



The use of PILOT increment financing (PIF) to offset project costs

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The redevelopment of brownfield sites or projects involving the adaptive reuse of long-vacant buildings frequently present unique obstacles not faced in the development of a typical "greenfield" project. The cost of environmental remediation and monitoring, the expense of complying with updated building code standards and other complications arising from the re-use of former industrial sites or buildings for residential or commercial use are among the challenges faced by developers. When confronted with these obstacles, developers look for ways to bridge the "financing gap" to make these projects economically feasible. One innovative way to offset the added costs of these challenging development projects is through the use of "PILOT Increment Financing" or a PIF.

Simply put, a PIF structure allows for the diversion of monies which are otherwise payable to a taxing jurisdiction into a fund that is used either to offset the developer's project costs or to repay project financing. The arrangement requires the participation and cooperation of the taxing jurisdictions, an entity which can provide a real property tax exemption such as an industrial development agency (IDA), and the lender. When all of the parties have the shared goal of moving the project forward, a PIF can help turn a seemingly infeasible project into one which is economically viable and successful.

There are two essential elements required for the PIF structure to work. First, the developer must obtain a real property tax exemption and second, the developer's project must be eligible for a tax credit program.

For the first element, a developer must apply and qualify for a real property tax exemption through an entity such as an IDA. As part of such an exemption, the developer would be required to enter into a payment in lieu of tax (PILOT) agreement with the IDA, which would typically allow for reduced payments in lieu of taxes. The second element requires that the developer's project be eligible for tax credits through a program such as the New York Brownfield Cleanup Program or the New York Empire Zone Program. With the tax credits under such programs, the developer could obtain partial or even full reimbursement from NYS for the PILOT payments made by the developer. Since some or all of the PILOT payments will be reimbursed under the tax credit program, in a PIF transaction the amount of the PILOT payments is often adjusted upward to the full amount the real estate taxes would have been without the exemption. The difference between the full tax amount and the amount to be ultimately remitted to the taxing jurisdictions is the amount which, subject to the consent of the taxing jurisdictions, is available for "diversion."

In determining whether to allow a diversion of a portion of the PILOT revenues toward project-related costs or financing, a taxing jurisdiction will consider the public purpose served by the project. The public purpose could be the construction of needed infrastructure, the remediation of a contaminated site or the rehabilitation and reuse of a long-vacant building which has contributed to

neighborhood blight. Taxing jurisdictions frequently engage legal counsel to evaluate the project and the proposed PIF arrangement prior to seeking legislative approval for the diversion.

Although the diverted funds can be targeted toward specific development costs, given the fact that the PIF funds will be available over the course of the PILOT arrangement, it is more likely that the development costs will be financed up front and the funds will be applied toward debt service. Given the possible uncertainty of the payment stream, which, depending on the method of calculation of the PILOT payment, may be subject to changes in assessments and tax rates, a lender may not be willing to look solely to the PIF stream for repayment. A developer should be prepared to stand behind the debt or provide guaranties or other credit enhancements.

In addition, the parties must acknowledge and address the possible loss of the real property tax exemption due to a default by the developer, which would eliminate the revenue stream altogether. Particularly in today's political climate, a developer must also be mindful of the possible loss or reduction in the available tax credits which would adversely impact the economic benefit of the PIF structure to the developer. If possible, the developer would want to preserve the ability to revert to a standard PILOT abatement schedule and either eliminate the diversion or, if agreeable to the taxing jurisdictions, allow for a continued split of the reduced payment between the taxing jurisdiction and the project debt.

The availability of a payment in lieu of tax structure and tax credits also allows for a variant of the PIF arrangement in which diverted payments are used not by a developer but by a municipality, local development corporation or other public entity for other municipal or regional development projects. For example, certain public sector sponsored projects may be structured to require developers to apply for and maintain real property tax credits and commit to a PILOT arrangement for a specified period of time, thereby allowing for a diversion of a portion of their payments toward the costs of developing public infrastructure improvements. A leading example of this is the PIF arrangement established at Buffalo Lakeside Commerce Park, a commercial and light industrial park located in the city of Buffalo. For that project, a portion of the property owners' PILOT payments are diverted to a redevelopment fund which is then used to pay for roads, utilities and other infrastructure improvements at the park. With the cooperation of the various stakeholders, this type of "infrastructure PIF" can be a valuable tool for funding infrastructure development and advancing regional projects.

While a PIF transaction can be complicated, when approached cooperatively by the taxing authorities, the developer, its lender and an industrial development agency or other exempt entity, a PIF can help make a challenging project a reality.

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