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Executive Summary: Balancing the Needs of Local Governments, Businesses, and the Public

Businesses in Tennessee made payments in lieu of ad valorem taxes (PILOTs) totaling \$75.7 million in 2016 for tax exempt properties they lease from local industrial development boards (IDB). Although businesses can negotiate PILOT agreements with IDBs equal to the taxes they would otherwise owe if they owned the properties themselves, in practice the payments can be for less **and vary by agreement**—total payments in 2016 were equal to approximately 47% of the taxes that would have otherwise been owed **based on the 2016 assessed value of the property, including any improvements made by the businesses**. As a result, PILOT agreements often function as indirect property tax abatements that are used by IDBs and their affiliated local governments to encourage economic development.

While stakeholders interviewed generally support the use of PILOT agreements to encourage businesses to invest in Tennessee, conflicts arise over the details of individual agreements and the process for negotiating them. This was the case in Pigeon Forge and Sevier County in 2015, when the city's IDB negotiated a PILOT agreement with a Publix grocery store, abating not only the business's city property taxes but also its county property taxes for a 20-year period. Sevier County's mayor has expressed concern that PILOT agreements like this one could reduce local governments' ability to fund public education and other services that are supported by property tax revenues and that the terms of the abatements in some PILOT agreements are too long. But like IDBs for other local governments in Tennessee that levy their own property taxes, Pigeon Forge's IDB was not required to seek the county's approval before agreeing to the PILOT.

In response to the concerns raised by the county mayor, House Bill 1223 by Representative Hicks and Senate Bill 1362 by Senator Bailey would have prohibited municipal IDBs from entering into PILOT agreements longer than five years unless they receive approval for each agreement from the county in which they are located. Alternatively, the IDB or its affiliated municipality make annual payments to the county after the first five years of each agreement, and those payments would have to be equal to the real property taxes the county would have received based on the affected property's assessed value. Stakeholders raised concerns that the bill's restrictions applied only to city IDBs abating county property taxes and not county IDBs abating city property taxes.

Responding to the general concerns about PILOTs as well as the specific concerns with the original bill, the General Assembly passed an amended version as Public Chapter 431, Acts of 2017, which instead directs the Commission to study

- the economic benefits to counties and municipalities from the use of PILOT agreements and leases by IDBs organized by municipalities;
- whether in the absence of county approval for a PILOT any economic benefits are derived from limiting the agreements length to five years or from requiring the IDB or municipality to make annual payments to the county after the first five years equal to the amount of real property taxes the county would have received based on the property's assessed value; and
- any additional issues that the Commission deems relevant.

The assumption made by IDBs concerning tax abatements is that the business would not have chosen to locate in their jurisdiction but for the agreement. If this is true, such an agreement could mean economic benefits for the community, but it is often difficult to prove. Whether or not there are economic benefits depends on a number of factors, including the assessed value of the affected property before it was acquired by the IDB, as well as any economic impacts (employment, income, business and household spending), fiscal impacts (new government revenues and new expenditures), and project impacts (direct, indirect and induced). To better ensure that local governments achieve an economic benefit from the exchange, some IDBs require proof that benefits outweigh costs before they will approve a PILOT, but unfortunately, local governments and the state don't generally collect enough information from businesses that have PILOT agreements to determine whether the incentives these businesses received have resulted in economic benefits to their communities. While collecting this information would be helpful, the state could also address some of the issues raised when an IDB representing one local government abates the taxes of another—as happened in Sevier County—both by encouraging greater cooperation among local governments in the process for negotiating PILOT agreements and by increasing transparency in this process without compromising the confidentiality necessary for conducting negotiations with private businesses.

Property Tax Incentives and Economic Development

State and local governments use a wide array of incentives to encourage businesses to invest in their communities. While these incentives are only one of many factors—including available workforce, infrastructure, and logistics—that businesses consider when determining where to locate or invest, they can be the deciding factor when making a final choice among several short-listed locations that otherwise offer similar resources or advantages.

Nationwide, the abatement of local property taxes is a common incentive at the disposal of local governments, though the types of property tax incentives that can be offered and the process for granting them vary by state

and community. For example, the Constitution of the State of Tennessee authorizes the General Assembly to exempt from property taxes only those properties held by local governments or the state that are used exclusively for public purposes and other non-government-owned properties that fall into certain narrowly defined categories—including those used exclusively for religious, charitable, scientific, literary, or educational purposes. This prohibits local governments in Tennessee from directly abating property taxes for all but a limited subset of property.

Tennessee Communities Provide Property Tax Incentives through PILOT Agreements Made by IDBs

While their ability to directly abate property taxes is limited, local governments in Tennessee can lease government-owned tax-exempt property to businesses, providing them with a form of indirect abatement. Consistent with the limits in the state's constitution, local governments acting either individually or jointly are authorized to establish IDBs that hold and lease property to businesses for a variety of purposes, many of which include uses that encourage economic development, under Tennessee Code Annotated, Section 7-53-101 et seq. The properties the IDBs own are tax exempt, and local governments can authorize IDBs to negotiate and accept PILOTs from the businesses that lease their properties. These PILOTs can help offset local government revenues lost when the properties are removed from tax rolls.

The ultimate value of the incentive that a business receives from a PILOT agreement with an IDB is equal to the difference between any negotiated payments and the property taxes a business would otherwise owe if the property were subject to taxation.

The process for approving IDB PILOT agreements in Tennessee varies based on

- whether the negotiated payments are at least equal to the taxes that would be owed if the property were subject to taxation,
- an agreement's length, and
- the local governments involved.

State law allows local governments that have authorized their IDBs to negotiate PILOTs to require that any agreements be submitted to them for approval. For agreements where payments made to the city and county are at least equal to the taxes that would otherwise be owed, no additional approval is necessary beyond what is required by the local government or governments that created the IDB.

But for agreements where payments made to either the city or county are less than the taxes that would be owed if the property were subject to

taxation, additional restrictions apply depending on an agreement's length and whether the IDB that negotiated the agreement is established by a municipality without its own property tax. All PILOT agreements where payments are less than taxes owed for periods longer than 20 years—not including up to three years allowed for construction—must be approved not only according to the procedures required by an IDB's affiliated local government but also by both the Tennessee Department of Economic and Community Development and the Tennessee Comptroller of the Treasury. State approval is not required for agreements that don't exceed this threshold. Though the data is incomplete, it appears the most common length of term for a PILOT agreement in Tennessee is 10 to 15 years.

IDBs established by municipalities without their own property taxes are prohibited from entering PILOT agreements that would abate the taxes of the counties in which they are located without receiving those counties' approval for each agreement. Absent county approval, these IDBs or the municipalities that created them must agree to make payments to the affected counties equal to the property taxes that would otherwise be owed for real but not personal property, under Tennessee Code Annotated, Section 7-53-305(h). Of the 184 IDBs in Tennessee, only five are established by one of the 74 municipalities in the state that don't levy their own property taxes. Overall, 271 cities and all 95 counties in Tennessee have their own property taxes.

In contrast, 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.

Encouraging Cooperation on PILOT Agreements Can Reduce Conflict among Local Governments

The ability of some local governments' IDBs to abate the property taxes of other jurisdictions can cause conflicts, as was the case between Pigeon Forge and Sevier County in 2015 discussed above. Several stakeholders have also expressed concern that local property taxes foregone in PILOT agreements can create revenue shortfalls that either result in cuts to public services or have to be made up from other local revenue sources so local governments can maintain compliance with state law. For education, for example, the state's "maintenance of effort laws ensure that local funds budgeted for schools do not decrease as state funding for schools increases. County commissions, city councils and special school districts must budget

the same total [local] dollars for schools that they did the previous year. . . . If student enrollment declines, the funding bodies must budget at least the same dollars per student as the previous year. Dollars budgeted for capital projects and debt service are not included in maintenance of effort calculations.”¹ Although it would be difficult to document, there is the possibility that any reduction in property tax revenue including those resulting from the use of IDB PILOT agreements could result in a local government or special school district having difficulty meeting the state’s maintenance of effort requirements or increasing other taxes to maintain compliance. Regardless, when one local government abates the taxes of other local jurisdictions without their approval, it is in effect making budgeting decisions for them.

Tennessee could address these concerns by prohibiting local governments from abating each other’s taxes through IDB PILOT agreements, as many other states have done. It could also simply require that IDB PILOT agreements be approved by all affected local governments before taking effect, as is already the case for the other major local property tax incentive program in Tennessee—tax increment financing (TIF), in which local governments finance improvements to properties and are repaid through future growth in property tax revenues—regardless of whether the incentive is offered by a municipality with its own property tax. Or, as was initially proposed in House Bill 1223 by Representative Hicks and Senate Bill 1362 by Senator Bailey, Tennessee could encourage IDBs to seek approval for PILOT agreements from all affected local governments by limiting the length of agreements that don’t receive such approval to a set number of years.

But both stakeholders who help businesses negotiate PILOT agreements with IDBs and representatives for several IDBs in Tennessee say that strict statewide requirements could disadvantage the state’s communities when negotiating with businesses. They say that even simply requiring the approval of all affected jurisdictions could cause businesses that might otherwise have located in Tennessee to choose communities in other states because it could delay the approval process or undermine the confidentiality of negotiations. Preserving flexibility for local governments and their IDBs when negotiating the terms of PILOT agreements allows them to shape development strategies to fit their unique needs.

Fortunately, there are already several alternatives available in state law that can help local governments collaborate to meet their economic development needs through IDB PILOT agreements by resolving intergovernmental conflicts before these agreements reach the final stages of approval. In particular, local governments, as noted above, have the

¹ Tennessee Comptroller of the Treasury Office of Research and Education Accountability 2015.

authority to form joint IDBs with one or more other local governments, under Tennessee Code Annotated, Section 7-53-104. When establishing joint IDBs, local governments could jointly select criteria—such as minimum investment, number of jobs created, and average wages—that will be used to determine the terms of PILOT agreements, and they can determine the circumstances, if any, under which agreements will require approval from each government. There are currently 13 joint IDBs in Tennessee. Alternatively, local governments can enter into interlocal agreements under Tennessee Code Annotated, Section 12-9-101 et seq., to achieve the same ends via individual IDBs without formally creating joint IDBs. An example of this exists in Shelby County, where five of the six IDBs established by city governments have pursued this option, which allows them to develop their own process yet still maintain cooperation with the county as is required by law. Among them is the City of Bartlett. While Shelby County can abate up to 75% percent of real and personal county property taxes, the City of Bartlett limits the percentage of city property taxes that can be abated to personal property and the improved value of real property, requiring the payment of PILOTs equal to taxes that were previously owed. In Shelby County, local governments are required to form a joint IDB or enter an interlocal agreement in lieu of receiving written approval from the county mayor and the county legislative body for their IDBs' PILOT agreements.

Increased use of the existing cooperative approaches for IDB PILOT agreements would help local governments meet their economic development needs and preserve local flexibility in negotiating PILOT agreements without undermining the tax base of other cities, counties, 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. Further, the state may consider requiring that local governments receive PILOT payments at

least equal to the portion of the revenue that would have otherwise gone to schools.

Increasing the Accountability of PILOT Recipients

Regardless of whether local governments adopt cooperative approaches to resolving conflicts over PILOT agreements, greater accountability is needed to ensure that the economic benefits businesses promise to communities in exchange for receiving PILOT agreements are being achieved. As a first step toward improving accountability, a representative for Accountability for Taxpayer Money (ATM) has argued for including the general public in a more transparent approval process. Currently, when IDBs seek approval for PILOT agreements from local governments, they provide information about the type of business seeking the agreement—though usually not the name of the actual business—and the expected benefits to the local economy, including the number of new and retained jobs, average wages, total capital investment, and the amount of the PILOT, if any. Stakeholders who help businesses negotiate PILOT agreements with IDBs and representatives for several IDBs say that publicizing details of negotiations and allowing the public to comment on agreements before they are finalized would make Tennessee less competitive with other states by lengthening the approval process and releasing potentially sensitive business information. 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. Ten other states have abatement programs that require public hearings, of which seven require public notice beforehand. **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.**

Improving accountability also involves assessing whether promised economic benefits are being achieved after PILOT agreements are approved. Economists and other scholars often disagree about the overall economic benefits of incentive programs. But the performance of individual recipients of PILOT agreements can be assessed at least in part based on whether they follow through on promises for investment, job creation or retention, and wages. Some IDBs in Tennessee, including the Economic Development Growth Engine (EDGE) of Memphis and Shelby County, already collect this information annually from businesses that receive PILOT agreements from them. EDGE uses these annual reports

to assess whether businesses are meeting performance requirements negotiated as part of their agreements.

It is not uncommon for PILOT agreements to be reevaluated because a lessee is missing jobs, wages, or investment projections, according to EDGE representatives. Some agreements contain provisions requiring businesses that fail to meet their performance criteria to payback incentives they have already received. More often, the penalties in PILOT agreements are forward looking, according to stakeholders involved in negotiating them, allowing IDBs to reduce, restructure, or eliminate only future promised incentives. EDGE has reduced, restructured, or terminated 44 agreements since 2011.

However, most local governments and the state do not collect enough information to determine whether promised economic benefits are being achieved. Tennessee law requires all IDB PILOT lessees to submit their lease agreements and cost-benefit analyses to the Comptroller. Lessees are also 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 reporting requirements 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 delivering on promised benefits. **Lessees with PILOT agreements should be required to include information about total investments made, number of jobs created, and taxes abated in their 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 plans 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.**

Fiscal Capacity

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 state's Basic Education Program (BEP) 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 to ensure that “[n]o reduction shall be made in any calculation of a local jurisdiction’s ability to raise local revenues from property taxes for agreements entered into by the local jurisdiction that result in payments in lieu of taxes being made to the local jurisdiction.” 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.**

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The Role of PILOT Agreements in Economic and Community Development

Tennessee's state and local governments, much like governments in other states, provide incentives for business to encourage economic development. There are a variety of state-level incentive programs in Tennessee. The state offers FastTrack grants for job training, infrastructure, and other business expenses, sales and use tax exemptions for industrial machinery, energy, fuel, and water used at manufacturing facilities, and job and industrial machinery tax credits.² Local governments in Tennessee have fewer options. They can indirectly abate property taxes by leasing tax-exempt properties held by local industrial development boards (IDBs) to businesses and accepting payments in lieu of taxes (PILOTs) from those businesses that are less than the taxes that would otherwise be owed if the businesses owned the properties outright, or they can offer tax increment financing (TIF) for projects whereby local governments finance the cost of improvements to an area and are then repaid out of future growth in property taxes. They can issue industrial revenue bonds to finance industrial plants. Local governments can also offer financial assistance for job training and infrastructure development.

With any of these incentive options, businesses and the public have competing demands. Businesses want incentive approval processes that are quick and confidential. The public wants not only a transparent process but also accountability to ensure that communities achieve the benefits that businesses promise in return for receiving these incentives. There may also be competing demands between local governments that disagree over the types of incentives that should be used or the circumstances in which they should be offered. The tensions between local governments can be exacerbated when, as is the case with PILOT agreements negotiated by IDBs, the law allows one local government to abate the taxes of another without its approval.

Overview of PILOTs and Study

Abatements reduce or eliminate a business's property tax obligation.

Property tax abatements reduce or eliminate a business's tax obligation on real or personal property or both. This can potentially encourage businesses to locate in a particular community. In some states the terms of the abatement are negotiated between the business and the government; other states set out these details in statute. Many states allow their governments to abate property taxes directly but Tennessee

² <https://www.tnecd.com/advantages/incentives-grants/>

and two other states—Arkansas and Georgia—cannot because their state constitutions have provisions that prohibit the abatement of property taxes for businesses. In these states, tax-exempt property owned by local governments is leased to businesses, and the businesses can agree to make PILOTs, which are equal to or less than the property taxes that would have been due on the property.

Governments use property tax abatements to encourage economic development.

Governments must deal with unemployment while also dealing with significant fiscal challenges at all levels of government.³ To address these issues, governments use property tax abatements and PILOTs as a tool to encourage economic development. These can be used to entice businesses to locate in a community and develop property in a way that will increase property values and result in increased property tax revenue once the property tax abatement has ended. Slower industrial growth, greater mobility of business, and use of economic incentives by other localities put pressure on elected officials to use them.⁴

Community factors influence the extent to which abatements are used. Research has shown that distressed areas with higher unemployment,⁵ greater crime rates, or high property taxes are more likely to offer larger abatements.⁶ The use of abatements can be a way of compensating for these negative factors in a locality. Areas with more services, greater highway networks, and higher incomes are likely to offer smaller abatements.⁷

Tennessee’s local governments can abate a business’s property taxes by leasing tax-exempt properties to them.

The Tennessee Constitution, Article II, Section 28 requires that “all property, real, personal or mixed, be subject to taxation.” However, it authorizes the General Assembly to exempt four types of property including property “held by the state, by counties, cities or towns, and used exclusively for public or corporation purposes” from property taxes. It does not authorize the General Assembly to directly exempt from taxation property owned by private businesses.

The General Assembly worked within this constitutional limitation and passed laws authorizing local governments to lease the tax-free property they own to businesses thus providing indirect property tax abatement for

³ Kenyon, Langley, and Paquin 2012.

⁴ Ibid.

⁵ Fisher and Peters 1998.

⁶ Wassmer 1992.

⁷ Ibid.

businesses. One law, the Industrial Building Bond Act of 1955 allows local governments to own and lease industrial property.⁸ The law has some stringent requirements, including a requirement for getting a certificate of public purpose and necessity from the state, which discourages its use by local governments.⁹ Another law authorizes local governments to form industrial development corporations, also known as industrial development boards (IDBs). These boards are public nonprofit entities and can be formed by a single city or county or jointly by two or more local governments. The property owned by an IDB is tax-exempt and publicly owned. An IDB can lease property it owns to businesses.¹⁰

Local governments can authorize IDBs to negotiate and accept PILOTs that are equal to or less than the property tax that would have been owed on the property.¹¹ If it is a project located within a central business improvement district, the amount of the PILOT shall not be fixed below the lesser of ad valorem taxes otherwise due and payable by a tax-paying entity upon the current fair market value of the leased property or taxes that were or would have been due on the property for the period immediately preceding its acquisition by the IDB. The law does not specify how the PILOT revenue must be distributed. IDBs may keep the PILOT revenue for use in further economic development. The IDBs can also enter into agreements with local governments to distribute all or a portion of the revenue to them and the governments can decide how to spend the money.¹² There is no requirement that PILOT revenue be used for education purposes. Unlike in Tennessee, some states—Arkansas, Kansas, and South Carolina—require revenue to be distributed to local governments in proportion to the amount of taxes the governments would have received if the property taxes had not been abated.

Some states have chosen not to use property tax abatements to encourage economic development but this is probably not an option for Tennessee.

All states have some type of economic incentive program. However, eleven states don't authorize property tax abatements or PILOTs, directly or indirectly, for businesses.¹³ They do offer other tax incentives like TIFs or sales tax exemptions. It is unlikely that Tennessee could do away with

⁸ Tennessee Code Annotated, Title 7 Chapter 55.

⁹ Mamantov 2003.

¹⁰ Tennessee Code Annotated Title 7, Chapter 53.

¹¹ Lessees may be subject to taxation on the value of the leaseholds (the difference between fair market value of rent and what is being paid, minus any PILOT), but such values are often discounted by the way they are defined in the agreements.

¹² Opinion No. 85-264, Office of the Tennessee Attorney General, October 22, 1985 and Opinion No. 96-083, Office of the Tennessee Attorney General, June 5, 1996.

¹³ California, Colorado, Maine, Massachusetts, Nebraska, New Hampshire, Rhode Island, Utah, Vermont, Washington, and West Virginia.

PILOTs for businesses. They are the primary business incentive tool used by many local governments in Tennessee.¹⁴ As one panelist speaking before the Commission said, PILOTs are “a necessary tool to play this game.”¹⁵ It has also been said that Tennessee has low business costs and incentives are a way to set Tennessee apart from other states that have low business costs as well.¹⁶ Other states like Mississippi, a competitor for Memphis and Shelby County, offer income tax incentives and other incentive programs that Tennessee does not.¹⁷

The catalyst for this study was a conflict over the use of PILOTs in Sevier County.

When the goals of cities and counties do not align, conflict may arise over the use of PILOTs. This was the case in Sevier County in 2015, when the Pigeon Forge IDB negotiated a PILOT agreement with a Publix grocery store, abating the business’s taxes for a 20-year period. It has been argued that without the PILOT the deal would not have happened because the investment cost was too high.¹⁸ In this instance, the Pigeon Forge IDB abated Sevier County’s property taxes without its approval though the law did not require the county’s approval.¹⁹ There was no way the county could stop the abatement. Sevier County Mayor Larry Waters has concerns about this abatement because he thought it was too long and reduces Sevier County’s ability to fund public education from property tax revenues. Mayor Waters thinks that a city should only be able to abate its own taxes. He also thinks allowing abatements for retail businesses sets an unwanted precedent because all retail developers will ask for one and this seems to be happening.²⁰ In October 2017, the Pigeon Forge IDB granted developers a 20-year property tax abatement for a shopping center with a Food City.²¹

In 2017, Senate Bill 1362 by Bailey and House Bill 1223 by Hicks was introduced in the General Assembly to address the issue of a city government IDB abating county property taxes. The bill would have required approval by the county for any agreements over five years in length, or, absent county approval, after five years the taxes that would otherwise be due would have to be paid to the county. Some were concerned that the limitation would make Tennessee less competitive with other states because of the

¹⁴ Testimony by Tom Trent, attorney, Bradley, at the TACIR August 30, 2017 meeting.

¹⁵ Testimony by Matthew N. Murray, Professor of Economics and Associate Director, Boyd Center for Business & Economic Research; and Director, Howard H. Baker Jr. Center for Public Policy, University of Tennessee, at the TACIR August 30, 2017 meeting.

¹⁶ Testimony by John Lawrence, Senior Economic Development Specialist, Economic Development Growth Engine for Memphis and Shelby County (EDGE), at the TACIR August 30, 2017 meeting.

¹⁷ Mississippi Development Authority <https://www.mississippi.org/home-page/our-advantages/incentives/tax-incentives/>.

¹⁸ Interview with Ken Maples, City Commissioner, Pigeon Forge, June 12, 2017.

¹⁹ Ibid.

²⁰ Comment made at the TACIR August 30, 2017 meeting.

²¹ Gaines 2017.

public scrutiny applied to PILOT agreements²² and the additional time it would take to get one passed.²³ Another felt that it would chip away at a system that had worked for many years.²⁴

The General Assembly amended the legislation and directed the Commission to do a study. It then passed the legislation. Public Chapter 431, Acts of 2017 directs the Commission to study

- the economic benefits to counties and cities from the use of PILOT agreements and leases by IDBs organized by cities,
- any economic benefits are derived from limiting the length of term of a PILOT agreement or lease to five years or less without county approval or requiring the business or city to pay to the county, each year after the initial five years, 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.

See appendix A for a copy of Public Chapter 431, Acts of 2017.

Property tax abatements represent a small portion of the total business incentives offered in the state.

State and local business incentives for industry in Tennessee for fiscal year 2015-16 were \$560.7 million. State incentives were most of that, totaling \$425.3 million of the \$560.7 million. Local incentives were \$135.4 million of the \$560.7 million, including \$85.2 million²⁵ (15.5%) in IDB property tax abatements. See table 1 for a breakdown of amounts for each individual incentive program. The tax increment financing (TIF) program, tourism development zones (TDZ), and grants by local governments for land, services, or money were not included in the chart because information on the dollar amount of these incentives was not available.

The assessed value of IDB properties in the state has increased in recent years, and that value is concentrated in a few counties.

The assessed value of all tax-exempt property in Tennessee has increased in recent years. This includes IDB and Health, Education, and Housing

²² Interview with Tom Trent, attorney, Bradley, July 7, 2017 and Interview with Mark Mamantov, attorney, Bass, Berry, and Sims, June 2, 2017.

²³ Testimony by Tom Trent, attorney, Bradley at the TACIR August 30, 2017 meeting.

²⁴ Interview with Mayor Richard Venable, Mayor of Sullivan County, May 30, 2017.

²⁵ Staff calculation. Were they not tax exempt, IDB properties would have owed \$160.9 million in property taxes in 2016, and lessees reported paying 47% of that amount in PILOTs (\$75.7 million) for a net abatement of \$85.2 million.

Table 1. State and Local Business Incentives in Tennessee, Fiscal Year 2015-16

State	\$425.3 million
State Sales Tax Exemptions for Industrial and Farm Machinery and Equipment	\$234.1 million
Industrial Machinery Tax Credit (Franchise and Excise Tax)	\$55.6 million
FastTrack Infrastructure and Job Training Assistance	\$63.5 million
Jobs Credit (Franchise and Excise Tax)	\$48.0 million
Cap on the Value of Inventories (Franchise and Excise Tax)*	\$24.1 million
Local	\$135.4 million
<i>IDB PILOT Program (Property Tax Abatements)</i>	<i>\$85.2 million</i>
Local Option Sales Tax Exemptions for Industrial and Farm Machinery and Equipment	\$50.2 million
Total State and Local	\$560.7 million

*From the Tennessee Franchise and Excise Tax Guide, September 2017: “In 1995, a provision was enacted to encourage the development of manufacturing, warehousing, and distribution facilities in Tennessee by setting a cap on the value of finished goods inventory included in the taxpayer’s franchise tax base minimum measure.”

Sources: Budget of the State of Tennessee, Fiscal Year 2015-16, page A-71. For FastTrack Infrastructure and Job Training Assistance, Budget of the State of Tennessee, Fiscal Year 2017-18, page B-326. For IDB Property Tax Abatements, Staff calculations based on data from the Tennessee Comptroller of the Treasury. Table based in part on Tennessee Department of Economic and Community Development’s incentives fact sheet: <http://www.tnecd.com/incentives-fact-sheet/>

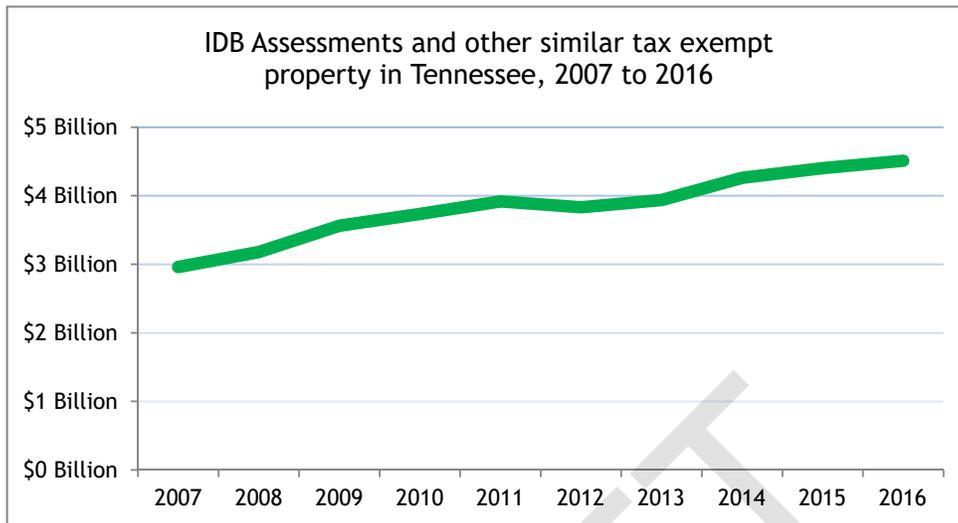
Facility boards (HEHB) - owned²⁶ property, property held by economic development entities other than IDBs,²⁷ and property held by counties, cities, and the federal government for economic development purposes. The total assessed value increased from \$3.0 billion in 2007 to \$4.5 billion in 2016, an average annual increase of 4.8%. Besides the \$4.0 billion in IDB assessments, this \$4.5 billion includes \$476.8 million of HEHB-owned property and other similar tax abated property. See figure 1. For comparison, total property assessment in Tennessee increased by 2.8% per year on average over that same period.

The use of PILOT agreements varies widely across counties in Tennessee and so does the value of IDB assessments. Of Tennessee’s \$163.7 billion in assessed value of property, \$4 billion (2.5%) is IDB property. Half of that \$4 billion is spread across 77 counties, but the other half is in just six counties, either because a high value IDB property is located in the county or because counties with larger property tax bases tend to have

²⁶ Health, Education, and Housing Facility Boards (HEHBs) can also lease tax-exempt properties to entities for education, hospital, and low income housing purposes and accept PILOTs. See Tennessee Code Annotated, Sections 48-101-301 et seq.

²⁷ These include the Metropolitan Knoxville Airport Authority, Newport and Cocke County Economic Development MNAA, Lexington Civic Center, Newport Tennessee Port Authority, Lake County Community Development Council, EDB-Lawrenceburg, McMinn Economic Development Authority, Meigs County Decatur Economic Development Corporation, Memphis Center City Revenue Finance Corporation, Sullivan County Economic Development Partnership, Sullivan County Economic Development Board, and the McMinnville Downtown Revenue And Finance Corporation.

Figure 1. IDB Assessments and Other Similar Tax Exempt Property in Tennessee, 2007 to 2016



Source: Boyd Center for Business and Economic Research, University of Tennessee, Knoxville for 2007-2015. <http://cber.haslam.utk.edu/bep.htm>; Tennessee Comptroller of the Treasury for 2016.

more IDB property as well. The three counties in Tennessee with auto assembly plants, Rutherford, Hamilton, and Maury, are 1st, 2nd, and 5th for IDB assessments. Bradley, with Wacker Polysilicon, is 3rd. Counties with larger property tax bases tend to have more IDB property as well.²⁸ Davidson and Shelby are 1st and 2nd for property tax assessments and 6th and 4th for IDB assessments. Twelve counties do not have any IDB property.²⁹ Of those 12, three—Moore, Pickett, and Unicoi—do not have an IDB.

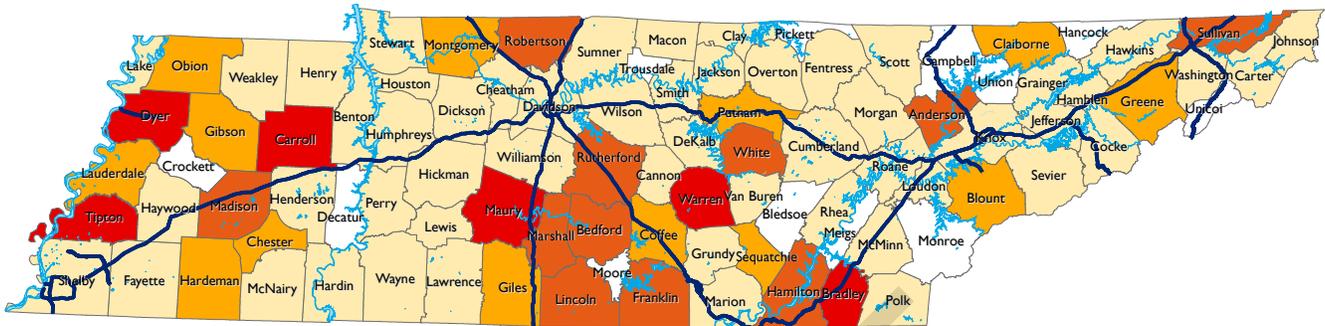
While counties with larger property tax bases tend to account for more IDB property based on value, IDB properties make up a larger percentage of the overall tax base and a larger percentage of the industrial and commercial property tax base in other counties. Six counties, shaded red in map 1, have the greatest percentage of property tax assessment that is IDB property at 9% to 18.2% of their property tax bases. Of these six, only Bradley and Maury counties are in the top six for IDB properties based on overall value. Eleven other counties are between 3.5% and 9%, another

²⁸ One way to measure the strength of that relationship is the correlation coefficient. The strength is reported as a range from zero for no correlation to one for perfect correlation. The coefficient will be positive if one set of numbers increases as the other increases or decreases as the other decreases; it will be negative if one increases and the other decreases. The correlation between counties' property tax bases and the assessed value of their IDB properties was 0.616 for 2016. This correlation suggests that one reason some counties have more IDB property is simply because of scale.

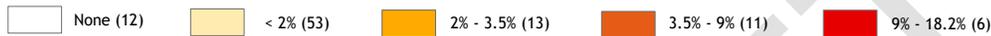
²⁹ Bledsoe, Campbell, Crockett, Decatur, Hancock, Meigs, Monroe, Moore, Pickett, Trousdale, Unicoi, and Union.

13 are between 2% and 3.5%, and 53 abate some property but less than 2% of their property tax bases. See appendix B for a copy of the map data.

Map 1. Tennessee Counties, Percentage of Property Value Abated, 2016



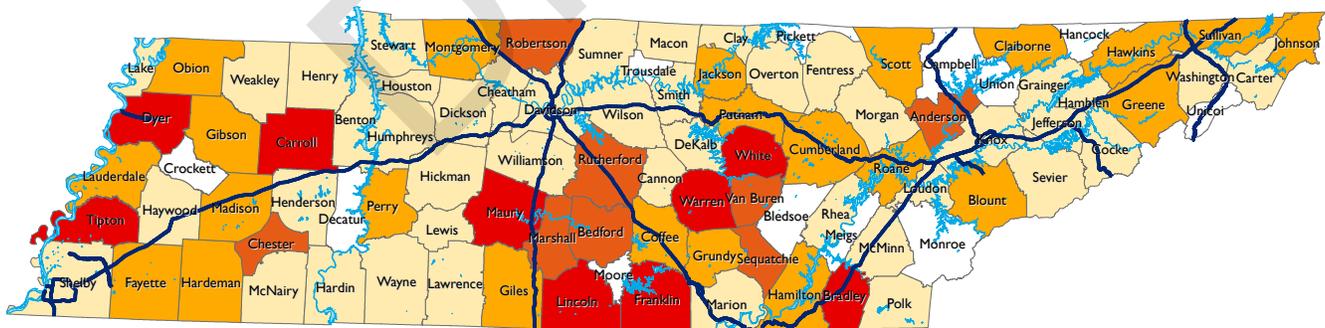
Percentage of Assessed Total Value Abated (2016)



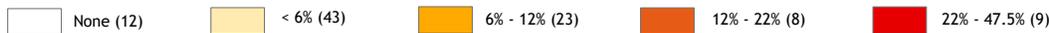
Source: Tennessee Comptroller of the Treasury, Division of Property Assessments, 2016.

Nine counties, shaded red in map 2 below, have the greatest percentage of property tax assessment that is IDB property at 22% to 47.5% of their industrial and commercial property tax bases. Again, Bradley and Maury are the only counties also in the top six for IDB properties based on overall value. Eight more are between 12% and 22%. Another 23 are between 6% and 12%, and 43 abate some property but less than 6% of their industrial and commercial property tax bases.

Map 2. Total Percentage of the Commercial and Industrial Property Owned by IDBs, 2016



Total Percentage of Commercial /Industrial Property Owned by IDBs (2016)



Source: Tennessee Comptroller of the Treasury, Division of Property Assessments, 2016.

It is unclear whether PILOTs offer much in the way of economic benefit.

There are many arguments for and against property tax abatements and PILOTs. The arguments in favor of them are that they increase tax revenue,³⁰ affect business location decisions, create jobs, foster competitiveness, keep taxes low, and allow local officials to be proactive about economic development.³¹ Arguments against them are that taxes are not the only factor considered when making location decisions, and some research has shown them not to be cost effective.³² They pull public spending away from things like education and infrastructure that could benefit businesses.³³ Abatements can also create a zero-sum game when one community wins at the expense of another.³⁴

If abatements and PILOTs are always economically beneficial, then communities should be allowed to use them indiscriminately because they are always going to benefit from their use. If they are not beneficial, then they shouldn't be used at all. However, after years of research there is no consensus among researchers on the effects of these incentives,³⁵ and most research recommends a middle ground of targeting use of incentives but not ending their use.³⁶

Taxes and tax abatements are not a major factor when choosing a development site.

One important assertion concerning the use of abatements (and incentives in general) is that “but for” the abatement the business would not have located there. If the abatement is the deciding factor for a business in its location decision, the economic development can “be considered a success... [and] the forgone local tax revenue may well be justified.”³⁷ If the business would have located in an area without an abatement, then the government is giving up potential tax revenue for no reason if it gives an abatement to that business. See figure 2 for a list of questions IDBs and local governments could review when considering granting a PILOT agreement.

Research and surveys of business professionals suggest that abatements are not the most important determinant in site selection especially when comparing metropolitan areas.³⁸ When the process is taking place,

³⁰ Wassmer 1992.

³¹ Chi and Hoffman 2000.

³² Reese and Sands 2006.

³³ Chi and Hoffman 2000.

³⁴ Reese and Sands 2006.

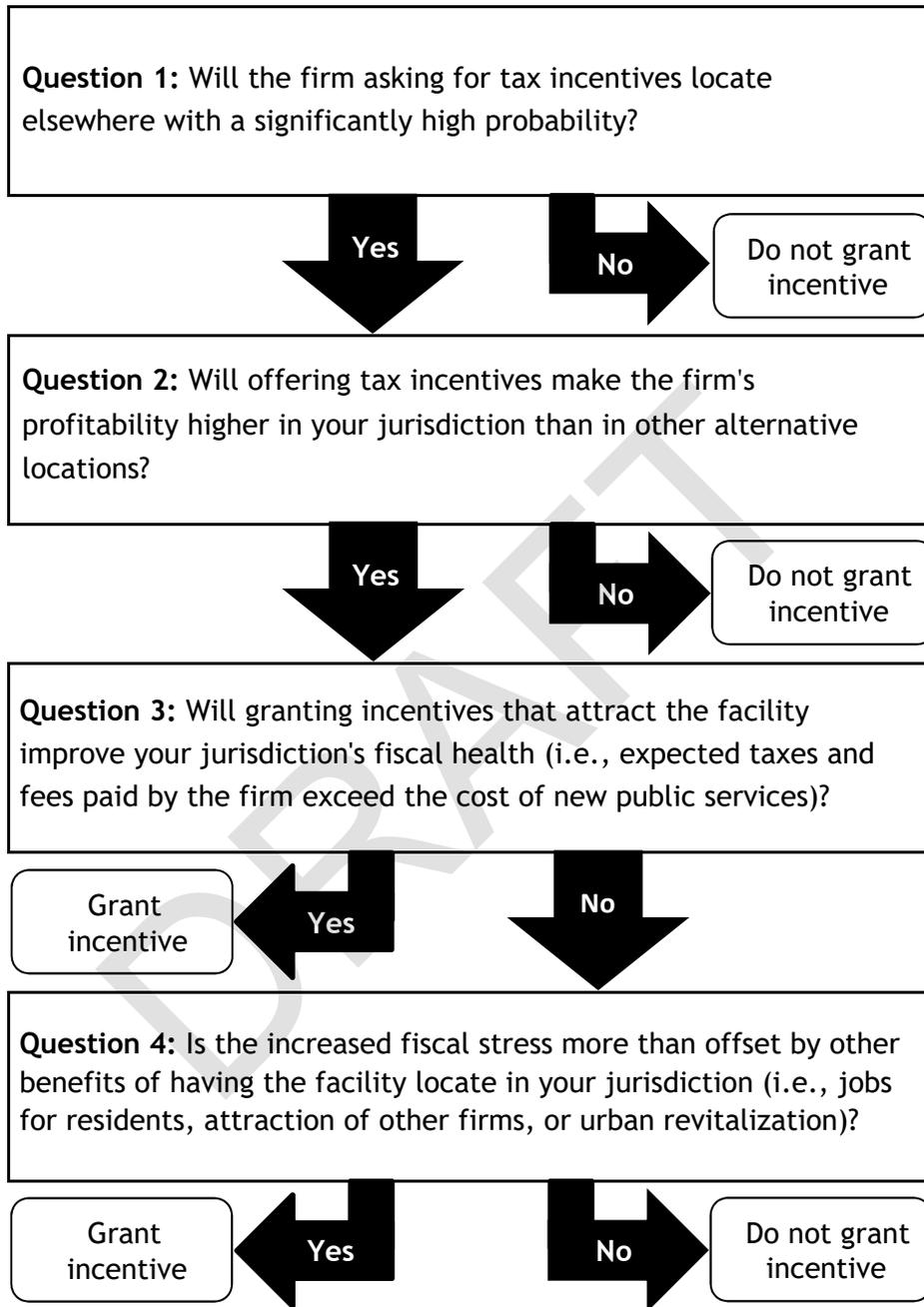
³⁵ Ibid.

³⁶ Wassmer 2007.

³⁷ Wassmer and Anderson 2001.

³⁸ Wesylenko 1997.

Figure 2. Questions to Ask Before Granting Local Tax Incentives



Source: Kenyon, Langley, and Paquin 2012.

many factors are considered, such as quality and availability of labor,³⁹ infrastructure,⁴⁰ access to major highways, access to specific markets, and the quality of the community. Surveys have shown that abatements and taxes are not the most important factor when considering where to locate a business. In the 31st annual survey of corporate executives by the Area Development publication, highway accessibility and availability of skilled workers were the two most important factors. Tax exemptions came in as the 7th most important factor, while the corporate tax rate was 6th.⁴¹ Endeavor Insight, an organization that promotes entrepreneurs in emerging markets, did a survey of 150 entrepreneurs asking why they chose to locate their businesses in certain cities.⁴² They found that a talented pool of potential employees and access to customers and suppliers were the main reasons. Low taxes were not a major concern. Taxes and tax abatements may be of little concern because taxes are a small percentage of a business's costs.⁴³ For example, property taxes represented .3% of manufacturing firm's costs between 2004 and 2009.⁴⁴ In contrast, labor represented 21.8% of their costs.

Taxes and tax abatements begin to play a more important role in decision making once a business has narrowed down their choices.⁴⁵ Site selection is a two-stage process where a business selects a metropolitan area and then a site in that area. Since property taxes have a smaller impact on costs than other factors it won't be a major consideration when looking for a metropolitan area. Property taxes will play a larger role when narrowing down the number of sites within that area.⁴⁶

There is no consensus on the economic effects of property tax abatements.

As discussed previously, the consensus among local government and economic development officials is that Tennessee communities need to use PILOTs to stay competitive in business recruitment. However, while many people have studied the economic effects of property tax abatements and incentives in general over the years, many of their conclusions have been contradictory. Some studies have found positive effects while others have found negative effects. This seems to suggest that communities

³⁹ Middleton 2001. Interview with Tom Trent, attorney, Bradley, July 7, 2017.

⁴⁰ Fullerton and Aragonés-Zamudio 2006. Interview with Tom Trent, attorney, Bradley, July 7, 2017.

⁴¹ <http://www.areadevelopment.com/Corporate-Consultants-Survey-Results/Q1-2017/responding-executives-confident-about-Trump-economy-skilled-labor-top-concern.shtml>

⁴² Endeavor Insight 2013.

⁴³ Bartik 1987.

⁴⁴ Kenyon, Langley, and Paquin 2012.

⁴⁵ Middleton 2001. Interview with Tom Trent, attorney, Bradley, July 7, 2017.

⁴⁶ Kenyon, Langley, and Paquin 2012.

should not assume that the use of property tax abatements and PILOTs will automatically result in economic growth.

Some studies such as the 2006 study *The Equity Impacts of Municipal Tax Incentives: Leveling or Tilting the Playing Field?* have shown that abatements have negative effects. The authors looked at the effect of industrial tax abatements on the economic health of several Michigan cities.⁴⁷ They found that

- municipalities that do not grant abatements have had the greatest relative improvement in the community economic health index over the 20-year period of the study;
- frequent abatement users had the greatest declines in economic health; and
- occasional abatement users, while also experiencing some economic health declines, had the highest economic health index levels by 2000.

In the 2006 study *Local Tax Incentives in Action: The Payment-In-Lieu-Of-Tax Program*, the authors compared the economic health of two Tennessee cities that use PILOTs: Memphis and Nashville.⁴⁸ The authors wrote that

Nashville uses PILOT incentives sparingly, but it has done well economically. In comparing the economic activity and poverty of these two cities, Nashville typically performs better than Memphis, though this is sensitive to the measure used. This comparison does not necessarily suggest that Nashville excels because it operates without as many PILOTs, but rather, it suggests that the PILOT-style programs are not a necessary component of economic growth.

Other studies like the 2007 study *The Increasing Use of Property Tax Abatement as a Means of Promoting Sub-National Economic Activity in the United States* found positive effects.⁴⁹ In this study, the authors wrote that evidence indicates that a 10% reduction in local business taxes is likely to result in a long-term 15 to 20% increase in the local economic activity generated by firms that are mobile between communities. However, this was subject to some caveats that

- the forecast change will only occur if state policymakers are diligent in restricting abatement and other business incentives to localities at a comparative advantage; and
- a response of the magnitude predicted is for most manufacturing firms and only some commercial firms (like regional retail malls,

⁴⁷ Reese and Sands 2006.

⁴⁸ Sautet and Shoaf 2006.

⁴⁹ Wassmer 2007.

auto malls, or large “big-box” stores whose market consists of most of the region).

Other research has looked at more specific economic effects of PILOTs and incentives in general. One argument in favor of PILOTs and any business incentives is that they will lead to an increase in employment.⁵⁰ The use of incentives may even cause an increase in the unemployment rate according to the 2001 report *Bidding for Business: New Evidence on the Effect of Locally Offered Economic Development Incentives in a Metropolitan Area*. In the study, they looked at the effect of incentives on 112 cities in Michigan.⁵¹ They concluded that the use of incentives can “increase business property value, causing an increase in local population that is greater than the increase in new jobs going to local residents.” This same study also found a decrease in the poverty rate, which the author writes could “be the consequence of gentrification or local displacement of the poor and not the result of providing more employment opportunities to the formerly poor in a city.”

Another benefit often touted for PILOTs is that they will cause an increase in tax revenue. A 1992 study, *Property Tax Abatement and the Simultaneous Determination of Local Fiscal Variables in a Metropolitan Area*, found that abatements could lead to an increase in property tax revenue.⁵² However, a 2016 study, *The Fiscal Impact of Local Property Tax Abatement in Indiana*, found that “local tax abatement use tends to be correlated with higher effective tax rates on existing households and businesses within a county.”⁵³

Local government services could be affected by the use of PILOTs. There may be new public service demands because of the new business brought into the community. For example, there may be a need for new roads or sewage lines that must be built and maintained. These demands may outweigh the additional revenue available because of the PILOT, according to a 2007 study, *The Increasing Use of Property Tax Abatement as a Means of Promoting Sub-National Economic Activity in the United States*.⁵⁴ The 1992 *Property Tax Abatement* study suggests there may also be an increase in user charges. PILOTs might also cause an increase in the crime rate. In the 1992 study, the author estimated that “a 1% increase in commercial property tax abatements results in a 0.01% increase in crimes per capita.”

PILOTs might also negatively affect home values. In the 1992 study *Property Tax Abatement as a Means of Promoting Sub-National Economic Activity in the United States*, the author estimated that a 1% increase in abatements reduces the median value of homes by .03%. Another 2006 study, *El Paso*

⁵⁰ Man 2002.

⁵¹ Wassmer and Anderson 2001.

⁵² Wassmer 1992.

⁵³ Hicks and Faulk 2016.

⁵⁴ Wassmer 2007.

Property Tax Abatement Ineffectiveness, found that in El Paso abatements did not increase home values.⁵⁵

There is not sufficient information to do a thorough economic analysis of effects of PILOTs statewide.

As we noted in the 2004 Commission report *Property Tax Abatements and Payments in Lieu of Taxes: Impact on Public Education*, the following information would be needed to do a thorough analysis of the economic effects of PILOTs

- The total number of tax abatements granted in each county
- The total amount of forgone revenues in each county
- A calculation of the total costs of each tax abatement—revenues forgone; additional infrastructure expenditures; increased traffic congestion; noise; air and water quality impact; loss of affordable housing; increased demand for services like solid waste disposal, education, and recreation and parks; higher property taxes; and perceived lowering of the community’s quality of life
- A calculation of the total benefits of each economic activity receiving a tax abatement—increased collections of sales and other taxes; payroll multiplier effects; creation of spin-off suppliers; increased property tax collections after expiration of the abatement; higher property values; and enhanced local pride and prestige
- Isolation and analysis of the tax abatement as the critical variable among all the factors affecting economic decisions
- Isolation and analysis of the economic activity receiving the abatement as an element of the larger economy
- Consideration of mitigations like impact fees, development taxes, and dedications of land and facilities
- Conclusion as to whether enhanced economic activity (if any) offsets the impact (if any) of the abatement

Little of this information is currently collected by the state. State law does require some information to be reported by lessees,⁵⁶ but not all lessees comply with reporting requirements.

Lessees are required to submit all leases and PILOT agreements to “the chief executive officer of each jurisdiction in which the property is located and to the Comptroller of the Treasury, for review, but not approval.”⁵⁷ The State Board of Equalization (SBoE) of the Comptroller’s Office manages the

⁵⁵ Fullerton and Aragones-Zamudio 2006.

⁵⁶ Tennessee Code Annotated, Section 7-53-305.

⁵⁷ Tennessee Code Annotated, Section 4-17-303.

PILOT information. They have recently scanned copies of the agreements to make it easier to respond to open records requests but copies of these agreements have not been made available online.⁵⁸

A cost-benefit analysis must be filed with every agreement. The Tennessee Department of Economic and Community Development (ECD) provides a free cost-benefit analysis form, but lessees may use their own if it meets the conditions prescribed by ECD. See appendix C for a copy of the ECD cost-benefit analysis form. This form includes the lease term and amount of the first year PILOT payment. It also includes the market value of real and personal property, number of new and indirect jobs, direct and indirect income, and total of new annual state and local sales taxes. It doesn't include analysis of the PILOT costs. Some IDBs use cost-benefit tests as part of their evaluation of PILOT agreements, comparing the new revenue the investment in the abated property is expected to generate, both directly and indirectly, to the amount abated. New revenues include direct revenue like PILOT payments and indirect tax revenue like property taxes paid by the supply chain of the abated property and from local option sales taxes paid by new employees at the abated property and employees of its supply chain. A shortcoming of cost-benefit tests is that they often do not consider every cost. For instance, when a company comes into an area and brings existing employees to the new jurisdiction, those people are going to live there and put a new burden on the city and the schools. See table 2 for a comparison of costs and benefits of property tax incentives.

Table 2. Benefit-Cost Framework for Property Tax Incentives

Benefit-Cost Framework for Property Tax Incentives	
Benefits	Costs
Fiscal Effects	
Revenue gain from expanded economic activity attributable to tax incentive	Revenue loss from tax incentive
	Increase in public service costs due to growth in
Labor Market Effects	
Increase in earnings for newly employed local residents (excludes in-migrants)	Less time for leisure and work at home for newly employed residents
Increase in earnings for currently employed local residents (switch to better paying occupations)	
Economic and Social Effects	
Increase in profits for firms serving the local market	Decrease in profits for firms serving the national market
Increase in property values	Environmental and congestion costs
Changes in community character viewed positively	Changes in community character viewed negatively

Source: Kenyon, Langley, and Paquin 2012.

⁵⁸ Interview with Betsy Knotts, executive secretary, Tennessee State Board of Equalization, June 9, 2017.

After the filing of the initial agreement, the lessee is required to file an annual report with the Comptroller’s Office and the local property assessor’s office with the following information:

- A list of all the real and personal property owned by the IDB and its associated entities and subsidiaries that is leased or subleased by the lessees
- The estimated value of each listed property as estimated by the lessee
- The date and term of the lease for each listed property
- The amount of payments made in lieu of property taxes for each listed property
- The date each listed property is scheduled to return to the regular tax rolls
- The property address and parcel identification number of the property assigned by the assessor of property
- The amount of rents paid
- The amount of any property taxes paid on the leasehold assessment under 67-5-502(d)
- Any changes in the name since the last filing
- How the PILOTs are allocated between the city and county according to the agreement
- Identification of project type

Information on actual jobs created, wages paid, and actual capital investment made is not required to be included in the annual reports. There is information on jobs created for PILOT recipients who also have FastTrack grants. These are state grants that can be used to fund infrastructure improvements, job training, and a variety of other expenses.⁵⁹ FastTrack recipients are required to submit yearly reports to the state for five years

detailing their total number of employees—four years is the most that has been reported thus far. In a 2016 performance audit, the Comptroller’s office found that businesses were “submitting conflicting or unclear reports on the number of new jobs created after a FastTrack grant award.”⁶⁰ See table 3 for a summary of FastTrack grantees performance

Table 3. Summary of Performance Reports of FastTrack Grantees, 2013-2017.

Years of Performance Reports	Number of Grantees	Committed Jobs	Number of Actual Jobs			
			1 st Year	2 nd Year	3 rd Year	4 th Year
1	29	8,052	3,562			
2	16	4,348	1,150	1,256		
3	12	3,384	751	1,344	2,146	
4	3	390	191	250	321	416

Source: <https://www.tn.gov/transparenttn/jobs-economic-development/openecd/fasttrack-baseline-and-performance-reports.html>. Accessed October 20, 2017.

⁵⁹ See the following for the grants offered by the TN Department of Economic and Community Development <http://www.tnecd.com/advantages/incentives-grants/>

⁶⁰ Comptroller of the Treasury, State of Tennessee, October 2016.

reports between 2013 and 2017, which includes the number of actual jobs created.

There are penalties in the law for lessees who fail to file these agreements and annual reports. A lessee who fails to file an agreement within 30 days after written request from the Comptroller or another public entity shall owe an additional PILOT payment of \$500 to the IDB.⁶¹ Lessees who don't file their annual reports are required by law to pay a late filing fee of \$50.00 to the Comptroller. In addition, any lessee who fails to file the annual report within 30 days after written request from the Comptroller or property assessor shall owe an additional PILOT payment of \$500, payable to the county.⁶²

These filing requirements aren't stringently enforced. The only way that the SBoE is aware that a lessee has not filed is if that lessee filed the year before. In the future, SBoE plans 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.⁶³ The SBoE sends a letter to those lessees who filed the year before prior to the filing deadline of October 1 each year. Those who are late are expected to send in their report with a check for the late fee amount, but not all do.⁶⁴ In 2016, there were 69 late filers but only 32 have paid the late fee.⁶⁵ In the 2004 Commission report *Property Tax Abatements and Payments in Lieu of Taxes: Impact on Public Education* the authors concluded that the SBoE and the Division of Property Assessment (DPA) did not have adequate authority to enforce filing requirements and to audit and report their findings. This is still the case and may explain the low number of filers that actually pay the late fees.

Not all affected jurisdictions have a say in the PILOT approval process.

In most circumstances, Tennessee law does not require approval of the PILOT agreement by all affected governments.⁶⁶ If the city is one of the 275 cities with a property tax, then the city IDB may approve a PILOT without the input or approval of the county. A county IDB may also approve a PILOT without the input or approval of an affected city.

⁶¹ Tennessee Code Annotated, Section 4-17-303.

⁶² Tennessee Code Annotated, Section 7-53-305.

⁶³ Email correspondence with Arlene Hailey, business analyst, State Board of Equalization, December 6, 2017.

⁶⁴ Testimony by Betsy Knotts, executive secretary, Tennessee Board of Equalization, at the TACIR August 30, 2017 meeting.

⁶⁵ Email correspondence with Arlene Hailey, business analyst, State Board of Equalization, June 9, 2017.

⁶⁶ Tennessee Code Annotated, Section 7-53-305.

In a few circumstances, the agreements must be approved by local governments other than the one seeking the lease or PILOT agreement.⁶⁷ If the city that has created the IDB does not have a property tax but the county does, then the city can only enter into a PILOT or lease if the county had approved the PILOT or lease, or if the city or IDB agrees to pay to the county an amount equal to the amount of real property tax that would have been assessed to the property each year in which the PILOT or lease is in effect. In Shelby County, IDBs are not permitted to negotiate a PILOT agreement for less than the county property taxes due unless the IDB

- is a joint IDB organized by the county and one or more of the cities in the county,
- has entered into an interlocal agreement with the county in regard to PILOTs, or
- has received written approval from the county mayor and the county legislative body regarding PILOTs.⁶⁸

Contrast this with the approval process required for a TIF, another property tax incentive. Tennessee law authorizes IDBs to issue a TIF.⁶⁹ With a TIF, the cost of improvements to an area is paid out of future growth in property taxes. An economic impact plan is prepared by the IDB that identifies the area subject to the TIF and must include a project that will be financed with the TIF. The economic impact plan must be approved by all local governments whose property taxes are to be allocated to the IDB.

During the PILOT negotiations, there is a balance to be sought between transparency for the good of the public and confidentiality for the business to remain competitive. It has been argued that if a PILOT agreement were to require approval by more than one entity, it could compromise confidentiality, since multiple meetings increase the likelihood that information will leak.⁷⁰ If information about the potential PILOT deal leaks to the media and the company's board finds out about it before the staff tells them, this could cause the board to stop the deal from going forward.⁷¹

There are also concerns about the need for a swift approval process. PILOT negotiations can move fast, and local governments want to be prepared to make a decision quickly. Requiring approval by more than one entity might slow the process down.

⁶⁷ Tennessee Code Annotated, Section 7-53-305(h).

⁶⁸ Tennessee Code Annotated, Section 7-53-305(g). In 2003, Roane County was included in this law through the passage of Public Chapter 405, Acts of 2003 but then removed a year later with Public Chapter 813, Acts of 2004.

⁶⁹ Tennessee Code Annotated, Section 7-53-312. The Metropolitan Nashville-Davidson County TIF statute is at Tennessee Code Annotated, Section 7-53-314. See also Mamantov, Oldham, Nelson, and Moneyhun 2014.

⁷⁰ Testimony by Tom Trent, attorney, Bradley, at the TACIR August 30, 2017 meeting.

⁷¹ Testimony by Tom Trent, attorney, Bradley, at the TACIR August 30, 2017 meeting.

Some reports have recommended that affected local governments be given the opportunity to provide input on or approve abatements that can affect them. In the 2007 study *The Increasing Use of Property Tax Abatement as a Means of Promoting Sub-National Economic Activity in the United States*, the author recommends that input from school boards and other affected jurisdictions should be requested before approving an abatement that impacts them.⁷² In the Lincoln Institute of Land Policy's 2012 *Rethinking Property Tax Incentives for Business* report, the authors recommend that local governments should be prohibited from abating taxes of other overlying governments without their approval.⁷³

The PILOT process can reduce education funding for some local governments without giving them a say.

Counties and some cities, as well as special school districts, have school systems that rely heavily on property tax revenue.⁷⁴ Some IDBs in Tennessee already preserve school funds when negotiating PILOT agreements. For example, the Williamson County IDB and the IDBs of Chattanooga and Hamilton County require that lessees make PILOT payments equal to 100% of the portion of property tax revenue that would have otherwise been paid to schools.⁷⁵ In both circumstances, the education requirement is written into the agreement. Not all IDBs require this.

When PILOTs are approved, property tax revenue could be reduced with no input from the affected local government, and if this causes the system to fall short of its maintenance of effort (MOE) requirement, funding must be found to meet that requirement.⁷⁶ Under the MOE requirement, counties, cities, and special school districts “must budget at least the same total [local] dollars for schools that they did the previous year to comply.”⁷⁷ Tennessee law says that no school district “shall use state funds to supplant total local current operating funds, excluding capital outlay and debt service.”⁷⁸ The Tennessee Attorney General’s Opinion Number 02-068 says that this statute has been interpreted to mean that a school

⁷² Wassmer 2007.

⁷³ Kenyon, Langley, and Paquin 2012.

⁷⁴ Tennessee Department of Education, 2016 Annual Statistical Report, Table 16.

⁷⁵ Hamilton County Board of Commissioners Resolution Number 211-9 requires that all educational payments received by the county pursuant to PILOT agreements be designated and retained separately by the county for capital improvements for schools.

⁷⁶ The maintenance of effort requirement is reduced if state funding to the county decreases, which can happen when student enrollment declines. Tennessee Code Annotated, Section 49-3-314(c)(3)(A) says that “if state funding to the county for education is less than state funding to the county for education during the previous fiscal year, except that a reduction in funding based on fewer students in the county rather than actual funding cuts shall not be considered a reduction in funding for purposes of this subdivision (c)(3)(A), local funds that were appropriated and allocated to offset state funding reductions during any previous fiscal year are excluded from this maintenance of local funding effort requirement.”

⁷⁷ Tennessee Comptroller of the Treasury Office of Research and Education Accountability 2015.

⁷⁸ Tennessee Code Annotated, Section 49-3-314(c).

district “cannot use local funds as part of its operating budget and then discontinue this funding and use state funding to fill the gap.” Because the total dollar amount is what is required, as long as the money is made up somewhere else, like an increase in local sales tax revenue, and the total remains the same, then the MOE has been met.

The effect of PILOTs is exacerbated if there are other incentives in the area like tourism development zones (TDZs). This is what happened in Sevier County; the Publix whose property taxes were abated is located in a TDZ. The TDZs are established by cities to fund the construction of a designated qualified public use facility (QPUF).⁷⁹ Convention centers, privately owned tourist attractions, and associated development within a mile and half of the attractions and convention centers can qualify as a QPUF. In a TDZ, the incremental increase in the state and local sales and use tax is apportioned and distributed to the city or county that created it. The local option sales tax revenue apportioned for schools must still go to schools but the state sales tax incremental increase is wholly diverted to the TDZ to pay for the QPUF.⁸⁰

PILOT agreements can also affect state funding of education through their effect on property tax assessments, which are used to calculate each county’s fiscal capacity, a measure of a county’s relative ability to raise revenue for education from its own resources, such as its property and sales tax bases. Fiscal capacity is used in the Basic Education Program (BEP), 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, directing more state funds to systems in counties with less ability to fund education with local resources and less to those with more ability to fund education.

When the Commission first calculated fiscal capacity for the 1992-93 school year, PILOT payments were converted into assessments and then added to property tax assessments to account for revenue generating property in counties, whether they pay property taxes or a payment in lieu of tax.⁸¹ This PILOT payment data was produced by the Comptroller of the Treasury’s Division of Local Finance as part of its County and Municipal Finances report—discontinued in 1995, and so changes in PILOT assessments are not reflected in TACIR’s model. 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, such as whether or not to enter into a PILOT agreement. In the 2008 brief *Getting It Right The Effect*

⁷⁹ Tennessee Code Annotated, Title 7, Chapter 88.

⁸⁰ Opinion No. 09-180, Office of Tennessee Attorney General, November 24, 2009.

⁸¹ Tennessee Advisory Commission on Intergovernmental Relations 2005.

on the Property Tax Base of Economic Development Agreements and Property Tax Incentives for Businesses, the Commission found that

if tax exempt properties leased to private companies are not properly accounted for in the calculation of cities' and counties' ability to raise revenue, then the fiscal capacity of those cities and counties that make heavy use of them will be understated.

As noted in TACIR's 2016 staff report, "Starting in school year 2007-08, a new tax capacity model produced by the Center for Business and Economic Research (CBER) at the University of Tennessee has been used in combination with the county-level fiscal capacity model produced by TACIR."⁸² So that CBER's model could account for PILOT agreements as required by state law,⁸³ the Comptroller's Division of Property Assessments began collecting IDB Assessment data for CBER, which includes IDB assessments and assessments of properties owned by tax exempt entities other than IDBs. Of the assessed value in this report, 89.4% can be attributed to IDBs, 6.4% is owned by other economic development entities, including economic development corporations, airport and port authorities, civic centers, and revenue and finance corporations; 2.7% is owned by health, educational, and housing facility corporations; 0.8% is owned by local governments; 0.04% is owned by the Federal government; and for 0.7%, the owner could not be identified. State law authorizes local governments in Tennessee to collect PILOTs from municipal gas systems;⁸⁴ municipal electric systems;⁸⁵ telecommunication services;⁸⁶ cable television, internet, and related services;⁸⁷ industrial development corporations;⁸⁸ HEHBs;⁸⁹ housing authorities;⁹⁰ the Tennessee Valley Authority;⁹¹ and local hospital authorities for leased commercial real property.⁹²

Local decisions to enter into PILOT agreements would affect TACIR's model less if the 1993-1995 PILOT payments data were replaced with the up-to-date IDB Assessment data used by CBER; however, the BEP Review Committee has not yet made this recommendation.⁹³ Including IDB Assessment data in TACIR's model would increase some counties' fiscal capacities and decrease others; as with any change to fiscal capacity,

⁸² Tennessee Advisory Commission on Intergovernmental Relations 2016.

⁸³ Tennessee Code Annotated, Section 49-3-307.

⁸⁴ Tennessee Code Annotated, Section 7-39-404.

⁸⁵ Tennessee Code Annotated, Section 7-52-304.

⁸⁶ Tennessee Code Annotated, Section 7-52-404.

⁸⁷ Tennessee Code Annotated, Section 7-52-606.

⁸⁸ Tennessee Code Annotated, Section 7-53-305.

⁸⁹ Tennessee Code Annotated, Section 48-101-312.

⁹⁰ Tennessee Code Annotated, Section 67-5-206.

⁹¹ Tennessee Code Annotated Section 67-9-101 et seq.

⁹² Tennessee Code Annotated, Section 67-9-201.

⁹³ Tennessee Advisory Commission on Intergovernmental Relations 2005.

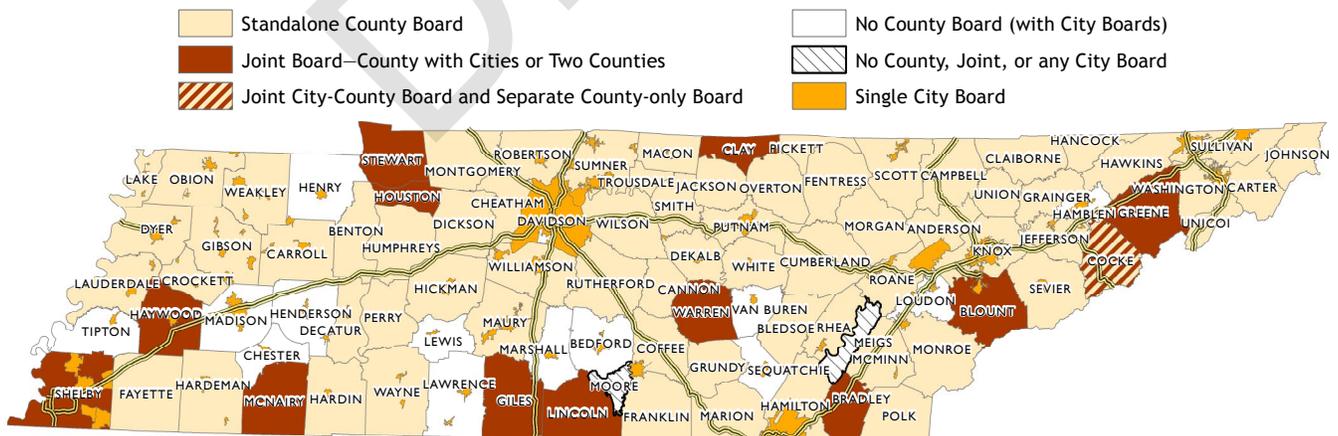
some counties would see an increase in their percentage of state funding, and others would see a decrease.

Some local governments in Tennessee are choosing to work together on PILOTs.

Local governments can work together on PILOTs through a joint IDB.⁹⁴ A joint IDB can provide an opportunity for more than one local government to approve PILOT agreements. For example, a county and city could form a joint IDB and both the city and county could vote on a PILOT in the city. It also provides an opportunity for local governments to jointly work together to establish criteria for PILOT agreements, as Memphis and Shelby County have done through their joint IDB, Economic Development Growth Engine (EDGE). One potential drawback to joint IDBs is that the statute allowing them is vague. For example, if a joint IDB is created between a county and two or more cities, it is unclear if one city can veto a PILOT in another city.⁹⁵ It has been argued that local governments tend to be afraid to create a joint IDB because of the vague language in the statute.⁹⁶

Of the 184 IDBs currently active in Tennessee, only 13 are joint IDBs. See appendix D for a complete list of active IDBs in Tennessee. Of these, eleven—Blount County and the Cities of Alcoa and Maryville; Bradley County and the City of Cleveland; Clay County and the City of Celina; Cocke County and the City of Newport; Greene County and the Town of Greeneville; Giles County and the City of Pulaski; Stewart and Houston Counties; Lincoln County and the City of Fayetteville; McNairy County and the City of Selmer; EDGE of Memphis and Shelby County; and Shelby County and the City of Memphis (in addition to EDGE)—are located along the Tennessee border and so may be more likely to compete with other states located directly across the border. Just two—Haywood County and the City of Brownsville and Warren County and the City of McMinnville—do not share a border with another state. See map 3.

Map 3. Tennessee's Industrial Development Boards



Source: Tennessee Secretary of State, Business Information Search, <https://tnbear.tn.gov/Ecommerce/FilingSearch.aspx>.

⁹⁴ Tennessee Code Annotated, Section 7-53-104.

⁹⁵ Interview with Mark Mamantov, attorney, Bass, Berry, and Sims, June 2, 2017.

⁹⁶ Interview with Tom Trent and Jim Murphy, attorneys, Bradley, July 6, 2017.

As an alternative to joint IDBs, single government IDBs can work together on PILOTs through the use of interlocal agreements. An example of this exists in Shelby County where five of the six IDBs established by city governments have opted for this option.⁹⁷ Among them, the City of Bartlett has worked within this framework to develop a model that works for their community, which includes a provision that only the city property taxes on the improved value of real property may be abated. They have also decided to require that the PILOTs payments must at least be equal to the education portion of the city property tax that would otherwise be due.⁹⁸ See appendix E for the interlocal agreement between Shelby County and the City of Bartlett. Other local governments have chosen to work together without any formal agreement. For example, the IDBs of Hamilton County and Chattanooga cooperate with one another and the local governments each pass a resolution approving an agreement when either negotiates a PILOT.⁹⁹ This option gives them the flexibility to choose how and when they work together. Local governments can quickly come together to work on attracting businesses without having to go through the laborious process of setting up a joint IDB. This flexibility comes at a cost, though, since one government's IDB could quickly choose to abandon the arrangement.

Regardless of whether it is through a joint IDB, there is broad agreement that encouraging or requiring all affected jurisdictions within a county to participate in the creation and approval of local criteria for PILOTs would give them more of a say in the process.

The 2012 report *Rethinking Property Tax Incentives for Business* recommends that “restricting incentives to projects that meet certain standards will improve the likelihood that their benefits will exceed their costs.”¹⁰⁰ See table 4 that shows when economic development goals may or may not be achieved using property tax incentives. This view has been echoed in other studies as well.¹⁰¹ As an alternative to joint IDBs, some IDBs in Tennessee have already established a set of standards or criteria for PILOT projects. To make the process of PILOT negotiation smoother, local governments and the IDBs in a county could collectively agree on criteria like number of jobs, length of agreements, and types of businesses considered.

⁹⁷ Shelby County has seven cities: one—Memphis—has formed a joint IDB with Shelby County, five—Arlington, Bartlett, Collierville, Germantown, and Millington—have established an interlocal agreement with Shelby County, and one—Lakeland—is a new IDB and has yet to negotiate a PILOT.

⁹⁸ Interview with A. Keith McDonald, Mayor of Bartlett, December 19, 2017.

⁹⁹ Resolutions of Hamilton County and the City of Chattanooga. <http://www.hamiltontn.gov/PILOT/>.

¹⁰⁰ Kenyon, Langley, and Paquin 2012.

¹⁰¹ Buss 2001; Murray and Bruce 2017.

Table 4. Property Tax Incentives and Economic Development Goals

Goal	Goal May be Reached If Incentives	Goal May Not Be Reached If Incentives
Increase Income or Employment	<p>Attract facilities that export goods or services out of the area</p> <p>Promote industry clusters that increase productivity in the area</p>	<p>Have little impact because property taxes account for such a small share of total business costs</p> <p>Create jobs that largely go to in-migrants or commuters Create jobs that are low-wage or part-time</p> <p>Require governments to effectively "pick winners"</p>
Improve Fiscal Health	<p>Obtain partial property taxes from firms that would have located elsewhere without tax breaks</p> <p>Attract suppliers paying full taxes by providing tax breaks for anchor firms</p> <p>Obtain other taxes or fees from the firm that offset foregone property taxes</p>	<p>Are given to firms that would choose the same location even without tax breaks</p> <p>Are given to facilities that require costly infrastructure investments by jurisdiction</p> <p>Extend for a longer time period than the lifespan of recipient plants</p>
Promote Urban Revitalization	<p>Redirect business investment within a metro area to distressed areas</p> <p>Offset lower business costs in wealthier areas</p>	<p>Have little effect on relative tax burdens due to widespread use of tax breaks</p> <p>Are utilized aggressively by wealthy areas</p> <p>Require very large tax breaks per job created to attract investment to distressed area</p>

Source: Kenyon, Langley, and Paquin 2012.

IDBs can use criteria to help determine whether a business will be eligible for a PILOT agreement, as well as the amount and length of a PILOT if one is granted. Some IDBs put their criteria into an evaluation matrix to determine if a business will get an abatement or the amount or length of the term. In the matrix, points are given to each criterion. The more criteria a business meets, the higher their points and the more favorable the PILOT agreement terms. For example, Knox County uses a matrix to determine who will get an abatement and the length of the abatement. If a business scores less than 31 points, the business doesn't get an abatement, but if it scores 31-40, it can get a 100% property tax abatement for three years.¹⁰² The EDGE for Memphis and Shelby County uses a matrix to determine the length of term of the abatement.¹⁰³ The more points a business gets, the longer their term.

¹⁰² County of Knox, Tennessee Property Tax Incentive Program Policies and Procedures. <http://www.knoxdevelopment.org/LinkClick.aspx?fileticket=3SS5tsDYKbA%3D&tabid=120&mid=627>.

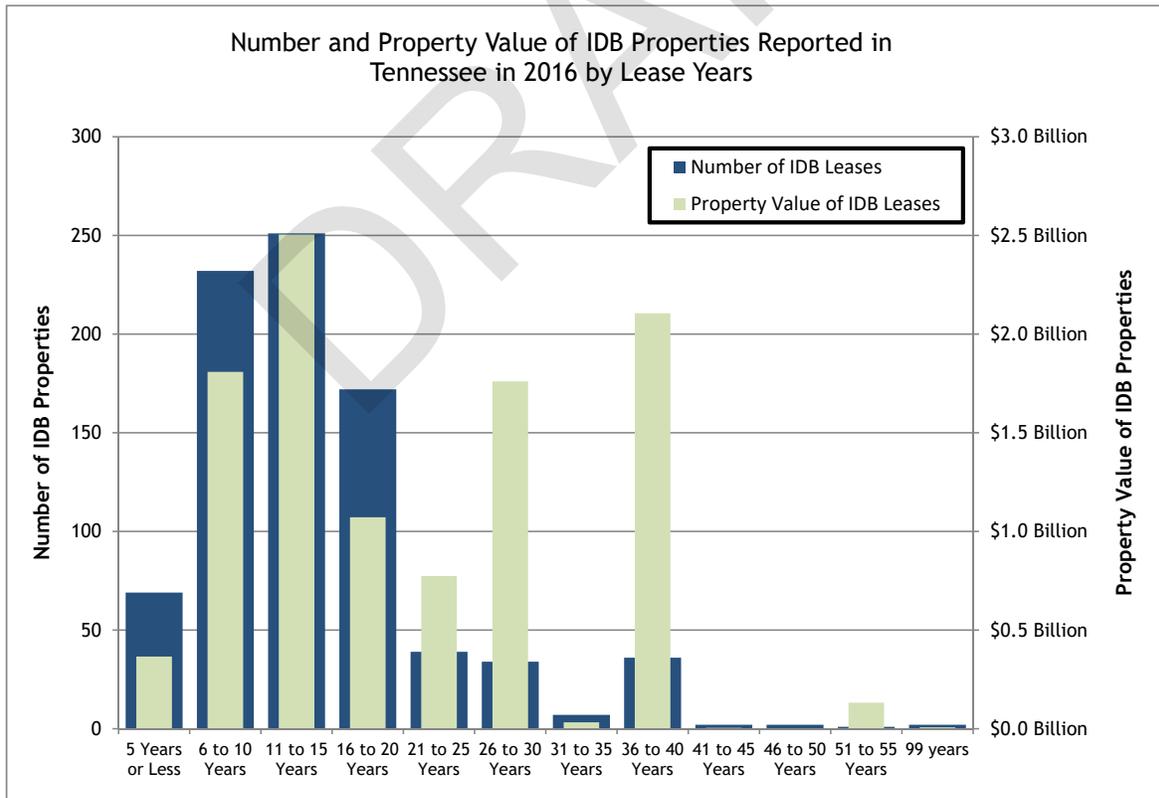
¹⁰³ Interview with John Lawrence, senior economic development specialist, EDGE for Memphis and Shelby County, November 27, 2017.

Commonly used criteria include number of jobs, average wages, and a minimum expected capital investment requirement, but there are others. These criteria could be decided on locally and go into a matrix that local governments could use to determine the length of a PILOT if one is granted, as some local governments in Tennessee have done already. Some states have set criteria for property tax abatements and PILOTs in their statutes. Below is a discussion of different types of criteria that could be adopted by local jurisdictions in Tennessee.

Time limit on abatements

Tennessee law limits PILOT agreements to 20 years plus up to three years for construction, unless approved by the Tennessee Comptroller of the Treasury and the Tennessee Commissioner of Economic and Community Development.¹⁰⁴ Most agreements are less than 20 years, but those that are longer have greater property value on average. The most common length of term for a PILOT agreement in Tennessee is 10 to 15 years, but the data is self-reported, and it is unclear as to whether some properties are being counted more than once. See figure 3.

Figure 3. Number and Property Value of IDB Leases Reported in Tennessee in 2016 by Lease Years



Source: Tennessee Comptroller of the Treasury, State Board of Equalization. 2016 Industrial Development Board/Health & Education Report, <https://www.comptroller.tn.gov/sboe/PDF/20170727IDBSummary2016.pdf>.

¹⁰⁴ Tennessee Code Annotated, Section 7-53-305 (b)(1)(B)

Greg LeRoy, Executive Director of Good Jobs First, a national policy resource center promoting accountability in economic development, has argued that agreements should be limited to 5 years or even less because it is difficult to predict the condition of the economy beyond that period of time.¹⁰⁵ One attorney experienced in working on PILOT agreements has stated that most businesses will not consider PILOTs for that short a time period.¹⁰⁶ Ten years is the most common time limit in other states' laws; sixteen states have programs with a 10-year limit.¹⁰⁷ Five years is the second most common term; thirteen states have programs with a 5-year limit.¹⁰⁸ Other state programs have limits anywhere from 2¹⁰⁹ to 50.¹¹⁰

Limit to specific regions

Several reports recommend that abatements may be more effective when targeting areas of concern like high levels of unemployment, poverty, or fiscal stress.¹¹¹ This helps focus abatements where most needed. One study, the 2006 *The Equity Impacts of Municipal Tax Incentives* report, suggests that abatements should be used in exurban communities only in exceptional circumstances.¹¹² It is more likely that new infrastructure would have to be built for exurban areas. Tennessee does not limit PILOTs to specific areas, but 20 other states do.¹¹³

Limit to new jobs and investment

In 2006, *The Equity Impacts of Municipal Tax Incentives* report recommended limiting abatements to businesses that will bring in new jobs and investments.¹¹⁴ However, in 2007, *The Increasing Use of Property Tax Abatement as a Means of Promoting Sub-National Economic Activity in the United States* found that incentives may be more effective in relocating business within the state rather than in attracting new businesses or retaining businesses.¹¹⁵ Tennessee law does not restrict PILOTs to new jobs or investments. Two states—Montana and Oklahoma—have programs that target new jobs and investment.

¹⁰⁵ Interview, July 7, 2017.

¹⁰⁶ Interview with Tom Trent, attorney, Bradley, July 6, 2017.

¹⁰⁷ Connecticut, Florida, Illinois, Indiana, Iowa, Kansas, Louisiana, Maryland, Michigan, Mississippi, Montana, Nevada, New Mexico, New York, Pennsylvania, and Texas.

¹⁰⁸ Alaska, Connecticut, Idaho, Iowa, Kentucky, Maryland, Montana, New Jersey, North Carolina, Oklahoma, Oregon, South Carolina, and South Dakota.

¹⁰⁹ Illinois and Oregon.

¹¹⁰ South Carolina. Some states have unlimited abatements for some types of property like pollution and inventory control equipment in South Carolina.

¹¹¹ Wassmer and Anderson 2001; Reese and Sands 2006.

¹¹² Reese and Sands 2006.

¹¹³ Alabama, Connecticut, Florida, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Mississippi, Missouri, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, and Virginia.

¹¹⁴ Reese and Sands 2006.

¹¹⁵ Wassmer 2007.

Job quality standard

In the 2007 report *Solving the Problem of Economic Development Incentives*, the author suggests that incentives should have a certain job quality requirement because projects that fail to meet the requirements would likely not pass a cost-benefit test. It would also give businesses an idea of what types of projects should be pursued and give the public extra assurance that there is some selectivity in the process. There are no job quality requirements in Tennessee's law. Four states have wage requirements for certain programs.¹¹⁶ Some local IDBs in Tennessee have job quality standards. For example, Knox County gives special consideration to applicants who pay wages that surpass 160% of the county's published annual average wage.¹¹⁷

Local worker requirement

The 2007 report *Solving the Problem of Economic Development Incentives* recommends that "incentives should be somewhat greater for projects that hire local residents, and considerably greater if the business hired the unemployed." The author writes that incentives should be designed to focus on social benefits of business growth and the biggest portion of the benefits comes from increasing the local employment rate. Local employment rates are most likely to go up when the business hires locals and unemployed, and least likely to go up when they hire people from outside of the community. No state including Tennessee has a local worker requirement in their state laws.

The author also recommends tying incentives to participation in a first source hiring program. The businesses consider but are not required to hire local workers from the first source program. These programs can help businesses find qualified local workers and screen and train them. They may be better equipped to connect with local groups to identify potential hires and help coordinate training for the workers locally.¹¹⁸ One state, Oregon, authorizes abatements in enterprise zones if businesses enter into first source hiring agreements.¹¹⁹

Type of business

Studies show that incentives are more effective for manufacturing¹²⁰ but not as effective for commercial and residential properties.¹²¹ Manufacturing activity is more responsive to abatement than commercial (and residential)

¹¹⁶ Alabama, Oklahoma, Oregon, and Texas.

¹¹⁷ County of Knox, Tennessee Property Tax Incentive Program, Policies And Procedures

¹¹⁸ Bartik 2007.

¹¹⁹ Oregon Revised Statutes, Section 285C.215

¹²⁰ Wassmer 1994 and Wassmer 2007.

¹²¹ Wassmer 2007.

activity because it is easier for manufacturers to move their operations.¹²² However, another study cautions that governments should not focus on manufacturing since they may lose valuable opportunities if they focus on it.¹²³ Tennessee law does not restrict PILOTs to certain types of businesses. Other states vary in their requirements. Some states are quite broad with almost no limitations to more specific requirements like an industrial business or research and development. One of Oklahoma's abatement programs explicitly prohibits it from being used for retail.¹²⁴ North Dakota has one program that explicitly includes retail but the local government must get approval from a majority of voters in a referendum to grant property tax abatements to new or expanding retail sector businesses.¹²⁵

Capital Investment Requirements

Some other states have capital investment requirements for businesses, though Tennessee does not. Twelve states have capital investment requirements in their statutes.¹²⁶ The amounts range from \$1,000 of personal property in Oregon to \$1 billion in Idaho.

Some states have approval procedures in their laws that local governments must follow if they want to abate other local governments' property taxes.

Many states allow local governments to abate their own taxes and not the taxes of other local governments. However, some states have approval procedures in their laws for a local government that wants to abate another local government's property taxes. In North Dakota, one program requires a city that wants to grant an abatement longer than five years to send the county and each school district notice of the proposed abatement.¹²⁷ Within 30 days, the county and each school district must notify the city if it intends to participate in the abatement. If a county or school district fails to respond within 30 days, then that county or school district must be treated as if they were participating in the abatement. One program in Maryland authorizes property tax abatement in enterprise zones, but a county's property tax can't be abated unless the county agrees to the designation of the enterprise zone.¹²⁸ In Ohio, one property tax abatement program requires affected school districts to approve abatement agreements, but approval is not required if 50% or less of the tax is abated.¹²⁹ School district

¹²² Ibid.

¹²³ Buss 2001.

¹²⁴ 62 Oklahoma Statutes Section 860.

¹²⁵ North Dakota Century Code Annotated, Section 40-57.1-03

¹²⁶ Alabama, Arizona, Idaho, Iowa, Maryland, Mississippi, Montana, New York, Oregon, Pennsylvania, South Carolina, and Texas.

¹²⁷ North Dakota Century Code, Section 40-05-24.

¹²⁸ Maryland Tax-Property Code, Section 9-103.

¹²⁹ Ohio Revised Code Annotated, Section 3735.671.

approval is required for abatements in excess of 60% of the assessed value of property or for an abatement period in excess of 10 years up to 15 years in another Ohio program.¹³⁰

Georgia is a bit different since it doesn't require approval of a PILOT agreement by all affected local governments but it does require approval for use of PILOT revenue.¹³¹ It requires approval from the affected school districts, if they set the property tax rate for education, cities, and counties before PILOTs revenue can be used for repayment of revenue bonds for capital projects. In lieu of consent, the local governments may agree to receive separate PILOTs equal to the property taxes for education they would have received or in other amounts agreed to by the parties.

Statewide, there is little accountability and transparency in the PILOTs law.

In the 2017 study *Best Practices for the Design and Evaluation of State Tax Incentive Programs for Economic Development*, the authors list the characteristics of a good incentive program. The authors write that a program should be transparent “so that benefits to taxpayers and costs to the state are clear.”¹³² They also think that a program should have accountability. They write “Performance-based incentives should be built into the program. The alternative is prospective provision of incentives and then the imposition of claw-back penalties for non-performance.”¹³³ Lastly, they think that evaluation should be a part of any incentive program. They write that “Incentives should be implemented with a built-in mechanism or framework for evaluation. ... To the extent possible, evaluations should seek to identify the extent to which incentives induced new economic activity rather than rewarding existing economic activity.”¹³⁴ Looking at Tennessee's PILOT program, one finds there is little transparency or accountability built into the state law governing it.

There are no required public notices or hearings before approval of a PILOT though academic studies recommend that it be an open process.

Tennessee's IDB meetings are required to be open to the public, but there is no requirement for public notice or hearings on specific projects in the PILOT law, unlike the TIF law for IDBs.¹³⁵ The TIF law requires IDBs to hold a public hearing on the economic impact plan that shows where the

¹³⁰ Ohio Revised Code Annotated, Section 5709.63.

¹³¹ Official Code of Georgia Annotated Section 36-80-16.1.

¹³² Murray and Bruce 2017.

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Tennessee Code Annotated, Section 7-53-302.

TIF will be used.¹³⁶ IDBs must publish notice in a local newspaper two weeks prior to the public hearing.

Academic literature recommends that the approval process be transparent with input from the public. The 2012 article titled *Rethinking Property Tax Incentives for Business* recommends publishing information on incentives and making the negotiations an open process, including the public in the process.¹³⁷ Other reports also recommend that the public be given an opportunity to provide input.¹³⁸ Ten states actually require public hearings before abatement of property taxes;¹³⁹ seven of these states require public notice beforehand.¹⁴⁰

Businesses may have confidentiality concerns if the process is too open. It can be important to keep the site selection process confidential in order to avoid disruptions to current operations.¹⁴¹ A confidential site selection process can help improve the business's negotiating position and minimize hassles from salespeople, local government officials, and real estate brokers.¹⁴² A confidential process also protects the business from unwanted public scrutiny.¹⁴³

Tennessee law does not require local governments to monitor lessee performance to see if they have complied with the terms of the agreements.

PILOT agreements usually include goals that businesses are expected to meet, such as creating a certain number of jobs or making a certain capital investment amount. Because economic growth is important, the IDBs and local governments want to get the most out of the deal. To hold the businesses accountable, a clawback provision or a list of performance criteria is often included in the agreements. A clawback provision requires the business to repay the amount of the taxes that were abated if they fail to reach the goals in the agreement or possibly pay a financial penalty in addition to the amount of taxes that were abated. With performance criteria, if the business fails to reach its goals, the time period for the PILOT may be reduced or the PILOT may be eliminated entirely. In Tennessee, businesses seem to prefer performance criteria.¹⁴⁴ It has been estimated that 80% of PILOT agreements have these performance criteria or clawbacks in them, and 80% of these provisions are enforced.¹⁴⁵ Clawbacks and performance

¹³⁶ Tennessee Code Annotated, Section 7-53-312.

¹³⁷ Kenyon, Langley, and Paquin 2012.

¹³⁸ Buss 2001; State of New Jersey Office of the Comptroller 2010.

¹³⁹ Alaska, Kansas, Louisiana, Michigan, Minnesota, Missouri, Montana, North Dakota, Oregon, and Pennsylvania

¹⁴⁰ Kansas, Louisiana, Michigan, Minnesota, Missouri, Montana, and North Dakota.

¹⁴¹ Greyhill Advisors. "The Site Selection Process." <http://greyhill.com/site-selection-process>

¹⁴² Ibid.

¹⁴³ Ibid.

¹⁴⁴ Testimony by Tom Trent, attorney, Bradley, at the TACIR August 30, 2017 meeting.

¹⁴⁵ Interview with Mark Mamantov, attorney, Bass, Berry and Sims, June 2, 2017.

criteria are not required by law to be a part of the PILOT agreements. Several reports including the 2008 Commission report *Getting It Right: The Effect on the Property Tax Base of Economic Development Agreements and Property Tax Incentives for Businesses* recommend using clawbacks to hold the businesses accountable and protect taxpayers in case the business fails to meet the objectives set forth in the agreement.¹⁴⁶

There is no requirement in the law that they regularly monitor their performance, although doing so would help ensure that the PILOTs meet their jobs and capital investments goals. The 2010 report *A Programmatic Examination of Municipal Tax Abatements* argues that there should be follow up throughout the abatement period to ensure compliance with the agreement. It is unclear how closely IDBs and local governments monitor the performance of these businesses. EDGE of Memphis and Shelby County is one IDB that monitors the performance of its lessees. It requires follow up reports to be filed with the IDB with additional information like the number of jobs created and wages for those jobs. Since 2011, it has reduced the length of term for 23 agreements, restructured two agreements based on substantial changes to the project, and terminated 19 agreements because the businesses failed to meet their performance goals.¹⁴⁷

Few other states require local governments to monitor business performance on a regular basis. Florida requires businesses to report the number of full time jobs created and their average wage before the expiration of abatement.¹⁴⁸ Nine states have provisions governing clawbacks in their laws.¹⁴⁹ The laws in seven of these states require businesses to pay taxes that would otherwise have been due.¹⁵⁰ In Montana, the businesses have to pay penalties and interest in addition to the taxes. In Connecticut and Ohio, clawbacks are optional.

There is no required review or evaluation of the economic effects of PILOTs on local governments and the state.

Very little information on the economic effect of PILOTs is required by law to be submitted by businesses or IDBs and local governments. Cost-benefit analysis of the value of real and personal property, number of new and indirect jobs, direct and indirect income, and total of new annual state and local sales taxes is required to be filed with the PILOT agreement. Tennessee does require a review of the economic impact of other business incentive programs, specifically six state business tax credit programs.¹⁵¹

¹⁴⁶ Bartik 2007; Wassmer 2007.

¹⁴⁷ Email correspondence from John Lawrence, senior economic development specialist, EDGE for Memphis and Shelby County, September 1, 2017.

¹⁴⁸ Florida Statutes, Section 196.1995.

¹⁴⁹ Connecticut, Indiana, Michigan, Montana, New Jersey, Ohio, Oregon, South Carolina, and Texas.

¹⁵⁰ Indiana, Michigan, Montana, New Jersey, Oregon, South Carolina, and Texas.

¹⁵¹ Tennessee Code Annotated, Section 67-1-118 says it included the credits found in Sections 67-4-2009, 67-4-2109, and 67-6-224.

It must include an evaluation of the foregone revenue to the state, any benefits provided to the state, and the estimated indirect economic impact of the tax credit. The review is required every four years.¹⁵² The first report was submitted in 2016.¹⁵³

Local governments in other states are required to report information about the effect of abatements because of the Government Accounting Standards Board (GASB) issued Statement 77. It requires disclosure of tax abatement information about a reporting government's own abatement agreements and those that are entered into by other governments and that reduce the reporting government's tax revenues. PILOT agreements in Tennessee do not meet the definition of tax abatement in the Statement 77 because Tennessee's IDBs must hold the lease for the duration of the agreements and the IDB property is exempt from taxation. According to representatives with GASB and the Tennessee Comptroller's office, cities and counties are not required to comply with the new rule but may choose to do so.¹⁵⁴ Davidson and Williamson counties are two local governments that have voluntarily chosen to disclose this information on their PILOTs.¹⁵⁵

A number of reports recommend regular evaluation of incentives to help states see how well the programs are working and help the states decide if they should modify or end ineffective programs or continue effective ones.¹⁵⁶ In the 2001 study *Effect of State Tax Incentives*, the author recommends periodic evaluations of all tax incentive programs and termination of poorly performing ones. The author also suggests requiring sunset provisions for incentives and terminating programs unless they are reauthorized by the legislature. In the 2015 brief *Tax Incentive Programs Evaluate today, improve tomorrow*, the author looked at the best practices of states that evaluated their tax incentives programs and identified three steps for effectively evaluating incentives:

- 1) Make a plan: Determine who will evaluate, when, and how.
- 2) Measure the impact: Assess the results for the state's economy and budget.
- 3) Inform policy choices: Build evaluation into policy and budget deliberations.

Several states have laws requiring review of state tax incentives but none requires state legislative review of local property tax abatements.

¹⁵² Tennessee Code Annotated, Section 67-1-118.

¹⁵³ Anderson Economic Group 2016.

¹⁵⁴ Interview with Pam Dolan, project manager, Government Accounting Standards Board, August 2, 2017 and Interview with Jerry Durham, assistant director, Research, Compliance, Contract Review, Comptroller of the Treasury, August 2, 2017.

¹⁵⁵ Interview with Ken Young, attorney, October 24, 2017.

¹⁵⁶ See Kenyon, Langley, and Panquin 2012; Pew Charitable Trusts 2017.

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DRAFT

Persons Contacted

Paul Bailey, State Senator
District 15, Tennessee

Dale Carr, Representative
District 12, Tennessee

Summer Carr, Assistant General Counsel
Tennessee Department of Community and
Economic Development

Mike Carter, Representative
District 29, Tennessee

David Connor, Executive Director
Tennessee County Services Association

Jim Coppinger, Mayor
Hamilton County

Bryan Daniels, Chief Executive Officer
Blount Partnership

Kim Denton, Tennessee Certified Economic
Developer Director
University of Tennessee Knoxville Institute for
Public Service

Pam Dolan, Project Manager
Government Accounting Standards Board

Ryan Duggin, State Valuation Manager
Division of Property Assessment, Tennessee
Comptroller of the Treasury

Reid Dulberger, President/CEO
Economic Development Growth Engine

Jerry Durham, Assistant Director
Division of Local Government Audit, Tennessee
Comptroller of the Treasury

Maryanne Durski, Executive Director
Office of Local Finance, Tennessee Department of
Education

Arlene Hailey, Business Analyst
Tennessee Comptroller of the Treasury

Karen King, Assistant Superintendent, Finance and
Human Resources
Sevier County School System

Betsy Knotts, Executive Secretary
Tennessee State Board of Equalization

John Lawrence, Senior Economic Development
Specialist
Economic Development Growth-Engine

Greg LeRoy, Executive Director
Good Jobs First

Mark Mamantov, Attorney
Bass, Berry, and Sims

Kenny Maples, Commissioner
City of Pigeon Forge

A. Keith McDonald, Mayor
City of Bartlett

Jim Murphy, Attorney
Bradley

Matthew N. Murray, Professor
University of Tennessee Boyd Center for Business &
Economic Research

John New, Lobbyist
City of Sevierville

Bob Rochelle, Attorney
Rochelle, McCulloch and Aulds, PLLC

Deborah Scott, Former City Councilperson
City of Chattanooga

Angela Scott, Capital Budget Coordinator
Division of Budget, Tennessee Department of
Finance and Administration

Helen Burns Sharp, Founder and President
Accountability for Taxpayer Money

Jamie Stitt, Assistant Commissioner of Business and
Workforce Development
Tennessee Department of Economic and
Community Development

J. Thomas Trent Jr., Attorney
Bradley

Richard Venable, Mayor
Sullivan County

Larry Waters, Mayor
Sevier County

Lauren Webb, Legislative Policy Coordinator
Tennessee Comptroller of the Treasury

Kenneth J. Young, Attorney
Buerger, Moseley, and Carson PLC

Sharon Younger, Founder and President
Younger Associates

DRAFT