Evaluation of the Proposed 7th Street Project PILOT in the City of Hudson, New York

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Introduction

A diminished supply of affordable housing has been one consequence of the rapid revitalization of the City of Hudson in recent years. Roughly two-thirds of the city's housing stock is rentals.[1] The 2017 *Housing Assessment of Columbia County*, in which Hudson is located, estimated that since the year 2000 rental prices within it have nearly tripled.[2] The resulting affordable housing crisis has become the focus of remedial efforts by the city.

In 2018, the City of Hudson Housing Task Force released the *Hudson Strategic Housing Plan*. This report highlighted the need for affordable housing in the city, and prioritized the development of mixed-income housing by private and non-profit developers, community groups, and individuals. Newly created rental housing was to serve a wide range of income levels, household sizes, and populations. A mix of senior, family, supportive, and transitional housing was sought, along with rentals at prevailing market rates.

The Galvan Foundation has proposed a multi-use new construction project at 75 North 7th Street that includes 83,000 square feet of residential space divided into 77 units of mixed-income housing and an additional 4,000 square feet of commercial space. The plan was developed in collaboration with City of Hudson Mayor Kamal Johnson to align with the goals set forth by the Housing Task Force. In support of this project, the Galvan Foundation seeks a Payment in Lieu of Taxes (PILOT) agreement, with a duration of forty years, that provides for an initial $77,000 per year payment to the city, with an escalator of 2%/year thereafter. The parcels which would be developed currently generate approximately $20,000 in property tax revenues.

To adhere to the requirements of the Department of Homes and Community Renewal's Low Income Housing Tax Credit program, the proposed agreement additionally specifies that the project's level of affordable housing be maintained for a 50-year period. Lastly, under the terms of the proposed PILOT the commercial space in the building would remain taxable.

This analysis looks at each of the terms of the proposed PILOT individually, discusses them in context of other recent PILOT agreements for affordable housing projects in small cities in the Hudson valley, presents alternatives, and discusses the pros and cons of the options.

[1] http://hcdpa.com/wp-content/uploads/2016/03/Columbia-County-Hudson-Housing-Needs-Assessment-Findings-Final-Edited-Sept-29-2017.pdf

[2] http://hcdpa.com/wp-content/uploads/2016/03/Columbia-County-Hudson-Housing-Needs-Assessment-Findings-Final-Edited-Sept-29-2017.pdf

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Other Recent Affordable Housing Project PILOTs in the Hudson Valley

Table 1 presents the key elements of a selection of recent PILOT agreements in Mid-Hudson small cities similar to the one proposed for Hudson, and the agreement proposed by the Galvan Foundation. These agreements summarize current practice in the region regarding PILOT payments per unit.

Notably, as recently as 10 years ago it was typical for PILOT payments in the region to be much lower. The Half Moon Terrace project in the City of Hudson, for instance, executed in 2010, had a minimum PILOT payment of roughly $705 per unit. The lowest PILOT payment identified for a project in the area within the last decade for an affordable housing project was for the Varic Apartments in The City of Newburgh. Signed in 2012 it provided for a minimum PILOT payment of $123 per unit.

Table 1: Recent PILOT Agreements in the Mid-Hudson Valley

Project	Year	Location	Developer	Units	Initial Payment	$ / Unit	Escalator	Duration
Newburgh Progress	2019	Newburgh	RUPCO	61	$73,200	$1,200	2%	17 Years
7th Street	2020	Hudson	Galvan Foundation	77	$77,000	$1,000	2%	40 Years
Landmark Place	2019	Kingston	RUPCO	66	$69,000	$1,045	2%	32 Years
Fallkill Commons	2018	Poughkeepsie	Hudson River Housing	78	$80,000	$1,026	1%	40 Years

The Initial PILOT Payment Amount

The proposed initial PILOT Payment of $1000 per unit is generally in line with the more recent trend of higher PILOT payments for this type of project. It is marginally lower than that for two of the three comparable projects we identified, but 20 percent lower than a third. The financial information provided by the Galvan Foundation indicates that the $77,000 per year proposed initial PILOT payment is likely the maximum that the project can support without reducing other operating costs (Table 2). It was calculated based on the minimum Debt Service Coverage Ratio of 1.15 required for financing. (This figure is derived by dividing the project's net operating income by the total debt service.)

This analysis assumes that the total debt service for the project is fixed. Thus in order to increase the PILOT payment to the city an equal reduction of an expense or an increase in revenue would be necessary.

A revenue increase is not an option. Since the project does not include market rate housing, achieving more income would require shifting units from one AMI bracket to a higher one, undermining the policy goal of generating added affordable housing. Additionally, the number of units proposed for this project and their specified AMI brackets are designed to comply with requirements for the tax credit and low-income housing funding the developer will be seeking (Table 3).

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Table 2: Budget Cash Projection

75 North 7th Street Hudson Galvan Initiatives Foundation Proforma 04/21/2020						
CASH FLOW PROJECTIONS						
Stabilized **EFFECTIVE INCOMES**		**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Residential Income	2.00%	908,956	927,135	945,678	964,592	983,883
Commercial Income	2.00%	42,898	43,756	44,631	45,523	46,434
Community Space Income	2.00%	0	0	0	0	0
Parking Income	2.00%	0	0	0	0	0
Ancillary Income	2.00%	6,930	7,069	7,210	7,354	7,501
Total Income		**958,784**	**977,959**	**997,519**	**1,017,469**	**1,037,818**
EXPENSES						
M&O Expenses	3.00%	227,585	234,413	241,445	248,689	256,149
Management Fee	2.00%	54,537	55,628	56,741	57,875	59,033
Utilities	3.00%	90,170	92,875	95,661	98,531	101,487
Building Reserve	3.00%	23,100	23,793	24,507	25,242	25,999
Operating Reserve	3.00%	30,365	31,276	32,214	33,180	34,176
RE Taxes	2.00%	77,000	78,540	80,111	81,713	83,347
Total Expenses		**502,758**	**516,525**	**530,679**	**545,231**	**560,192**
Net Operating Income		**456,026**	**461,435**	**466,840**	**472,238**	**477,626**
First Mortgage Debt Service		376,389	376,389	376,389	376,389	376,389
Second Mtg. Debt Service		12,000	12,000	12,000	12,000	12,000
Third Mtg. Debt Service		6,567	6,567	6,567	6,567	6,567
Fourth Mtg Debt Service		1,668	1,668	1,668	1,668	1,668
Total Debt Service		396,624	396,624	396,624	396,624	396,624
CASH FLOW						
Available Cash Flow		**59,402**	**64,811**	**70,216**	**75,614**	**81,003**
Debt Service Coverage Ratio (DSCR)		*1.15*	*1.16*	*1.18*	*1.19*	*1.20*
BANK DSCR REQUIREMENT	**1.15**					

Table 3: Detailed Income Budget

75 North 7th Street Hudson
Galvan Initiatives Foundation Proforma 04/21/2020

INCOME & EXPENSES

NON-RESIDENTIAL INCOME

	SF	$/SF	Total	
Commercial (above grade)	3,972	$12	$47,664	
Commercial (below grade)			$0	
Community			$0	
	# Spaces	$/Month		
Parking			$0	
	# units	$/Year		
Laundry			$7,700	
Subtotal Non-Residential			**$55,364**	*5.47% of total income*

RESIDENTIAL INCOME

		37% AMI		47% AMI		57% AMI		77% AMI	
# Units	*Rent*	*# Units*	*Rent*	*# Units*	*Rent*	*# Units*	*Rent*	*# Units*	*Rent*
0		4	$454	4	$ 597	0	$739	0	1,024
0		5	$490	4	$ 642	0	$795	14	1,100
0		5	$602	5	$ 785	0	$968	5	1,334
0		0	$689	0	$ 900	0	$1,112	0	1,535
0		0	$775	0	$1,011	0	$1,247	0	1,718
0	**$0**	**14**	**$87,312**	**13**	**$106,572**	**0**	**$0**	**19**	**$264,840**

Unit Type			*# Units*	**Totals**	*Total*
0-BR			8		$50,448
1-BR			23		$245,016
2-BR			15		$163,260
3-BR			0		$0
4-BR			0		$0
Total LIHTC Units			**46**		**$458,724**
Unit Type			*# Units*	**Totals**	*Total*
0-BR			0		$0
1-BR			15		$220,992
2-BR			15		$277,080
3-BR			0		$0
4-BR			0		$0
Total Non-LIHTC Units			**30**		**$498,072**
Total Residential Income					**$956,796**
	$27,523	**$1,469**	**CHECK**		**$956,796**
TOTAL ANNUAL INCOME					**$1,012,160**

				77%AMI		87% AMI		100% AMI	
# Units	*Rent*	*# Units*	*Rent*	*# Units*	*Rent*	*# Units*	*Rent*	*# Units*	*Rent*
0		0		0	1,024	0	1,166	0	$1,351
0		0		5	1,100	8	1,252	2	$1,450
0		0		2	1,334	10	1,516	3	$1,754
0		0		0	1,535	0	1,746	0	$2,021
0		0		0	1,718	0	1,954	0	$2,261
0	**$0**	**0**	**$0**	**7**	**$98,016**	**18**	**$302,112**	**5**	**$97,944**

Table 4: Detailed Expense Budget

MAINTENANCE & OPERATING COSTS				
M&O Expenses*		**Total**		
Legal		5,000	*$5,000*	*per proj.*
Accounting		16,000	*$16,000*	*per proj.*
Management Fee		$54,537	*6.0%*	*EGRI*
Fire & Liability Insurance		40,425	*$525*	*per unit*
Heating		44,450	*$175*	*per room*
Electricity		20,320	*$80*	*per room*
Water & Sewer		25,400	*$100*	*per room*
Supplies/Cleaning/Exterminating		25,400	*$100*	*per room*
Repairs/Replacement		63,525	*$825*	*per unit*
Salaries & Benefits		69,300	*$900*	*per unit*
Security			*$0*	*per unit*
Tax Credit Monitoring Fee		3,440	*0.75%*	*Max tax credit rent*
Elevator Maint. & Repairs	1	4,000	*$4,000*	*elev.*
Benchmarking		495	*$495*	*/bldg*
M&O Subtotal		**372,293**	***$4,835***	*per unit*
Real Estate Taxes		77,000	*$1,000*	*per unit*
Replacement Reserve		23,100	*$300*	*per unit*
Operating Reserve		30,365	*3%*	*Gross Rents*
TOTAL OPERATING COSTS		**502,758**	***$6,529***	*per unit*

**Expenses based on CPC 2018 Maintenance and Operating Standards*
Income and expense projections are subject to change.

The developer provided a high level of transparency by providing a detailed budget of operating expenditures at a granular level (Table 4). Nothing on the expense side of this budget stands out as extraneous or inflated. There is probably a small amount of room within it to negotiate. An elevator maintenance item of $4,000, for instance, might not be necessary in the years immediately after project opening, though creating a reserve fund for this purpose might be prudent in anticipation of large repairs in out years.

In its initial years, the project's available financial resources for operating expenses will be at their lowest. Overall, maintenance and operating costs are budgeted with an annual escalator of 3%. Thus, these will grow faster than both revenues and the PILOT payments to the city. This is not to say that the escalator is unnecessary, or inflated. It clarifies that the effect over time is to elevate operating expenses as a portion of the budget as the project ages.

In general, while there may be some room for negotiation on the initial PILOT payment, it is likely that any increase in that payment would be relatively small, and further tightening the operating budget of the project in the initial years of operation may not be the best way to maximize the revenue from the PILOT agreement.

The PILOT Duration

As shown in Table 1 above, the duration of PILOT programs for this type of project varies greatly in the region, with the shortest being 17 years (two years of construction and 15 years of operation), and the longest being 40 years. As a requirement of Department of Homes and Community Renewal's Low Income Housing Tax Credit (LIHTC) program, the project will be maintained as affordable housing for a period of 50 years, regardless of the PILOT's duration.

Private investment in the project (the mortgages) will be satisfied in 30 years. This is important for two reasons. The first is that after the mortgages are paid off the developer's uncommitted income from the project will increase substantially. The second is that the Real Property Tax Law provides in §420-a that a not-for-profit organization operating low-income housing properties is eligible for tax exemption on those properties. Once all private investment in the project is satisfied, it would be within the rights of the Galvan Foundation to apply for such tax-exempt status, which it would likely receive. Counterintuitively, therefore it is likely in the City of Hudson's best interests to grant a longer PILOT duration unless it already has an agreement with the developer that tax-exempt status will not be pursued in the future.

The city may therefore want to consider extending the PILOT agreement to 50 years to coincide with the 50-year requirement of the LIHTC program, contingent on receiving the tax credit. This would ensure that as long as the project is required to be affordable housing it will continue to make PILOT payments.

The Escalator

The proposed agreement includes a 2% annual escalator of the PILOT payment. As shown in Table 1, this is a typical escalator as it generally conforms to recent long-term inflation rates. There are many ways to structure the escalation of PILOT payments over the duration of the agreement. The method proposed is a fixed annual percentage increase. Other methods would be to use a variable percentage pegged to another indicator such as annual inflation, the percentage increase in the city's property taxes, the ratio of the PILOT payment to the overall property tax revenues of the city, etc. Another method of escalation is to create a "ladder" system whereby at regular intervals the payment increases by fixed amounts. This section will look at several options and their effects.

Table 5: Various Escalator Scenarios

	1st Year	Year 10	Year 20	Year 30	Year 40	Year 50	
Escalator	2022	2031	2041	2051	2061	2071	Total
2%	$77,000	$92,022	$112,174	$136,740	$166,685	-	$4,650,953
2.25%	$77,000	$96,162	$123,096	$157,573	$201,707	-	$5,189,997
10 Year Steps	$77,000	$102,000	$127,000	$152,000	$152,000	-	$4,655,000
2% / 50 Years	$77,000	$92,022	$112,174	$136,740	$166,685	$203,189	$6,512,614

Under the proposed PILOT payment and escalators, the city will collect $4,650,953 over the proposed 40-year duration (Table 5). The 2.25% scenario above demonstrates the overall impact of relatively small increases in the escalator. The 10-year step scenario increases the PILOT payment by $25,000 every 10 years over 40 years; it results in roughly the same final total of the PILOT payments. Back loading the payment schedule in this manner may be preferable to the developer as it keeps the pilot payment fixed for the first 10 years of the agreement. Annual increases may be preferable to the city as the increase in PILOT payments would parallel annual increases in the city's fixed costs, though the amounts of money are unlikely to make a large impact in the city's budget (now nearly $12 million) one way or the other. The last line in Table 5 demonstrates the effect of extending the 2% escalator to a 50-year duration.

Another option would be to fix the escalator to the percentage of change in the property tax rate of the city from the year prior. The advantages of this method would be that in times of crisis the city could increase the payment by more, and that the developer would share the same percentage increase in their payment to the city as other property tax payers. The disadvantage of this method is that, with a state-mandated property tax cap in place and the overall increasing reliance on the sales tax as a percentage of city revenues in typical years (Table 6), the escalator would likely often be below the proposed 2%. Also, given the pressure policy makers are always under to not raise the property tax, consideration of the PILOT payment is not likely to be a factor in that discussion.

Table 6: City of Hudson Financial Data

City of Hudson Tax Rates per $1000 Assessed Value		Budget	Property Tax Revenues	Full Value	Sales Tax Contribution	Sales Tax as a % of Expenditures
Year	Rate					
2020*	7.590613	$11,945,838	$5,452,273	$718,291,527	$1,900,000	34.8%
2019	12.9623	$11,679,799	$5,270,104	$528,583,055	$1,700,000	32.3%
2018	12.58342	$11,165,715	$5,116,606	$478,333,895	$1,500,000	29.3%
2017	12.69062	$10,588,605	$4,967,589	$419,952,792	$1,400,000	28.2%
2016	12.67301	$10,328,376	$4,879,753	$385,050,713	$1,340,000	27.5%
2015	12.8529	$9,893,183	$4,831,439	$376,036,218	$1,327,000	27.5%
2014	12.6762	$9,599,491	$4,759,911	$375,499,929	$1,315,000	27.6%

*2020 Full Value Calculated from Tax Revenues and Tax Rate. There was a reassessment conducted in 2019.

Pegging the escalator to external macro indicators such as the inflation rate would likely also result in a decrease in the total revenues generated by the project, barring a scenario where inflation becomes rampant. While it is impossible to predict the future, the current economic crisis, and the policies of the Federal Reserve since the last economic downturn, would indicate that all efforts at a macroeconomic scale are aimed at keeping inflation low.

Another option might be to structure the escalator with ladder steps in the percentage. Offering the developer a lower escalator in the first 10 years, and then increasing the escalator by small increments every 10 years would back load the PILOT payments to the city in a manner similar to the ladder structure with fixed increases in the payment, but would also have annual increases in the payments, and provide a higher total revenue from the PILOT. The following hypothetical scenario sets the escalator at 1.5% for the first 10 years, then increases to it to 2% for 10 years, 2.5% for 10 years, and 3% for the final 10 years of the project (Table 7).

Table 7: Escalator % Step Increases

	1st Year	**Year 10**	**Year 20**	**Year 30**	**Year 40**	Total
Escalator	2022	2031	2041	2051	2061	
% Steps	$77,000	$88,475	$108,378	$139,411	$187,357	$4,704,598

In sum, there is some room for the negotiation of the escalator. However, the 2% escalator in the proposal is typical in the region for the type of project proposed for Hudson. Any outcome must balance the total revenues generated over the duration of the PILOT and the timing of the escalation of the payments (annual increases, laddered increases, back ending the structure, etc.), with the developer's ability and willingness to agree to the terms.

Conclusion

Generally the proposed PILOT for the project is defensible and clearly in the public interest given the stated policies of the city. The initial PILOT payment appears to be the maximum that the developer can offer given the terms of their financing, and the reserve requirements of the low income housing tax credit and other programs for which they wish to apply. The duration of the PILOT as proposed is reasonable, extending 10 years past when the private investment in the project will be satisfied, though it may be in the city's interest to extend it further. The 2% annual escalator of the PILOT payment in the proposal is the norm, though there may be room for negotiation on that matter.

Too many alternative scenarios are possible to detail all of them here. One that might prove interesting to the developer is to lower the escalator to 1.5% in the first 10 years, and then increase it in steps of .5% for ten-year increments topping out at 3% for the last 20 years, for 50 years (Table 8). This would assure the city a total of $6,916,866 in income (Table 8), with most coming when expenses will no doubt be higher. It gives the developer more to work with in early project years, and shifts more of the obligation to a time at which their discretionary revenue is higher because mortgages are satisfied. And if there is inflation, the developer pays in cheaper dollars.

A caveat: without knowing the estimated assessed value of the completed project, and the future tax rates, it is impossible to calculate the difference between the planned PILOT payments in the future and what the potential tax liability of the property would be.

Table 8: Escalator %Step Increases Over 50 Years

	1st Year	Year 10	Year 20	Year 30	Year 40	Year 50	
Escalator	1.5%	2.0%	2.5%	3.0%	3.0%	-	
Year	2022	2031	2041	2051	2061	2071	Total
% Steps	$77,000	$88,475	$108,378	$139,411	$187,357	$251,792	$6,916,866

In coming to a decision on the terms and approval of a PILOT, the city must balance elements of benefit and cost to determine the public interest. The first question should always be: “Is the proposed project in the best interests of the people of the city?” It is clear, given the need for affordable housing in the City of Hudson, that this project meets this standard. The following question concerns cost: “How do the various elements of the PILOT agreement work together and what will the fiscal result be?” This report finds the proposed PILOT agreement reasonable, though there is likely room within the agreement to negotiate small changes.