

Value Capture for Transportation Finance in Minnesota: Untapped Potential or “Field of Dreams”?

Executive Summary

This Issue Brief examines the practice and potential of real estate “value capture” as a way to fund transportation infrastructure in Minnesota. As states struggle with highly stressed transportation finance systems, transportation agencies and think tanks around the country are generating considerable new attention to this very old idea. We explore the current practice of value capture and assess this idea’s potential to make a substantive and sustainable contribution to Minnesota transportation funding.

Value capture has very deep historical roots and more than a century of discussion and practice in public finance. Capturing land value wealth created by government action and using this “unearned benefit” to pay for government services scores well on tax policy and public finance principles. Specific value capture strategies fall into two general categories based on their application: 1) general finance value capture in which property wealth arising from public investment is continually captured for general public finance purposes; and 2) project finance value capture in which property value created by a specific public project – like new transportation infrastructure – is captured to help pay for its capital and/or operating costs.

The practice of value capture, however, often features considerable technical, administrative, and political obstacles that help explain why it is frequently described as a “new” or “emerging” idea despite a century and more of practice. Five major implementation challenges are:

- The difficulty of determining – and defending – land values, especially for already improved properties.
- The difficulty of determining the impacts transportation improvements have on land value in isolation from all the other factors that may cause land values to rise – or fall.
- The difficulty of projecting land value appreciation accompanying a planned infrastructure investment.
- The new legal and administrative infrastructure and the political support necessary to support value capture.
- The existence of “wipeouts” as well as “windfalls” from public investment, which complicates the politics of value capture.

Project finance value capture strategies include special assessments, tax increment financing, and impact fees. These tools are already a very familiar and standard, if often controversial, part of existing local development and infrastructure finance practice. They have been successfully used around the country for larger projects like transit development. But their extension into larger transportation infrastructure projects presents new complications. Such projects generate considerable general benefits to society as well as special benefits to property owners triggering potential legal issues as well as making cost allocation more difficult. In addition, the complications of measuring property specific benefits (especially when the value to be recaptured does not yet even exist), properly defining benefit zones, and obtaining the new legal authority, political cooperation, and administrative/technical skill sets needed to support these efforts are not inconsequential.

Yet we conclude the greatest challenge to a more expansive and aggressive use of value capture for transportation finance is likely the degree to which value capture is already being used in public finance. Local property taxes are a value capture tool, generating higher property tax bills over time for properties receiving “windfall” benefits from new infrastructure. Local

governments already use project finance strategies like exactions, fees, special assessments, to fund local infrastructure. Regional tax base sharing (Fiscal Disparities) captures and redistributes considerable value in areas where transportation value capture may be of most interest.

Multiple layers of value capture creates the potential for new development to pay above and beyond its obligations under even the most aggressive “pay its own way” development theory. Moreover, such “triple dipping” into the value pool portends much more modest cost recovery than planning projections may suggest. All this suggests policymakers need to give extreme care to the design and level of special assessments, fees, and related mechanisms to avoid major distortions and considerable harm to property development markets.

If there is new ground to be broken in the application of value capture for public infrastructure generally and transportation finance specifically, it may lie in general public finance recapture through some form of a statewide capital and real estate windfall tax (CREWT). Establishing such a tax would entail its own significant set of design and implementation issues and vigorous resistance from many stakeholders. But there are advantages. When a transaction occurs, an increase or decrease in land price becomes ascertainable minimizing the ambiguity surrounding the value available to be captured. Compared to the administrative and technical complexities surrounding project finance value capture efforts, a state-level CREWT whose proceeds flow through existing state special transportation accounts for distribution in some desired way seems relatively elementary. And perhaps above all, the “ability to pay” problems which plague all project finance value capture efforts targeting existing property owners are mitigated because the tax is paid only when the gain is realized.

Introduction

With the adequacy of traditional transportation finance workhorses like the gas tax in question and general funds under relentless pressure, states are looking at new ways to pay for transportation infrastructure. One idea receiving considerable attention, both in Minnesota and elsewhere, is “value capture.” In this Issue Brief we examine the potential this idea holds as a practical and implementable strategy for financing transportation infrastructure in Minnesota.

We discuss the concept itself and its historical practice in public finance. Based on a review of academic literature and case studies from the United States we summarize the primary challenges in making value capture a substantive and sustainable part of Minnesota transportation funding. We then examine three specific value capture strategies currently receiving attention in light of these challenges and offer some final conclusions and recommendations.

Our focus in this brief is on the general strategies, structures, and practice of value capture. We fully recognize that value capture often entails significant and complex legal issues that are highly relevant to their potential application in transportation finance. Although a review of these legal issues is beyond our expertise, we note that these considerations are no less critical to the successful implementation of these strategies.

Value Capture: What is it and How Has it Been Used?

It has long been understood that public investment in infrastructure increases the value of real estate (and private wealth accordingly). Value capture is the identification and capture of the increase in land value resulting from this public investment.

Capturing land value appreciation from public investment scores well on tax policy and public finance principles. The strategy is rooted in the “benefits received” principle of taxation – those who directly benefit from government investment should also help pay for it. A Brookings Institute study in 2011 on land value capture described its adoption for transportation finance in terms of “a virtuous circle”. “Infrastructure creates access, access creates value, value can be captured to finance infrastructure and therefore to create further access, and thus value”¹ Moreover, land value taxation is an efficient tax. Unlike labor and capital, land cannot move to escape taxation. Because the supply of land is inelastic, it will not deter production, distort market mechanisms or otherwise create deadweight losses the way other taxes do. For all these attributes, support for land value capture can be found across the political spectrum. Although its strongest modern day supporters are found within the progressive community, noted conservative economist Milton Friedman bestowed perhaps the highest praise he can muster for government taxation in calling a tax on land value “the least bad tax.”

Despite the heightened attention now being given to the topic, value capture has very deep historical roots and more than a century of discussion and practice in public finance. In his book *Progress and Poverty*, influential mid-19th century politician and political economist Henry George argued that people legitimately own the value they create, but the value of land belongs equally to all humanity. Governments, he argued, should capture that “unearned increment” – wealth created by the collective actions of society – and return it to the benefit of all through a tax on land value. The concept of value capture is also the basis for the modern property tax. There is overwhelming evidence that spending on public infrastructure and amenities like schools, roads, parks etc. is reflected (i.e “capitalized”) in higher private property values. The property tax effectively functions to capture some of that value and return it to public coffers for the maintenance and support of the public infrastructure and services which helped create the property wealth in the first place.

Nor is value capture by any means a new idea specifically with respect to transportation funding. Although transportation agencies and think tanks have described it as an “innovative” and “emerging” strategy in transportation finance, a more accurate adjective might be “ancient” as demonstrated by this excerpt from a New York Times editorial 85 years ago:

Although transportation agencies and think tanks have described [value capture] as an “innovative” and “emerging” strategy in transportation finance, a more accurate adjective might be “ancient”.

Nor will there be any quarrel with the City Affairs' Committee conclusion that "the logical source of new revenue to finance the subway system is the specifically benefitted land the value of which is increased by transit facilities." Chairman Delaney of the Board of Transportation advocated that theory in 1928. Three years earlier, Colonel William J Wilgus had put his idea of a fair division of transit costs with these suggestive words, "To place the full burden of rapid transit service on the passenger does not seem just, in view of the collateral advantages which flow to neighboring property owners in the form of enhanced land values, and to business interests and the public at large by reason of increased prosperity and convenience....An equitable division of the cost of service between the passenger through his fare, the neighboring property owner through assessment, and the business man and citizen through general taxation should make feasible the expansion of rapid transit facilities without weighing to heavily on any of the interests affected."

New York Times, December 12, 1930

Two Types of Application

Value capture strategies can be grouped into two general categories based on their application. "Type 1" is general public finance value capture – the continuing capture of new property wealth arising from public investment for general public finance purposes. There are two primary forms of Type 1 value capture mechanisms:

- "Split rate" property tax systems or "site value taxation" in which the tax rate applied to the land value component of a parcel is a higher than the tax rate applied to the building value of a parcel.
- Capital and Real Estate Windfall Taxes (CREWTS), which include various types of efforts to capture increases in real estate value resulting from a change in the ownership or status of land (e.g. zoning). These efforts focus just on capturing the increase in the value of land and are therefore much narrower in scope than a capital gains tax.

Like all forms of property taxation, the split rate property tax is an on-going – albeit "turbocharged" – value capture mechanism based on total value of real estate. In contrast, CREWTS are one-time, event driven mechanisms.

"Type 2" is project-based finance value capture in which property value created by a specific public infrastructure project is captured to help pay for the cost of that project. This more narrowly focused, case-specific application of value capture is the subject of most transportation finance investigations and applications. Strategies in this group include:

- Special assessments
- Tax increment financing
- Development impact fees

"A clear, transparent, and reasonably fair implementation strategy is critical to deriving the theoretical benefits of land value capture."

Unlike site value taxation and CREWTS, Type 2 strategies are already a familiar and standard part of the property development and public finance lexicon. Their well-established presence again speaks to the idea that, perhaps contrary to general public perception, "value capture" in some form has been and continues to be an integral part of local development and infrastructure finance.

With this considerable history and all the theoretical and policy advantages going for it, why is value capture for transportation finance still so often described as an "emerging" idea? The answer is that the actual practice of value capture often features considerable technical, administrative, and political obstacles. In the words of one recent study of value capture application in transit finance, "a clear, transparent, and reasonably fair implementation strategy is critical to deriving the theoretical benefits of land value capture."ⁱⁱ Over the idea's long history, this has proven much easier said than done.

Turning Theory Into Practice: Five Challenges

Our review of the literature on value capture generally, and on value capture for transportation finance specifically, identified five primary challenges. The significance of these issues with respect to successful value capture depends in part on whether the effort is a Type 1 or Type 2 application.

- 1. The difficulty of determining – and defending – land values, especially land values on already improved properties.** Property assessment for either a market transaction or tax purposes produces an estimate for both the land and improvement portion of a property, which are combined to determine the total assessed value. However, isolating and determining the land value component – which should be the focus of value capture – has long been recognized by scholars as a complex task and in practice is often based on a crude or imprecise estimate. Even though econometric models can be used to attempt to calculate land value in a more rigorous manner, such use in assessment practice is uncommon. Moreover, the practical challenges of adequately defending such estimates in an appeals process have been a longstanding concern in the assessment community.
- 2. The difficulty of determining land value impacts from transportation improvements separately from all the other factors that may cause land values to rise – or fall.** Land value is determined by several factors besides public investment in infrastructure, including changes in land use regulation, site factors like topography and soil conditions, population growth, general inflation, general economic conditions, real estate cycles, and private investment. Most value capture efforts do not attempt to allocate existing land value to different causes but instead focus on the change in value with respect to a particular time bound action – like a transportation project. But even within a specific project time frame, multiple and significant influences can be at work. As one scholar has noted, “Arguably only when a property changes hands does an increase or decrease in land price become fully ascertainable, but even then sorting out the value of the investments in improvements versus locational advantages is problematic.”ⁱⁱⁱ
- 3. The difficulty of projecting land value appreciation accompanying an infrastructure investment.** An exhaustive examination of the theory and practice of land value capture written back in 1979 said with respect to transit value capture, “almost nothing is known about the precise way property value increases are spatially distributed around stations. There does not seem to be any empirical work on the subject.”^{iv} Since that time, empirical studies have been done and econometric modeling has been used to project land value growth associated with many types of transportation infrastructure projects.^v Scholars have used these estimates to estimate the amount of project cost value capture may be able to cover.

However, these investigations are seriously limited by a failure to factor in the significant influence real estate market forces, conditions, and regulations have on the creation and ultimate capture of value. Depressed real estate markets directly impact land values. Local zoning ordinances affect development returns, which in turn get capitalized into land values. Moreover, there is a feedback loop with the adoption of many value capture policies. “How” value is captured, “when” that value is captured, and “how much” value is captured has potentially major implications for the nature and timing of development itself. Any value captured by government within the context of land development or redevelopment is recognized in the negotiation process between the buyer and seller. Depending on the required rates of return for both parties and the value capture ambitions and mechanisms of government, value capture can affect the economics of development proposals, the timing of development – and even the decision itself to proceed with development at all. The likelihood of these circumstances occurring increases when value capture for transportation is overlaid on top of existing local value capture efforts (development fees, exactions for local roads, utilities, sewer, parks, etc.) already imposed on developers.

“How” value is captured, “when” that value is captured, and “how much” value is captured has potentially major implications for the nature and timing of development itself.

4. **The new legal and administrative infrastructure and the political support that must be assembled to support value capture.** Depending on the type of value capture mechanism chosen, considerable new investments of time and resources may be needed to support its practice. These include enabling legislation or modifications to existing statute, new types of institutional and professional capacity to implement the value capture mechanism, and above all political support for these changes.
5. **The existence of “wipeouts” as well as “windfalls” from public investment complicates the politics of value capture.** Infrastructure projects can lead to “worsenments” as well as betterments. Noise, congestion, and related nuisance effects from being too close to new or expanded highways, rail lines, or transit hubs can offset increased locational benefits. For example, in a MN DOT-sponsored study on using value capture to expand Highway 610, researchers found a negative association between proximity to transit stops and assessed values as well as property tax contribution. Under the present system, government is not liable for “worsenments” its projects cause on adjacent properties. Scholars have argued that land value capture should also be seen as a financing tool for wipeouts and as a way to internalize the cost of government actions in addition to whatever public financing role it can provide.^{vi} The politics of an aggressive push for more value capture ideas seem predictable: if government increasingly asks property owners to reimburse it for the costs of infrastructure improvements based on resulting land value appreciation, it is almost axiomatic there will be an increasing interest to compensate landowners for reductions in property values stemming from all types of government action.

These challenges have made Type 1 value capture a relatively rare practice in the United States. On the other hand, Type 2 capture is already a very familiar and standard part of existing development practice. But their extension into larger, more complicated transportation infrastructure projects, which convey considerable general benefits to society as well as special benefits to nearby property owners, presents new complications.

Common Value Capture Tools

Following is a look at three of the more common value capture tools currently employed in transportation finance and some key implementation issues and considerations associated with their use.

Special Assessments

Special assessments are levies that finance at least part of the cost of a public improvement. Importantly, the use of special assessments demands the existence of “special benefits” – benefits that can be ascribed to specific parcels of property. Traditionally, special assessments have been used almost exclusively for local infrastructure projects such as street repair, curbs and gutters, streetlights, and storm drains where there is a clearly identifiable relationship between the project and the benefit a property owner receives. In theory, the assessment is in proportion to the benefit received by each parcel. In practice, because measuring benefit is difficult, charges are usually apportioned according to a rule of thumb, such as frontage, to derive a fair share of assessment cost.

Special assessments have become an increasingly popular tool to fund public transit. The table on the next page summarizes three of the more notable projects over the last decade or so employing special assessments. Portland, Charlotte and Atlanta are among other cities using this value capture approach to fund local transit projects.

| Location | Project Description | Key Assessment Design Features | Payment Options | Share of Total Project Cost Funded by Assessments |
|-----------------|----------------------------|---|--|---|
| Seattle, WA | 2.6 mile streetcar line | 5 fee levels based on distance to streetcar line | All upfront or 18 years at 4.4% | 52% |
| Washington, DC | New subway station | Only commercial properties within ½ mile of the new station | Fixed amount over 30 years | 23% |
| Los Angeles, CA | Downtown Metrorail segment | Only commercial, vacant land, and parking within ½ mile of new stations | Ave. 25 cents per square foot for 17-year assessment period. Early payment discounts | 9% |

Source: *A Decision Support Framework for Using Value Capture to Fund Public Transit: Lessons from Project Specific Analyses*. Mineta Transportation Institute, May 2012.

These and related projects also illustrate that the extension of special assessment practice into transportation finance introduces some complicated issues that must be carefully considered before embarking on this strategy.

How do you determine how much of the project cost should be paid by special assessments? As noted, special assessments require the existence of “special benefits” that can be ascribed to specific parcels of property. But unlike traditional projects funded with special assessments in which the linkage between the project and the benefit to a particular property owner is quite clear, large transportation projects also create substantial “general benefits” which are diffuse and accrue to the community as a whole and should be financed with general taxation.

A major challenge with using special assessments to recapture value is that the “special benefit” is unknown at the time of assessment.

How do you measure the special benefit and apportion the assessments accordingly? A major challenge with using special assessments to recapture value is that the “special benefit” is unknown at the time of assessment. Although a change in a parcel’s market value can be a legitimate basis for meeting the special benefits test, a special assessment based on recapturing value that does not yet exist may be legally problematic and politically controversial. The host of other potential factors affecting land value changes described earlier exacerbates this challenge.

The way this issue was addressed in the case studies above is informative. In the Washington, DC example, the entire 30-year special assessment schedule was based on the 2000 assessment year. As a result, each property paid special assessments in proportion to its circa 2000 value over the entire 30-year period, regardless of how its value changed relative to others in the assessment district over time. Los Angeles circumvented the problem by having properties pay assessments on a simple per square foot basis. Both strategies function to meet their project’s needs, but both represent how practical implementation issues dilute the premise of “value capture” and make the term as much a marketing label as policy practice. Only in the Seattle example was the actual assessment based on estimated future increases in property values resulting from the introduction of the streetcar system.

Should the assessment base be land value only or land plus improvements? Both theory and empirical studies have shown that value appreciation from infrastructure accrues to land much more than buildings or improvements. Yet as noted earlier, isolating and defending land value of already developed parcels is a difficult task. It may be administratively simpler to use total property value as the base for the special

assessment, but in doing so the gulf between theoretical rationale of targeting the “unearned increment” in value capture and actual practices widens.

How do you identify the benefit zone – the size and shape of the assessment district? Drawing precise boundary lines around where transportation improvements will result in land value appreciation is not only an empirically challenging task but likely politically controversial as well. Boundary lines introduce the possibility of “cliff effects”, creating development distortions and equity issues with nearly identical properties being treated very differently. Graduated assessment zones, such as those employed in Seattle, can help mitigate these effects but cannot completely resolve the issue.

Local jurisdictions in Minnesota already have authority to use special assessments to pay for transportation projects, but state law does not provide for the use of special assessments to help finance major road or transit projects. A review of the evolution of statutory authority around the country suggests a host of considerations deserve careful thought if policymakers revamp special assessment statutes to enable “transportation assessment districts” including:

- Design of investigations and hearing processes
- “Majority protest” provisions
- Treatment of exempt properties in the assessment district
- Relationship to other taxes (e.g. interest exemption and deductibility)
- “Ability to pay” circuit breakers / deferments

The experience of other states makes it clear that the importance of creating mechanisms to address property owners’ concerns and engage them in the process cannot be over-emphasized. Special assessment districts require not only that property owners tolerate the noise, disruptions, and inconvenience transportation projects bring, but also that they directly fund these project-related nuisances based on gains in their property wealth which can’t be directly used to pay the assessment. Moreover, these gains in property wealth – which remain prospective – will also likely generate higher annual property tax bills. Obtaining property owner support in light of these realities has proven to be the cornerstone of successful special assessment efforts.

Tax Increment Financing (TIF)

Tax increment financing is another very familiar existing tool now being considered to specifically address transportation finance needs. Like special assessments, governments implement TIF by creating a geographic district. Upon creation, the assessed value within the district (land only or land plus improvement) is frozen for a period of time. As development occurs both property tax values and revenues in the district increase. The increment (new taxes minus the tax based on the frozen values) is redirected to the TIF district to fund the project (or the bonds used to finance it).

Historically, governments have used TIF as an economic development and redevelopment tool, and its practice is ubiquitous across the United States. Examples abound of cities and redevelopment authorities employing TIF to help pay for transportation related infrastructure and related projects like transit oriented development as part of a larger redevelopment and urban rehabilitation initiative. TIF districts dedicated exclusively for transportation project finance appear to be far less common. One example is Texas’ “Transportation Reinvestment Zones” (TRZ). In a TRZ, a special district is created associated with a roadway project. As with all TIFs, the incremental revenue from property tax growth over time is used to service the bonds that were issued to fund the roadway project. Notably, the Texas A&M Transportation Institute gives TIF a score of “3” on a 5-point scale for transportation finance sustainability and a score of only “2” for transportation finance reliability. The latter score is likely a function of one of the challenges highlighted earlier regarding value capture – unanticipated economic decline and real estate supply and demand realities can reduce revenue available to service bonds.

Since transportation project TIFs do not materially differ from “traditional” economic development TIFs, the extensive literature on this topic would also apply to transportation focused TIF districts. Scholars have noted “in theory, TIF creates a perfect closed system of self sustaining finance, a textbook example of ‘value

capture’.^{vii} But these same scholars have noted a crucial (and politically gamebreaking) problem with TIF which undermines the theoretical idea of being a self financing device that doesn’t raise taxes – tax shifting to areas outside the TIF district. Because dedicating the tax increment requires the property tax base within the district to be frozen, affected jurisdictions must either impose higher effective tax rates in areas outside the TIF district or reduce funding for public services relative to the funding that could be realized if the TIF were not in place. The political reality is that budget-stressed local governments of all types are extremely unlikely to acquiesce to any move that would allow MN DOT or some other new transportation authority to tap into their primary revenue base for a transportation improvement project. This is especially true in the seven-county metro area where these potential problems are magnified by regional tax base sharing which already captures and redistributes considerable amounts of property value.

TIF also entails considerable design considerations. Two issues associated with special assessments – the appropriate assessment base and the shape and size of the district – also apply to TIF. In addition to new enabling legislation, project histories suggest the need for brand new institutional capacity to plan, create and manage a new TIF district. As one review of TIF in transportation finance noted, “TIF is complex often requiring the expertise of municipal bond financing experts, economic development experts, real estate appraisers, civil engineers, financial analysts and consulting planners.”^{viii}

Whether “transportation TIF” can and should play a major role in financing transportation infrastructure going forward is clearly in the eye of the beholder. Perhaps no other transportation finance strategy seems to engender such significant differences of opinion. Some reports enthusiastically cite TIF accomplishments as justification for pursuing value based mechanisms to finance transportation infrastructure. Other public finance scholars, with no direct connection to transportation issues, view the same case studies and TIF generally with a much harsher and critical eye, noting the impact on other services.

Impact Fees

An impact fee is a charge on new construction that attempts to recoup a proportionate share of the cost of public investments from those that benefit from them. Unlike development exactions, which are generally payments or contributions that developers and a local government negotiate, impact fees are typically based on calculations of the costs of delivering public services to new development. Governments have used impact fees to finance a wide variety of infrastructure and services. Similar to the “special benefits” requirement for special assessments, impact fees not only must have a direct relationship to the development but there also must be “rough proportionality” between the size of the fee and the impact. Laws and court decisions across the country have created an uneven landscape for the use of impact fees. One study found that while Minnesota did not have legislation explicitly prohibiting the use of impact fees for transit, unfavorable court decisions have made them problematic.^{ix}

With respect specifically to transportation, the use of impact fees for roads and bridges appears to be far more common than for transit. The table on the next page summarizes four relatively recent examples of impact fees for transit use.

| Location | Purpose | Key Fee Features | How Fee is Determined | Share of Transit Project Cost Funded by Fees |
|--------------------------|---|---|--|--|
| Portland, OR | 10 year multimodal capital improvement plan | Assessed at time of permitting. Amount varies by development type and building characteristics | Calculation of number and cost of trips generated by development | Varies – Generally backfill strategy for what grants and assessments can't cover (3%-5%) |
| Aventura, FL | Expansion, operation, and maintenance of new express bus system | Applies to new Developments/ redevelopment and changes of use | Estimates of transit users for different types of development | NA |
| Broward Co., FL | Capital expenses and operating costs of transit | Based on land use and development size. Commercial uses charged on a square foot basis | Total peak hour trip generation multiplied by a constant dollar figure that represents cost per trip | About 17% of capital budget |
| San Francisco, CA | Capital Improvements triggered by new non-residential development | Charged prior to permitting of new development based on type of land use and square footage of building | Calculation of number and cost of trips generated by development. Adjusted by CPI | About 1.5% of San Francisco Transit Authority's total operating budget |

Source: *A Decision Support Framework for Using Value Capture to Fund Public Transit: Lessons from Project Specific Analyses*. Mineta Transportation Institute, May 2012.

As with TIF, impact fees used specifically for transportation purposes do not function in a materially different way from the “traditional” impact fees property developers have been paying for decades. Therefore the extensive literature and history on impact fees (well beyond the scope of this brief) and the accompanying policy issues – including legislative authority, impacts on affordable housing, impacts on land use decisions, etc. – should be reviewed in any pursuit of transportation impact fees. One issue, however, may represent a unique issue specifically for transportation finance. Impact fees are typically collected by a local government as part of the permitting process but transportation investments often come under the purview of a separate authority. According to one study, the close level of coordination needed between one or more governments and a transportation agency to charge impact fees “is rare.”^x

In addition to special assessments, TIF, and impact fees, scholars have classified several other project finance value capture tools. In a 2009 report to the Minnesota Legislature, the University of Minnesota Center for Transportation Studies created a typology of value capture options highlighting their potential applications and evaluating their use based on four criteria: efficiency, equity, sustainability and feasibility.^{xi} Some options – like joint development practices and negotiated exactions – have a very strong developer finance orientation to them. Others, like transportation utility fees, expand the concept of user charges to the delivery of transportation services.

Summary and Conclusion

The litany of problems plaguing transportation finance has been well documented – shrinking federal support, an increasingly impotent gas tax, and rising costs are three notable issues. But another major constraint is the growing reluctance to prioritize and support spending on new transportation infrastructure through governments’ general funds. Increasingly, the stated “ideal” from nearly a century ago of allocating an equitable share of responsibility between users, beneficiaries and “the business man and citizen through general taxation” is giving way to a paradigm in which users and beneficiaries are expected to pick up most – if not all – of the tab for financing new development infrastructure. The push for value capture is a consequence of this new political reality.

Increasingly, the stated “ideal” from nearly a century ago of allocating an equitable share of responsibility between users, beneficiaries and “the business man and citizen through general taxation” is giving way to a paradigm in which users and beneficiaries are expected to pick up most – if not all – of the tab.

Contrary to current perception, value capture is not a new idea. Rather, it is an extremely old idea in both theory and practice. Governments around the world, across the United States, and here in Minnesota have routinely employed this concept to finance public infrastructure projects. If there is true novelty associated with this concept today, it lies in the transportation-specific focus of its application, the scale of ambition regarding its proposed use, and its marketing – not in its function.

Can governments use Type 2 applications even more strategically and intensively to support larger scale transportation projects including those of a more multi-jurisdictional/regional nature? Possibly, but aside from overcoming their technical, administrative and political intricacies, the biggest challenge may be the degree to which existing efforts preclude further expansion of their use.

Significant amounts of value capture already occur in property development. For starters, an administratively sound, properly functioning property tax system does an excellent job of capturing value from public investment and returning it to the public coffers. If a new transportation project results in property value windfalls, the higher values will almost certain generate higher property tax bills for those parcels. The practical difference is that these revenues fund general government operations instead of being dedicated to special transportation accounts. As a result, from a public finance perspective, Type 2 value capture strategies might be better described as “value dedication” strategies.

Any additional Type 2 value capture efforts would likely magnify the effects of concurrent value capture initiatives by other units of government. Local governments would almost certainly continue their current efforts to use exactions, fees, special assessments, and related value capture mechanisms to support their own infrastructure requirements. And, as noted, regional tax base sharing (Fiscal Disparities) programs are already capturing and redistributing considerable value in areas where policymakers may most want to fund transportation infrastructure through value capture.

Multiple layers of value capture results in enormous administrative complexity and creates the potential for new development to pay above and beyond its obligations under even the most aggressive “pay its own way” development theory. Moreover, such “triple dipping” into the value pool portends much more modest cost recovery than planning projections may suggest. All this suggests policymakers need to give extreme care to the design and level of special assessments, fees, and related mechanisms to avoid major distortions and considerable harm to property development markets.

There are broader potential public finance implications worth considering as well. As one scholar has noted, “It may be a relatively small step from ‘It’s appropriate for me to pay for a special benefit I receive’ to ‘It’s appropriate for me *not* to pay for anything for which I do not receive a special benefit.’.... Expanding the use [of Type 2 value capture strategies] may contribute to the shrinking of the public sphere that is currently underway in the United States.”^{xii} If transportation finance through benefit capture becomes even more mainstream and ingrained in public consciousness, it raises the question of whether there are risks associated with justifying more and more of the financing of essential public services through special benefits capture. For

example, as baby boomers age and the number of retired households skyrocket will we begin to see arguments that these households should not have to pay for local schools since the education of children is a “special benefit?”

If there is new ground to be broken in the application of value capture for public infrastructure generally and transportation finance specifically, it may lie in Type 1 recapture through some form of a statewide CREWT. Establishing a state-level capital and real estate windfall tax would entail its own sizable set of complex design and implementation issues meriting very careful and thoughtful consideration. Moreover, vigorous resistance to the idea is almost guaranteed to come from many different types of stakeholders including local governments who already share the CREWT tax base through various forms of Type 2 value capture practices at the local level. But there are advantages. When a transaction occurs, an increase or decrease in land price becomes ascertainable so the ambiguity surrounding the value available to be captured is minimized. Compared to the administrative and technical complexities surrounding Type 2 value capture efforts, a state-level CREWT whose proceeds are credited to the existing special transportation accounts for distribution in some desired way seems elementary. And perhaps above all, “ability to pay” problems which plague all Type 2 efforts targeting existing property owners are mitigated because the tax is paid when the gain is realized.

ⁱ “Access for Value: Financing Transportation Through Land Value Capture”, Brookings Institute, April 2011

ⁱⁱ “Sustaining Mass Transit through Land Value Taxation? Prospects for Chicago,” Massachusetts Institute of Technology, Department of Urban Studies and Planning, May 2013

ⁱⁱⁱ “Land Value Capture and Justice” in *Value Capture and Land Policies*, Lincoln Institute of Land Policy, 2012

^{iv} “Special Assessments” in *Windfalls for Wipeouts: Land Value Capture and Compensation*, American Planning Association, 1979

^v For an excellent example of such an effort, see “Value Increase and Value Capture: The Case of TH 610 in Maple Grove, Minnesota” MN DOT, January 2014

^{vi} “Wipeouts and their Mitigation” in *Windfalls for Wipeouts: Land Value Capture and Compensation*, American Planning Association, 1979

^{vii} “TIF at a Turning Point: Defining Debt Down” *State Tax Notes*, May 2, 2011

^{viii} *A Decision Support Framework for Using Value Capture to Fund Public Transit: Lessons from Project Specific Analyses* Mineta Transportation Institute, May 2012

^{ix} “Use of Fees or Alternatives to Fund Transit” *Legal Research Digest 28*, Transit Cooperative Research Program, Washington, DC

^x *A Decision Support Framework for Using Value Capture to Fund Public Transit: Lessons from Project Specific Analyses*

^{xi} *Value Capture for Transportation Finance: Report to the Minnesota Legislature*, University of Minnesota Center for Transportation Studies, June 2009

^{xii} Commentary to “Special Assessments in California” in *Value Capture and Land Policies*, Lincoln Institute of Land Policy, 2012