both monitization of vested rights
- CePACs market-based rather than bilateral negotiations
- CePACs provide complete transparency

DA-Development Agreement; CBA—Community Based Agreement

Land Value Capture Tools in the U.S.

Regulatory Incentives

Land Use/Zoning Incentives

- Zoning changes used as incentive to maximize exactions
- Approval rate high where MP outdated, also used as political tool
- Air rights/TDR—free, leased or sold; value capture from increase in property tax revenues and/or proceeds
- Density bonuses for affordable housing
- Vested rights for long-term projects

CePACs vs. Land Use/Zoning Incentives

- CePACs intersect with zoning changes, air rights, density bonuses, vested rights
- Key question: who owns the rights above by-right zoning?

TDR—Transfer of Development Rights

Potential Opportunities

Infrastructure Policy Perspective

- No impact of local governments' debt burden
- No new taxes for tax payers
- No new assessments or levies for property owners
- Potential to spread out early financial risks for developers
- New means to invest in real estate and infrastructure assets for investors/lenders
- Potential new opportunities for builders
- Innovative approach making LVC tool box more robust
- Encourage private sector participation on revenue side
- Increased transparency
- Less regressive when compared to property taxes

Potential Applications/Market Size

- Smart growth setting in urban/suburban areas
  - High density TODs with continued upzoning needs
- Large scale planned developments in suburban/ exurban areas
  - Special zoning stds, subdivisions, vested rights
  - Alternative to DAs
- Formal non-episodic zoning changes
  - Attracting new businesses, affordable housing
- Transfer of Development Rights (TDR)
  - Receiver site infrastructure needs
- Publicly owned land—can avoid takings concerns

Potential CePAC Investor Perspective

- Current investor focus on brownfield, lacking greenfield development finance
  - Equity assets in RE funds or AIFs (hi risk/hi return)
  - Debt assets in muni bonds (low risk/low return)
- CePACs risk/return in between AIFs and muni bonds, provide opportunity to diversify risk
- CePAC monetization for investors
  - Sell in secondary market or participate in development projects
  - CePACs issued in multiple tranches, significant value appreciation in each successive auctions
- Return proposition better than current "project-no project" binary situation

RE—Real Estate; AIF—Alternative Investment Funds

Zoning Budget, Commoditization

- Use of CePACs in managing "zoning budget" for affordable housing
  - Uneven political playing field in favor of down-zoning
  - Ensuring upzoning by integrating and enforcing the needs through CePACs
- Long term outlook: commoditization of land use entitlements
  - Secondary market potential tied to ability to commoditize, provide increased liquidity
  - Current trends favor commoditization—shared ownership, away from direct liability, increasing rental population
  - Potential for retail investors?

Implementation Challenges

Political Resistance, Investor Buy-In

- Political resistance
  - Lack of knowledge, misconceptions, private sector mistrust, uncertainties about outcome
  - Resistance to increased transparency
- CePAC buyers (landowners/developers/investors) bear most of market risks and their buy-in a prerequisite
- Risk of no developments
  - CePACs for high demand, highly desirable areas
  - Early infra provisions strengthen value appreciation
  - Property values increase whether buy CePACs or not
- Modifications to CePACs to reduce investor risks
  - Buy back options, tighter vested rights provision, more locational flexibility

Compliance with Planning/Approvals

- CePAC zoning changes must accompany master plan amendments
- Two-tier environmental clearance/approval process
  - Programmatic EIS/EIR when CePACs issued (land use entitlements)
  - Project-level EIS/EIR when projects implemented
- Compliance for multi-phase planned developments
  - Subdivision, tentative map, vested right approvals
  - Specific plans/zoning standards developments
- No different than current approval standards for land use and zoning changes

Legal/Constitutional Issues on Takings

- Takings doctrine re ownership of development right above by-right zoning
  - Publicly owned—no taking, CePAC purchase voluntary and market-based pricing
  - Privately owned, non-speculative—same takings concern as exactions but market transparency
  - Privately owned, speculative—potential uncharted takings concern, just compensation for air right?
- Per Sao Paulo, current owners are not negatively impacted with or without CePAC purchase
- Experienced owners rarely go to court, CePACs provide better value capture rationale than exactions?
- Potential holdouts re vested rights, need for term limits?

CePAC Classification/Legislation Needs

- How CePAC is classified and whether existing legislation enables or restricts CePAC transactions critical factor
- CePAC as financial security under federal securities law
  - Municipal security—registration/reporting exemption, anti-fraud provisions, intermediaries registration
  - Commodity-like—non-debt muni instrument, tax-exemption on interest income don't apply
- Potential options for administering CePAC transactions
  - National-level formal commodities exchange
  - State-wide clearinghouse, e.g., cap-and-trade in CA
  - Local auctions adminstered by local issuing agency
- Relevance of blue sky laws and Dillon Rule need to be further assessed for different states

Capacity Building, Scalability

- Capacity building needs at federal, state, local level
  - Depends on how CePAC transactions are administered
  - At local level, independent agency or embedded within existing department, coordination with treasury critical
  - Need for intermediaries/advisory community
- Scability concerns given land use and zoning issues are inherently local, episodic, political

Conclusions and Recommended Next Steps

Summary of Findings

- **Upside**
  - Improve upon existing tools, making LVC solutions more robust
  - Generate funding for local and private sector
  - Particularly suited for smart growth, TOD trends
- **Downside**
  - Political resistance due to knowlege gap, uncertainty
  - Potential legal/constitutional issues on takings doctrine
  - Complexity in CePAC classification/administration, legislative and institutional capacity building needs

Recommended Next Steps

✓ **Benefits sufficiently large to warrant further examination for potential limited applications with modifications**

- **Publicly owned land**
- **High-density urban/suburban settings—TODs, TDRs**
- **Managing zoning budget for affordable housing**
- **Local land use entitlements with better value capture rationale**
- **Catalyst to trigger lagging private investments in TODs**

Questions?