



Tennessee Advisory Commission on Intergovernmental Relations

Payment in Lieu of Tax Incentives ("PILOTs")

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Taxation of Property

- The Tennessee Constitution sets forth several restrictions concerning the taxation of property that:
 - Require “all real and personal property to be subject to taxation.”
 - And with certain limited exceptions, prohibit the creation of additional exemptions.
- Consequently, **Cities and Counties in Tennessee may not grant tax abatements** to non-exempt persons.

Taxation of Property

- Role of Industrial Development Corporations in Property Tax Abatements:
 - Property owned by an Industrial Development Board is exempt from property tax, so to do a PILOT, the property is conveyed to the IDB and leased back to the Company;
 - The Board may enter into payment in lieu of tax agreements, if authority is delegated to it by the city or county that created the IDB.

PILOTs – Benefit to Counties and Municipalities

- Lessons learned at Bradley's Economic Development Forum last week:
 - Process is different than 10 years ago:
 - With the analytics available to companies and site selectors, they are able to get most of the information they need, and **eliminate most locations, before ever reaching out to state or local people**;
 - Greatest focus is workforce, which can lead to their taking the 4th or 5th best economic offer;
 - **Speed** at which deals is done is now much faster;
 - Seeing an increase in state and local funding for incentives;
 - TVA has been a leader in economic development, now other power companies are catching up.

PILOTs – Benefit to Counties and Municipalities

- Lessons learned at Forum:
 - Process is different than 10 years ago;
 - Why incentives:
 - Incentives won't get you on the list, but can win you the deal by helping the cost structure. Once choice is down to a few locations, incentives help the company's internal rate of return as the incentive reduces their capital expenditures;
 - It can get the site an opportunity to be in the game – NJ was known as a high cost, high regulation state, but after Gov. Christie rolled out their new program, they got some deals on the map;
 - Once all sites are final, and if the workforce is addressed, incentives move to the top of the list – “you can't play without them.”

PILOTs – Benefit to Counties and Municipalities

- Lessons learned at Forum:
 - Process is different than 10 years ago;
 - Why incentives:
 - Incentives are a way for the locals to stay in the game once they are in the hunt for a project;
 - Companies want to go where they are wanted, feel valued and **listened to**;
 - It is a way to demonstrate a public private partnership;
 - Property taxes are often the only real source of incentive money available to local communities. Many communities do not have cash to offer. Many do not have free land to give;
 - **PILOTs** (or property tax TIFs) are how locals can incentivize.

PILOTs – Benefit to Counties and Municipalities

- Lessons learned at Forum:
 - Rural economic development is a major challenge.
 - Manufacturers want a more rural location in an area with a high quality of life;
 - As manufacturing is automated, the number of jobs needed for output declines and the wages of the jobs will increase as they will require more skills – results include:
 - cost of the project and equipment will increase, which will result in **more property tax revenue per job**;
 - also results in fewer jobs for lower skilled workers.
 - Migration from rural to urban areas will continue and the war for talent is accelerating.
 - Communities need to reinvest in themselves to stop outbound migration and reverse it if possible;
 - Some states are considering tax break incentives to lure their talent back to the state.

PILOTs – Benefit to Counties and Municipalities

- Why PILOTs Work:
 - If the project doesn't come, there is no new tax, so the concept is that a new project brings not just new jobs, but new tax revenue, some or all of which can be abated;
 - Over time, the property comes back on the tax rolls; sometimes in an escalating fashion (0%, 10%, 20% up to 90% and 100%). When PILOT ends, projects that were attracted to the community by the incentives, end up paying full property taxes;
 - States look for contribution (10% is common) from local communities when making incentive awards – in TN that is usually accomplished with a PILOT.

PILOTs – Issues with Proposed County Approval

- If City IDBs have to get a county to approve each deal with a term over 5 years then:
 - Everything is **slowed down** as many county commissions meet only once a month, and incentive deals may have to be approved by multiple committees or multiple readings at commission meetings;
 - **Confidentiality** can be critical for projects – many companies want to tie down all of the offers before they go to their board; cannot have the project leak to the press and the board find out about it from the media! – hard to do with multiple meetings over longer time;
 - **Speed counts** - If other states have valid sites and workforce and can move quickly, it will hurt us.

PILOTs – Issues with Proposed County Approval

- If City IDBs have to get a county to approve each deal with a term over 5 years then:
 - Some cities and counties have issues that can be played out in public meetings – no-growth advocacy, rivalries (between cities, or a city and county, mayors, etc.), and none of that is helpful if trying to attract a company.
 - Never air your dirty laundry while recruiting a company;
 - By having a delegation to the IDB, the politics, etc. are usually avoided (in public at least);
 - The **question is whether to err in favor of growth and new jobs** or in favor of deliberation.

PILOTs – Issues with Proposed County Approval

- If City IDBs have to get a county to approve each deal with a term over 5 years then:
 - Companies and City IDBs may be incentivized to seek 5 year abatements at 100%, rather than longer abatements with graduated PILOT payments (companies care most about the NPV). This may be a worse result for the community.
 - The company may have preferred to make some PILOT payments to help with schools, police and fire protection over that longer period of time but avoided it because of concerns over seeking County approval (due to speed, confidentiality, issues between the communities, etc.);
 - At a minimum, the county should be able to delegate authority to the City IDB, and its own IDB, to do PILOTs without having to require that each PILOT over 5 years be brought to the commission for approval.

PILOTs – Suggestions

- Communities should listen to the company and structure the deal around their needs, which requires flexibility at the local level;
- Incentives are not just a give away – there must be a return on investment:
 - New, good jobs create a significant multiplier effect of other people that create sales tax, property tax, etc. that does not get abated;
 - Having a good **cost-benefit analysis** that includes the project and the spin-off effects is a big help to understand the return on investment.

PILOTs – Suggestions

- Companies are partnering and do not want a “bad marriage” in the long term relationship that a project represents. Locals should **make incentives performance based**:
 - Performance criteria work well so that the abatement and value of the incentive decreases proportionately if the company does not create the jobs promised.
 - For free land or grants, the company can be required to **repay** the unamortized value if they do not perform.
- Most companies want to support schools – they don’t want to say that it is all about workforce and then not contribute - offers can be structured to **include some PILOT payments**, and communities usually expect this money to fund schools and sometimes police, fire or other protective services.

PILOTs – Suggestions

- PILOTs can take real property off the tax role, so a freeze or minimum PILOT payment can keep the budget intact, and then give a larger abatement on the new equipment;
- We are seeing more communities do incentives for expansions (retention and growth by current companies is easiest way to grow jobs) – this helps current businesses;
- The **bottom line** is that, in combination with maintaining flexibility in structuring incentives, local governments need continuing education on best practices. This is important given the normal turnover in elected officials. (This is a recommendation of the Governor’s Rural Economic Development Task Force)

PILOTS

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