The Tennessee Advisory Commission on Intergovernmental Relations

226 Capitol Boulevard Bldg., Suite 508
Nashville, Tennessee 37243-0760
Phone: (615) 741-3012
Fax: (615) 532-2443
www.tn.gov/tacir

MEMORANDUM

TO: Commission Members

FROM: Cliff Lippard
Executive Director

DATE: 14 December 2017

SUBJECT: Ad Valorem Payments in Lieu of Taxes (PILOT) (Public Chapter 431, Acts of 2017)—Draft Report for Review and Comment

The attached draft Commission report is submitted for your review and comment. The report was required by Public Chapter 431, Acts of 2017, which directs the Commission to study

- the economic benefits to counties and municipalities from the use of payment in lieu of ad valorem tax agreements and leases by industrial development corporations organized by municipalities;
- examining whether any economic benefits are derived from limiting the length of term of a payment in lieu of ad valorem tax agreement or lease to five or less years absent county approval or an agreement by the corporation or municipality to pay, each year after the initial five years, to the county a sum equal to the amount of real property tax that would have been assessed to a property if the agreement or lease had not been executed; and
- any additional issues that the Commission deems relevant to meet the objective of the study.

The Act requires the Commission to submit a report to the State and Local Government Committee of the Senate and the Local Government Committee of the House of Representatives no later than February 1, 2018.

Local governments are authorized to establish industrial development boards (IDBs) that hold and lease property to businesses. Because IDBs are considered extensions of local government, the properties they hold and lease for any of their authorized purposes are tax exempt, though local governments can authorize IDBs to negotiate and accept payments in lieu of tax (PILOTs) from the businesses that lease their properties. IDBs established by local governments—whether city, county, or both—that levy their own property taxes are not required to seek the approval of other governments affected by their PILOT agreements. Nor are they required to share with other affected tax jurisdictions any PILOTs made pursuant to their agreements. As a result, it is possible for IDBs established by some local governments in Tennessee to enter PILOT agreements that abate the property taxes of other local governments or special school districts without those tax jurisdictions' consent.

The draft report recommends that to ensure that economic development needs are being met without undermining the tax base of other city, county, or special school districts, **the state should encourage local governments to pursue one of the following cooperative approaches before entering into ad valorem PILOT agreements with private businesses:**

- **Form a joint IDB with representation of all separate taxing jurisdictions within the county.**
- **Enter into interlocal agreements with other taxing jurisdictions to establish criteria for any PILOTs that might affect shared tax bases.**
- **Receive written approval from the city or county mayor, the city or county legislative body, and local special school districts before approval of PILOT agreements.**

In the absence of local governments taking one of these three cooperative approaches, for any PILOT agreement longer than 10 years, either they or their IDBs should be required to make annual payments after the initial 10 years to the other affected local governments equal to the amount of property taxes those governments would otherwise receive for the affected property based on its assessed value.

All IDB meetings are already open to the public much like the hearings at which local governments approve other local incentive programs, such as TIFs. But unlike for TIF hearings, no public notice is currently required for IDB meetings. **To improve transparency in the PILOT approval process without undermining the confidentiality needed to negotiate agreements, IDBs should be required to provide at least some public notice prior to their meetings, similar to what is already required for TIF hearings. Notice requirements should allow IDBs flexibility regarding both the information provided and the time between posting and when a meeting is held to**

ensure they remain workable within business recruitment processes that are highly competitive.

Lessees are required to submit annual reports that among other things include identification numbers for affected parcels, the dates and terms of their leases, and PILOTs made for each property. But these annual reports do not include information about actual capital investments made, jobs created, or wages offered. Because local governments authorize IDBs to negotiate PILOT agreements to promote economic growth, it is important to know whether businesses are following through on promised benefits. **Businesses should be required to include the total number of jobs created and taxes abated in the annual PILOT report to the Comptroller of the Treasury. To allow for greater accountability and transparency, the Comptroller's Office has recently compiled a master list of all agreements and in the future plan to send a copy of the annual reports they receive from each company to the local property assessor's office from that county so they can compare their reports.**

PILOT agreements can affect the distribution of state funding of K-12 education through their effect on property tax assessments, which are one of the factors used to calculate each county's fiscal capacity. Fiscal capacity is used in the Basic Education Program (BEP) funding formula, the state's education funding formula, to equalize state funding for education and to determine each county's responsibility for the local share of the cost of the BEP. Tennessee uses two fiscal capacity models—TACIR's model since 1992 and the Boyd Center for Business and Economic Research's (CBER) model since 2007—and averages the results. To account for local decisions to enter into PILOT agreements, TACIR's model uses the most recent PILOT payment data available from the Comptroller, but these data have not been updated since 1995. Beginning in 2007, the Comptroller began collecting IDB assessment data, which CBER is required to use by state law. TACIR has not received approval, which would be required, to use IDB assessments.

Under the current model used by TACIR, local decisions regarding PILOT agreements have the potential to shift some of the responsibility to pay the local share of the BEP from one county onto the other 94 counties, which violates a basic principle of fiscal capacity models that they not be affected by local decisions. **TACIR's fiscal capacity calculation should be updated to include current IDB assessment amounts rather than the 1993-1995 PILOT payments data currently used. This would require a change in state law or a recommendation by the BEP Review Committee and approval by the General Assembly.**