

Economic Development Agreements: PILOTs and TIFs

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Mark Mamantov
Bass, Berry & Sims PLC
900 South Gay Street, Suite 1700
Knoxville, TN 37902
865-521-0365
mmamantov@bassberry.com

BASS BERRY  SIMS PLC

What is a PILOT?

- ❖ PILOT is an acronym for payment in lieu of tax.
- ❖ PILOT is a commonly used term for property tax abatement in Tennessee and is somewhat of a misnomer. In many cases, no payment in lieu of tax is required in a tax abatement transaction.
- ❖ Tax abatement is accomplished by an exempt governmental entity owning property and by that entity leasing the property to a private party (usually with a purchase option).
- ❖ PILOTs can be negotiated by industrial development boards ("IDB"), health ed boards and, in some cases, housing authorities.

What is a TIF?

- ❖ TIF is an acronym for tax increment financing. It is somewhat of a misnomer as no financing may be involved so tax increment incentive is a more accurate term.
- ❖ Incremental property tax growth from a specific area is allocated to an IDB or housing authority to provide an incentive.
- ❖ In the case of an IDB, incremental taxes allocated to the IDB can be used to make direct grants to a private party to reimburse eligible costs or to pay debt service on debt incurred by IDB to finance such costs. The proceeds of the debt are usually granted to a developer.
- ❖ In the case of a housing authority, tax increment must be used to pay debt service on tax increment financing issued by housing authority to finance eligible costs.

Topics To Be Covered

- ❖ Overview of trends in PILOTs and TIFs.
- ❖ New limitations on PILOT term for retail projects.
- ❖ PILOTs for low-income housing projects.
- ❖ Reporting under GASB 77.
- ❖ New IDB reporting requirements.
- ❖ Taxation of incentives under Tax Cuts and Jobs Act of 2017.
- ❖ Extension of Sales Tax TIF for Rural, Distressed Counties.
- ❖ Proposed GASB Statement on Conduit Debt Obligations.

Current Trends

- ❖ PILOTs are commonly requested for low-income housing projects with low-income housing tax credits ("LIHTCs") (reasons are discussed below).
- ❖ TIFs and PILOTs are common for retail and hotel projects in smaller markets.
- ❖ Fewer downtown redevelopment TIF projects are being done as PILOTs are more common for apartment projects (fewer condo projects are being done in some markets).
- ❖ More municipalities are interested in adopting policies to govern TIFs as well as PILOTs.
- ❖ PILOTs are still generally being used for most large manufacturing projects, particularly outside urban areas.
- ❖ Greater community focus on "but for" test (is the incentive really necessary?).
- ❖ Residential developers are requesting TIF incentives for sewer line extensions.

New Limitation on PILOT Term for Retail Projects

- ❖ Public Chapter No. 1064 (2018) was outgrowth of TACIR study.
- ❖ Until Public Chapter No. 1064 was enacted, an IDB only needed the approval of its creating city or county to negotiate a PILOT on any type of project.
- ❖ For projects that include a "retail business", with a term in excess of 10 years plus a reasonable construction period, an IDB now needs the approval of all taxing agencies for a PILOT (doesn't apply to Shelby County).
- ❖ "Retail Business" means a "retail establishment providing general retail sales or services."
- ❖ New special notice requirement for IDBs to approve a PILOT.

PILOTs for Low-Income Housing Projects

- ❖ Property taxes are high on such projects because of taxation of value of LIHTCs. Most developers seek a PILOT.
- ❖ Special statute permits Mayor to request IDB to provide a PILOT for LIHTC project without legislative body approval.
- ❖ In these cases, PILOTs typically provide a tax freeze and not full abatement.

GASB 77

Tax Abatement Disclosure

- ❖ Currently in effect.
- ❖ Applies to PILOTs that result in tax abatement and some TIFs that effectively act as a PILOT.
- ❖ Does not apply to some TIFs if for public infrastructure.

GASB 77

Key items that must be disclosed if agreement is with Municipality's IDB

- ❖ Name, purposes and authority of program.
- ❖ Mechanism for determining abatement (amount or percentage).
- ❖ Gross dollar amount of abatement.
- ❖ Criteria that makes recipient eligible.
- ❖ Description of clawbacks.
- ❖ Types of commitments of recipients.
- ❖ Additional commitments made by government.
- ❖ Individual agreement disclosure is optional.

GASB 77

Key items that must be disclosed if agreement is not with municipality's IDB

- ❖ Identity of other government entities.
- ❖ Gross dollar amount abated.
- ❖ PILOT payments received by municipality.
- ❖ Individual agreement disclosure is optional.

GASB 77

Challenges to Implementation

- ❖ Lack of knowledge of abatement agreements by other entities.
- ❖ Incongruity of tax year with fiscal year.
- ❖ Difficult to decide whether to include certain TIFs.

CITY OF KNOXVILLE, TENNESSEE
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2017

NOTE 22 - TAX ABATEMENTS

The City of Knoxville typically issues tax abatements in two forms, a payment in lieu of taxes (PILOT), and Tax Increment Financing (TIF Loan). The City's PILOT agreements do not contain clawback or recapture provisions based on performance goals. In the event of default, the City may clawback property or personal taxes that would have been otherwise owed.

The Industrial Development Board of the City of Knoxville (City IDB) performs public functions on behalf of the City of Knoxville. Authorized by Tennessee Code Annotated (TCA) Section 7-53-305, a provision of the Tennessee Industrial Development Corporations Act, the City IDB undertakes financing and development of projects deemed to promote industry, trade, commerce, tourism and recreation, and housing construction. The Board acts as a conduit organization for property tax abatements through PILOT agreements. The abatement, which may be as much as 100% of the standard real and/or personal property taxes, may be granted to any qualified business located within or relocating to property within the boundaries of the City limits. The City currently has 33 active PILOT agreements, with \$1,951,101 abated in 2017.

The nonprofit organization, Knoxville Community Development Corporation (KCDC), is the official redevelopment agency for the City of Knoxville. Through a Cooperation Agreement with the City of Knoxville, KCDC manages has 7 PILOT agreements. These agreements are for the development of affordable housing within Knox County and the City of Knoxville. Additionally, authorized by Tennessee Code Annotated (TCA) Section 9-23-101, the Uniformity in Tax Increment Financing Act of 2012, its board of directors oversee the approval of TIF loans within the City's redevelopment areas. The City remits the incremental portion of the levied taxes as payment to the issuer of the TIF loan. The portion of the tax levy that is allocated for debt service is not affected. The City currently has 29 active TIF agreements, with \$2,127,239 abated in 2017.

	City of Knoxville Tax Abatements		
	PILOT	TIF	Total
2017	\$ 1,951,101	\$ 2,127,239	\$ 4,078,340
1 - 5 years	7,814,661	9,136,258	16,950,919
6 - 10 years	4,794,205	7,517,625	12,311,830
11 - 15 years	2,208,501	4,018,552	6,227,053
16 - 20 years	405,530	3,274,689	3,680,219
20 + years	322,938	1,128,152	1,451,090
Total Taxes Abated Over the Next 20+ years	\$17,496,936	\$27,202,515	\$44,699,451

The above table is a current list of the amount of taxes the City of Knoxville estimates to abate over the life of all PILOT and TIF agreements throughout the next 20+ years, *ceteris paribus*.

KNOX COUNTY, TENNESSEE
Notes to Financial Statements
June 30, 2017

NOTE III. DETAILED NOTES ON ALL FUNDS (Continued)

M. Tax Abatements

Knox County, Tennessee is committed to enhancing the development and improvement of its local business environment and economy, especially in areas that will ultimately improve the quality of life enjoyed by its citizens. In furtherance of this objective Knox County has established a program using economic incentives based on tax abatement tools to attract and retain, on a basis competitive with other local governments, businesses that provide the types of employment, capital investment, community involvement and financial impact sought by Knox County and its citizens. Knox County established two incentive programs, the first being the Payment in Lieu of Taxes (PILOT). This program considers and evaluates on a case-by-case basis certain economic and business development opportunities. The PILOT's are administered for Knox County by The Industrial Development Board of the County of Knox (the "IDB"), a nonprofit quasi-governmental corporation that was established in 1966 pursuant to the Tennessee Industrial Development Corporation Act (the "Act"), Tenn. Code Ann. §§7-53-101. The IDB is authorized to negotiate and accept payments in lieu of ad valorem taxes in furtherance of the IDB's public purposes of economic welfare to maintain and increase employment opportunities and household income. As such, the IDB acts as a conduit organization for property tax abatements through PILOT agreements. Consideration is given on a case-by-case basis and includes analyses of job creation, economic impact, capital investment and wage rates. Housing authorities are also permitted by state law to undertake payment in lieu of tax programs and tax increment financing programs. State law permits these types of financing by housing authorities only in designated redevelopment areas approved by the City and County. Applicants for tax increment financing for projects located in redevelopment areas are referred to the Knoxville Community Development Corporation (KCDC).

Many of the tax abatement agreements entered into by the County also involve the City of Knoxville if they are located within the city limits. All of the tax abatement agreements entered into by the City will involve a County portion. The abatements are determined by a base appraisal of the property when the agreement is made.

During the fiscal year ended June 30, 2017, there were 42 PILOT agreements in force with net tax abatements totaling \$2,290,464. With the significant number of abatements in place the County chose to describe herein only those abatements that were greater than \$500,000 of which those tax abatement agreements are described below with the terms in effect for the fiscal year reported. The agreements include a provision for the recapture of abated taxes in the event an abatement recipient does not fulfill the commitment it makes in return for the tax abatement.

KNOX COUNTY, TENNESSEE
Notes to Financial Statements
June 30, 2017

NOTE III. DETAILED NOTES ON ALL FUNDS (Continued)

M. Tax Abatements (Continued)

Green Mountain Coffee Roasters – The PILOT abatement commenced on August 1, 2008 with Green Mountain's commitment for construction, development, renovation, improvement, equipping, and installation of equipment for a coffee roasting and distribution facility located in the Forks of the River Industrial Park. This project will result in the creation of at least 360 jobs paying wages on average of \$29,167 per year. Green Mountain will make a capital investment in the project of at least \$30,000,000. The project will take measures in purchasing equipment and making improvements necessary to reduce air pollutants to a level not exceeding 50% of the maximum allowable level permitted under a minor source permit for particulate matter as issued by the Knox County Air Quality Department. The abatement period is 15 years for real and personal property taxes. The abatement for June 30, 2017 was \$1,494,937.

The second incentive program is the Tax Increment Financing (TIF) which is an economic development tool used by the County to allocate all or a portion of the new, additional taxes generated by a project over a limited period of time to pay for public infrastructure and other improvements related to that project. Tax increment is the difference in tax revenues generated by the project in the plan area after the project has been completed, compared with the tax revenues generated in the plan area before the development plan was adopted. The difference in these tax revenues pays the costs of improvements to the public infrastructure serving the plan area.

In the County (typically for those areas outside qualified redevelopment and urban renewal project areas), the IDB has established policies and procedures for the facilitation of Tax Increment Financing. The County IDB's TIF Program is primarily for economic development projects that provide improvement to public infrastructure in blighted and under-utilized areas of Knox County and in other properties designated by Knox County Commission and Knoxville City Council. TIF notes are not included in the County's general debt obligations. The structure of these transactions allows the County, through agreements with private developers, to utilize the new incremental revenue streams to accelerate funding of improvements.

During the fiscal year ended June 30, 2017, there were 30 TIF agreements in force with net tax abatements totaling \$1,826,512. These abatements are used to make payments on the TIF notes for the benefit of the developers.

The remaining 41 PILOT agreements totaling \$795,526 in tax abatements at June 30, 2017 are all similar in nature incorporating the requirements mentioned above which include renovating buildings for the betterment and welfare of the citizens of the communities where they are located.

New IDB Reporting Requirements

- ❖ Temporary guidelines adopted on September 13, 2018 to implement Public Chapter 529 (2018).
- ❖ Must disclose to Comptroller outstanding annual debt of any kind, including conduit issues, by January 31, 2019 (for FY 17/18).
- ❖ Must file notices of default.
- ❖ Appears to apply to "phantom" bond issues issued to implement a PILOT.

Taxation of Incentives Under Tax Cuts and Jobs Act of 2017 ("TCJA")

- ❖ Remember TIF usually results in a grant to developer.
- ❖ Prior to TCJA, it was fairly easy to avoid taxation of grant as income. Government contributions were not generally considered taxable income as capital contributions.
- ❖ After TCJA, economic development grants generally result in taxable income to the developer, making TIFs less valuable to developer.
- ❖ Grants for public infrastructure are probably still not taxable.
- ❖ Value of tax abatement (i.e. PILOT) is still not taxable.

Extension of Sales Tax TIF Program for Rural, Distressed Counties

- ❖ Rural, distressed counties are supposed to be identified by State Department of Finance and Administration.
- ❖ Program is for commercial projects with at least \$5 million in capital investment.
- ❖ If project is approved by State, state sales taxes (other than school portion) are allocated to local government or IDB.
- ❖ Program extended until December 31, 2020.

Proposed GASB Statement on Conduit Debt Obligations

- ❖ Goal is to standardize treatment of conduit debt obligations.
- ❖ Conduit debt not generally recognized as a liability.
- ❖ Assets acquired to lease as part of conduit debt transaction would not be recognized as capital assets on balance sheet.
- ❖ "Moral obligation" or appropriation commitment or other commitments could result in balance sheet liability.
- ❖ "Phantom" bond issues are conduit debt.