TOD Infrastructure Finance and Delivery Strategy

State of Hawaiʻi | Office of Planning and Sustainable Development

Recommendations and Implementation Strategy

Phase 4 Report | December 2023

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Executive Summary

The link to the full report is available here: https://files.hawaii.gov/dbedt/op/lud/Reports/TOD_InfraFin_Strategy_20231221.pdf

Executive Summary

A key concern identified in the Hawaiʻi State TOD Strategic Plan is the lack of infrastructure in TOD areas needed to support affordable housing and mixed-use development across the State. Several State-funded studies have revealed the magnitude of the funding required for infrastructure improvements needed in these areas.[1] The State Legislature has also ramped up efforts to support development of infrastructure capacity to address Hawaiʻi's long-standing affordable housing crisis.[2]

Currently, infrastructure improvements are funded and constructed by individual developers in markets with favorable conditions or through Capital Improvement Program (CIP) investments when tax revenues and political will allow. The current process, while providing substantial resources, is fragmented and can produce inequitable outcomes. The scale of infrastructure needs requires more funding than what CIP and irregular infusions from the State can yield. In addition to current resources, Counties need tools that provide access to regular, large sources of funds, and financing that does not interfere with regular County bonding activity.

The State Legislature funded this study in recognition of the lack of sufficient funding for infrastructure – with a particular interest in examining the role of value capture and alternative delivery tools in filling gaps in the infrastructure funding and delivery capacity of Counties and the State to deliver TOD.[3]

Existing County and State funding for infrastructure is not enough to meet housing needs.

- Existing sources – even in good budget years – are just not sufficient for the infrastructure needed to support housing production goals.
- Counties have limited capacity to raise necessary revenues on their own.
- The State – as landowner and developer – needs to invest in infrastructure to expedite housing production.
- Additional tools are needed to supplement existing County and State resources.

Four TOD Pilot Areas were selected by their respective Counties for this study.[4]

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[1] These include the 2018 "State Transit-Oriented Development (TOD) Planning and Implementation Project for the Island of Oʻahu" commissioned by the Office of Planning (now the Office of Planning and Sustainable Development (OPSD)) and 2022 "State Infrastructure Improvement Master Plan for the Iwilei Area" commissioned by the Hawaiʻi Housing Finance and Development Corporation (HHFDC) and Department of Accounting and General Services (DAGS)

[2] These include 1) Act 48, Session Laws of Hawaiʻi (SLH) 2023, extending the timeframe for adoption of County GET surcharge ordinances, the Legislature acknowledged the need to increase funding for the counties to provide public infrastructure for housing development and 2) Act 184, SLH 2022 authorized a new TOD Infrastructure Improvement District Program under the Hawaiʻi Community Development Authority (HCDA) and established a TOD Infrastructure Improvement District Special Fund.

[3] Act 88, SLH 2021, Section 39 Budget Proviso.

[4] While this effort focused on pilot areas, the findings from and the financing tools identified for these pilot areas can be applied to other projects like Oʻahu's Aloha Stadium, or West Maui.

The study required consultation with key decision-makers and stakeholders who were formed into a Project Advisory Group (PAG) for the study. County Permitted Interaction Groups (PIGs) were also consulted throughout the project (please refer to Appendix 2 for agencies and individuals in the PAG and PIGs who participated in the study).

HR&A Advisors led the study, with the support of subconsultants PBR HAWAIʻI, KPMG LLC, Ashurst, Starn O'Toole Marcus & Fisher, and R.M. Towill (the Consultant Team).

The study started in June 2022 and spanned four phases, including:

- **Phase 1:** Reconnaissance and initial review of development opportunities and infrastructure needs in each TOD Pilot Area;
- **Phase 2:** Preliminary identification of funding, financing, and delivery instruments pertinent to the infrastructure requirements in the TOD Pilot Areas;
- **Phase** 3: An estimate of the potential funding and financing streams from funding and financing options in each TOD Pilot Area that could be implemented by County governments, consisting mostly of value capture tools such as Tax Increment Financing (TIF), assessment districts, and one-time fees, among others; and
- **Phase 4:** An implementation strategy for Counties and the State to streamline or allow for implementation of the tools and other measures to expand the funds available for TOD-related investments. This implementation strategy summarizes the findings from prior phases and recommends actions at the State and County levels to address infrastructure financing gaps and advance affordable housing and other development in TOD areas in each County and Statewide.[5]

Phase 4 culminated in this report. Reports for this and the other three phases will be available at the State of Hawaiʻi Office of Planning and Sustainable Development website.

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[5] As this study was in its final stages, catastrophic wildfires on Maui led to the deaths of nearly 100 people and the destruction of over 3,000 structures in August 2023. The fact that Maui officials continued to participate in this project speaks to their inner strength and understanding that now, more than ever, Maui will need infrastructure financing assistance. The full impact on Lahaina's water, sewer, and road systems is currently being assessed. Although Maui's TOD Pilot area – the Kaʻahumanu Avenue Community Corridor – was not physically impacted by the disaster, Maui's economy needs jumpstarting to ensure residents' livelihoods are protected and to promote sustainable economic growth. The concepts identified in the West Maui Community Corridor TOD planning effort may be useful to support recovery efforts. Large-scale infrastructure projects that contribute to Lahaina's rebuilding could benefit from some of the financing mechanisms discussed in this Strategy report.

In Phase 1, the Consultant Team identified redevelopment opportunities that would significantly expand the supply of housing, particularly of affordable units, within each of the Counties, but that first require important investments in terms of enabling infrastructure.[6] In particular:

- **Iwilei-Kapālama (Oʻahu)** has the potential to accommodate 27,500 new housing units, which require $667 million in upfront infrastructure investment to enable their construction;[7]
- The **Kaʻahumanu Avenue Community Corridor (Maui)** has a pipeline of 2,200 housing units, which require a water infrastructure investment of about $7 million;[8]
- The **Līhuʻe Town Core (Kauaʻi)** could accommodate the construction of 775 residential units but requires water and wastewater last-mile connections totaling $8 million; and
- The **Ane Keohokalole Highway Corridor (Hawaiʻi)** has a pipeline of 4,200 housing units, though it requires $462 million in upfront capital investments.

In Phase 2, it was clear that no County's infrastructure requirements are fully funded through existing programs, necessitating additional funding and financing tools. The Consultant Team identified a set of potential funding options (including project-level, districtwide, and countywide sources, as well as grants and government contributions), financing options (State and County debt, Federal loan programs, private options), and delivery models (from traditional procurement to public-private partnerships) for these infrastructure projects.

Among these options, the Consultant Team identified a specific set of instruments for further analysis that Counties could implement in the TOD Pilot Areas and in other priority areas, including TIF, special assessment districts such as Community Facilities Districts (CFDs) and Special Improvement Districts (SIDs), one-time fees (such as impact fees or development fees), Business Improvement Districts (BIDs), and earmarking of revenues produced from collecting General Excise Tax (GET) and Transient Accommodation Tax (TAT) County surcharges over retail and hotel expenditures derived from new real estate development activity in the TOD Pilot Areas.

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[6] The infrastructure costs identified are from a single point in time. These costs will naturally change, but the numbers provide insight into order-of-magnitude financing needs.
[7] The Consultant Team has not received complete information as to how much of this amount is already funded.
[8] There is likely additional water and wastewater infrastructure required to accommodate new growth, but individual projects have not yet been identified by the County.

In Phase 3, the Consultant Team then modeled the potential proceeds from implementing these instruments. From the analysis in Phase 1 to 3, the Consultant Team concluded that:

1. **Counties have a limited set of tools to raise the funds necessary to enable TOD**, given that a) in matters of taxation, they are only allowed to determine the rate of property taxes; and b) districtwide TOD funding tools – such as TIF, special assessment districts, etc. – are not suitable for all areas. Policy changes at the State level could provide Counties with new tools, while policy changes at the County level could streamline the implementation of tools already within their reach.
2. As opposed to most conventional funding sources, **value capture tools typically allow for ring-fencing[9] resources for specific TOD-enabling infrastructure,** which signals the commitment of public resources for infrastructure improvements in a designated area and increases certainty for developers to pursue housing and commercial development in those areas. Moreover, ring-fencing revenues generated within an area to pay for infrastructure for that area means that new development directly helps pay for the cost of that public investment.
3. **The implementation potential of districtwide tools is nuanced and varies depending on the market dynamics of each area and policies at the State and County levels.** In particular:
    a. TIF and CFDs can only yield significant revenues in areas with strong market and development potential, and their potential in areas where demand for market-rate residential and commercial development is low is limited. Moreover, the State constitution prevents implementation of TIF.
    b. Special Assessment Districts are viable only for market-rate developments with profit margins that are high enough for investors, tenants, and owners to absorb the cost of additional taxes or assessments (limiting their potential in affordable housing developments).
    c. One-Time Fees are applicable in the same financial circumstances as special assessment districts, but the existing regulatory frameworks in all Counties do not facilitate their widespread and systemic implementation. Moreover, one-time fees cannot support bond issuances and therefore are not viable for upfront financing.
    d. Earmarking GET and TAT surcharge proceeds originating from local development is not allowed by existing legislation, which determines the use of those proceeds by Counties. Moreover, State legislation does not

[9] "Ring-fencing" means reserving funds for a specific purpose.

authorize TIF districts to capture proceeds from these taxes, including both their base and surcharge components.

   e. BIDs in commercial centers can help increase market demand for residential and commercial development and thereby be a first step towards creating the market and financial conditions that make other districtwide funding tools viable.

4. **State-level measures are needed to provide further funding for TOD and supplement revenues from districtwide tools available to Counties.** These tools may not yield enough funds to support local infrastructure, given that their funding and financing capacity relies on market-rate and commercial development, which may not be in demand or may be financially unfeasible in areas requiring infrastructure investments.
5. **Value capture tools can provide greater flexibility in the eligibility of their uses than some traditional public funding** (such as GO Bonds, CIP, State grants, or Federal programs), which gives Counties more versatility in funding priority projects.

Phase 4 Recommendations. Based on this analysis, and as detailed in this report, the Consultant Team recommends ten legislative and administrative actions at the State and County levels to accelerate the funding, financing, and delivery of TOD-enabling infrastructure in the State.

While the key TOD financing recommendations focus on increasing the amount and reliability of funding available for infrastructure and housing development, this strategy also recognizes that implementing infrastructure financing and delivery programs requires understanding an area's development potential, the costs and timing of infrastructure improvements needed to support that development, and the entities best positioned to deliver the infrastructure. This typically requires preparing an infrastructure master plan to guide decisions about the funding, financing, schedule, and delivery methods for planned infrastructure. As a baseline, the State and Counties should continue collaboration via CIP investments and general fund appropriations as needed to advance infrastructure projects.

Five recommended State-level actions are aimed at creating new sources of funds for investments that unlock TOD and the advancement of affordable housing goals, including:

1. **Expand the infrastructure funding capacity of the State conveyance tax by amending State Law**, increasing its rate and allocating a fixed share of proceeds to TOD investments and affordable housing.
2. **Expand the infrastructure funding capacity of tourism-related taxes by amending State Law,** increasing the existing cap on TAT surcharge proceeds and authorizing counties to charge a surcharge on car rentals.
3. **Authorize a ballot measure for a constitutional amendment that permits TIF and amend State legislation to allow the allocation of TIF revenues for**

infrastructure in priority areas, allowing TIF districts to have non-contiguous boundaries and enabling the use of revenues outside the TIF district, particularly in areas that the State or Counties wish to prioritize for improvements, and to capture State GET revenues to encourage counties to use TIF and increase its impact. Once authorized, Counties can consider TIF ordinances that include a "but-for" test to avoid TIF being utilized in communities in which development could happen without the use of TIF and that require a net fiscal impact finding from TIF implementation.

4. **Create a TOD infrastructure revolving fund** capitalized by dedicated revenue sources, with a governance structure that includes all Counties and fund distribution criteria that incorporate equity and historic disparities in access to resources.
5. **Expand the infrastructure funding capacity of GET surcharge revenues by amending State Law**, particularly by providing more flexibility on the use of County GET surcharge revenues, removing the sunset over GET surcharge collection, and increase the existing cap on the surcharge rate Counties are authorized to adopt. Because the City and County of Honolulu's GET surcharge revenues are currently fully allocated to the Honolulu rail project, this recommendation is initially targeted to the Neighbor Islands.

Five recommended County-level actions are aimed at unlocking the funding capacity of tools they are already authorized by the State to adopt, including:

6. **Encourage the formation of CFDs to finance development-enabling infrastructure**, by identifying the areawide critical infrastructure needs, streamlining the entitlement process, and, when market circumstances permit, tying rezonings to the formation of a CFD or other district-level financing that can partly fund areawide infrastructure.
7. **Promote the creation of BIDs to improve land value and development feasibility**, since BIDs can fund services, minor streetscape improvements, and public parking that can enhance real estate demand in the area and the feasibility of infill development, particularly in existing commercial and mixed-used areas.
8. **Consider the implementation of countywide impact fees programs**, starting by conducting impact fee studies to determine their potential range of rates.
9. **Assess the potential modification of property tax exemptions in the City and County of Honolulu,** conducting a countywide rental housing market and feasibility study to evaluate and potentially reassess the existing RPT exemption on all units within mixed-income residential projects with a minimum of 20% of affordable units ahead of the exemption's expiration in 2030.
10. **Assess the progressiveness of the structure of property tax rates in the City and County of Honolulu**, studying the potential fiscal and housing market impacts of implementing a progressive property tax structure, akin to those implemented on the Neighbor Islands.

In addition to the TOD Pilot Areas, the financing tools evaluated and the study recommendations will have value to other priority projects across the State, such as the New Aloha Stadium Entertainment District (NASED) project being undertaken by the State Stadium Authority. The NASED project envisions the creation of a vibrant live-work-play-thrive destination on Oʻahu with a new multi-use State stadium serving as the centerpiece for a mixed-use real estate development on the 98-acre Aloha Stadium site located in the State Halawa TOD Priority Area.

Significant infrastructure investments will be required to achieve this vision, and financing mechanisms, such as TIF, may be explored as part of the financing strategy for the infrastructure improvements and NASED development program. Meetings with agency administrators and staff to discuss and respond to questions and concerns about specific tools, such as TIF for the Aloha Stadium site, have been conducted and will be an important part of the outreach to follow the issue of the final study report.

These recommendations will take time to implement. For the recommendations to be fully realized, policies will need to be changed, government's implementation capacity will need to be expanded, and new ideas will need to be further examined. While the State and Counties work on long-term strategies, they should continue to work together via the County and State CIP process and general fund appropriations to continue to push infrastructure projects forward.