The Industrial Development Board & PILOT Subsidies

BGR Presentation
to the Tax Fairness Commission

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The following is a presentation delivered by Janet Howard, BGR President & CEO, before the Tax Fairness Commission, City of New Orleans, on February 23, 2011.

GOOD AFTERNOON. Thank you for inviting me back to address you on the subject of the Industrial Development Board and the payment-in-lieu-of-taxes, or PILOT, subsidies that it provides to development projects.

BACKGROUND

The IDB is a nonprofit, public corporation that was established by City Council in 1973 pursuant to state legislation. The IDB is governed by a 15-member board. Members are selected by the Mayor and City Council for six-year terms. There are no term limits. As a matter of practice, each City Council member makes two appointments and the Mayor makes one. No professional qualifications are required for board membership. Members may not be employees of the City. The members serve without compensation.

The IDB serves as a conduit for the issuance of revenue bonds to finance eligible projects. Bonds issued by the IDB are exempt from state taxes and, depending on the transaction, may be exempt from federal taxes. Originally, only industrial projects were eligible under the state authorizing legislation, but eventually the universe of eligible projects was expanded to include almost all types of private development.

In conjunction with the bond issue, the IDB takes title to the property and leases it back to the business until the bond financing is paid off. At that point, the title reverts to the lessee. Under current Louisiana law, as long as the property is owned by the IDB, it is off the tax rolls. To offset the loss of property tax revenue that would otherwise be payable, the IDB is authorized to require an annual payment in lieu of taxes, or PILOT.

Once the lease is executed, the company remits the debt service on the bonds and the PILOT as lease payments.[1] The PILOT ultimately flows to the City, which then distributes it to the tax recipient bodies like normal property taxes.

In the 1970s and 1980s, the IDB typically set PILOTs at an amount equivalent to what would have been paid in property taxes if title to the property had remained in private hands. More recently, the IDB has set many PILOTs at a lower level, providing private enterprises with a subsidy in the form of a property tax abatement. I will refer to these reduced-rate PILOTs as PILOT subsidies.

In other words, PILOTs morphed from a way of compensating for lost tax revenues into a vehicle for tax breaks.

In two recent transactions, the New Orleans IDB has provided a PILOT subsidy without issuing bonds. The IDB entered into an "agreement to issue bonds" with both the Benson Tower and Hyatt projects, but did not actually issue any revenue bonds. The developers obtained other financing instead. The "agreement to issue bonds" still allowed them to execute the title transfer and leaseback of the property, and thus effectuate the PILOT subsidy. The IDB has cited the difficulties and costs of selling bonds in the current market as reasons for this alternative approach. The IDB has discussed pursuing similar agreements for the Hibernia Tower project and the long-stalled redevelopments of B.W. Cooper and Lafitte public housing sites.

PROJECTS

Prior to Hurricane Katrina, the IDB had approved 8 PILOT subsidies. After the storm, rising costs and the availability of GO Zone bond financing sent developers flocking to the IDB. This produced a spike in the number of PILOT requests. As of September 2007, the number of pending requests totaled 48.

Many of those projects have since withdrawn their requests or failed to materialize, and only a handful of new

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1 The bond proceeds and the lease payments flow through a trustee, rather than the IDB.

PILOT subsidy requests have been made since 2008. Altogether, the IDB has awarded 17 PILOT subsidies since Katrina, bringing the total approved to 25. We've come across only one case when the IDB has turned down a request for a PILOT subsidy.

13 of the post-Katrina PILOT subsidies have assisted residential apartment developments. These include seven redevelopments of public housing sites and six other apartment projects. The other four post-Katrina PILOT subsidies were for a drug store, a grocery store, the Hyatt hotel and the Benson Tower projects.

All but one of the residential developments have generally received PILOTs set at the level of the pre-development taxes. In the case of the public housing sites, this is zero. The taxes payable on the others have ranged from $8,900 to $128,000, with most of them at less than $30,000.

The IDB has set the PILOT below the pre-development taxes in three cases: the 930 Poydras Apartments, Benson Tower and Hyatt projects.

The seven public housing redevelopments have received 30-year PILOT arrangements. No taxes are payable for the first 15 years, even on market rate units. Taxes would be paid during years 16 to 30 on units other than the public housing ones. The average duration of PILOT subsidies for other residential developments is 14 years.

BGR lacks sufficient data on current property values to estimate the annual foregone taxes for all of these projects. However, to give you a sense of the impact, our March 2007 report on PILOT subsidies estimated a total of $2.7 million foregone from five projects awarded at that time.

In many cases, developers layered a PILOT subsidy on top of other federal and state subsidies in a project. For example, many of the apartment developments received federal tax credits, loans of federal funds and other public assistance. Tax credit equity alone covered 38% to 92% of the projected development costs, significantly reducing the carrying costs and making make the apartments more affordable. We questioned whether tax abatements on top of the significant federal subsidies were necessary and wise. We urged the IDB to analyze the need for the subsidy, including alternatives such as reducing development costs. These in some cases exceeded $300,000 a unit, or $260 a square foot. We expressed concern that in addressing one problem, housing affordability, the government was creating another, longer-term one by foregoing new resources to meet the increased demand for services that residential development creates.

PROBLEMS AND WEAKNESSES

When the IDB approves a PILOT subsidy, it is making an investment decision on behalf of the community. It goes without saying that the investment should be evaluated with a rigor worthy of any other long-term investment. It is not enough to consider a subsidy simply because it will enhance tax revenues or create jobs. It should be done only if it is strategic and necessary, and as efficient, effective and equitable as possible for the community.

When we looked at how the IDB reviewed, approved and monitored PILOT subsidies in 2007, we found serious problems, including inadequate information for evaluating PILOT requests, inadequate financial analysis, and a lack of standards for awarding PILOTs. We urged reforms to address these and other issues. Since then, the IDB has made some important changes:

- It revamped its application form to request more data from developers seeking PILOT subsidies. This includes specifying the amount and duration of the PILOT requested and stating the need for the subsidy.

- It now retains a consultant to analyze the project's financial need for the PILOT subsidy.

- It started using "claw-back" arrangements, by which it can increase the PILOT amount if the project generates more revenue or cash flow than projected.

Still, there are problems with the PILOT program:

- First, an appointed body is making decisions to forgive taxes, a matter with significant impacts for tax recipient bodies, including the city and the school system. State law does not require their consent. As a matter of practice, the IDB obtains a resolution of support from City Council, but not from the School Board, the body with the highest millage rate.

- Second, there is no requirement that the IDB's decisions tie in with an overall economic development strategy for the City. As a result, there's no assurance that the subsidies are going to the City's highest priorities and greatest needs. It's not enough just to show a financial or social return for a project. Now, the lack of coordination with the city's plan isn't the IDB's fault, since the city has not had a plan.

- The IDB lacks meaningful threshold criteria for project eligibility, such as a minimum level of job creation or a determination that a site will not be appropriately developed "but for" the subsidy. (Its current "but for" test focuses on a slightly different issue: does the specific proposed development need the subsidy.)

- Also missing are criteria for evaluating awards. For example, while the IDB uses a cost-benefit analysis to determine whether abatement will benefit the city, it does not have standards against which to measure the results.

- The IDB has not established any limitations on subsidy size or duration.

- The IDB provides limited opportunity for meaningful public review and comment on its projects. It often approves PILOT requests during the same meeting at which it receives the cost-benefit and financial need analyses. It does have public hearings, but in some cases, the IDB has held the public hearing after it approved the subsidy, making the hearing a meaningless formality.

- Lastly, it is difficult for the City and the public to track what happens after projects are built. The IDB does not regularly report on the estimated cost of PILOT subsidies, the measurable benefits they produce, or the projects' compliance with performance standards and claw-backs.

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Why should we care? First of all, the decisions made by the IDB shape the future tax base of the City. In my last presentation, I highlighted the long-standing problem of New Orleans having too much property off the tax rolls. The negative effects have included higher tax rates for other property owners, crumbling infrastructure and reduced services. PILOT subsidies can contribute to these negative effects if they needlessly keep property value from going onto the tax roll.

There are also fairness issues. Abatements can confer benefits on certain businesses at the expense of others, giving the beneficiary of the subsidy an unfair advantage. This can affect the viability of existing businesses. Such risks are particularly acute in the retail and housing arenas, where the subsidized development competes for business with unsubsidized developments.

To the extent that the subsidized businesses take revenues away from other businesses, the existing tax base of the local government is reduced. In other words, not only do we forego new taxes, we lose existing ones.

In addition, a subsidized development can increase a government's operating costs such as police and fire protection, street maintenance and schools, without providing commensurate operating funds to the local government. The end result is a transfer of the additional operating costs to others – including competitors. Other taxpayers effectively subsidize the beneficiary to the extent to which it does not contribute its fair share.

In short, subsidies to new businesses can harm existing property owners, both homes and businesses, in two respects: unfair competitive advantage and a need for higher taxes on the existing tax base to support the incremental service demand created by the subsidized business.

Finally, tax subsidies are too often viewed by developers and elected officials as "free money." Rather, they should be considered an investment of a future revenue stream of the local government. While it is an off balance sheet investment – sometimes referred to as a tax expenditure – it is nonetheless an investment, made in theory to produce development that would otherwise not occur. This demands careful analysis of the proposed investment.

BGR'S RECOMMENDATIONS

BGR recognizes that there may be instances in which tax subsidies are necessary and beneficial. However, the IDB must do more to demonstrate that the subsidies are strategic, necessary, and as efficient, effective and equitable as possible.

In 2009, the IDB asked us to prepare a set of recommended policies and procedures for PILOT. In the course of our research, we learned that the policies would vary, depending on whether the IDB's goal was job creation or area redevelopment. When we asked the IDB for guidance on these points, they asked us to prepare policies and procedures for both scenarios. For each strategic focus, we tailored eligibility criteria, evaluation criteria, a scoring system and performance standards. We have also proposed certain limitations on awards, again specific to the project type and tied to project benefits. We submitted our recommendations with annotations in October 2009, but the IDB has not brought them up for discussion.

We remain open to discussing our recommendations with the IDB and further assisting them in developing policies and procedures. Thank you for the opportunity to present this information, and I look forward to any questions you may have.

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