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NONPROFITS: POLITICAL ISSUES

PILOT Pressures for Major Nonprofits

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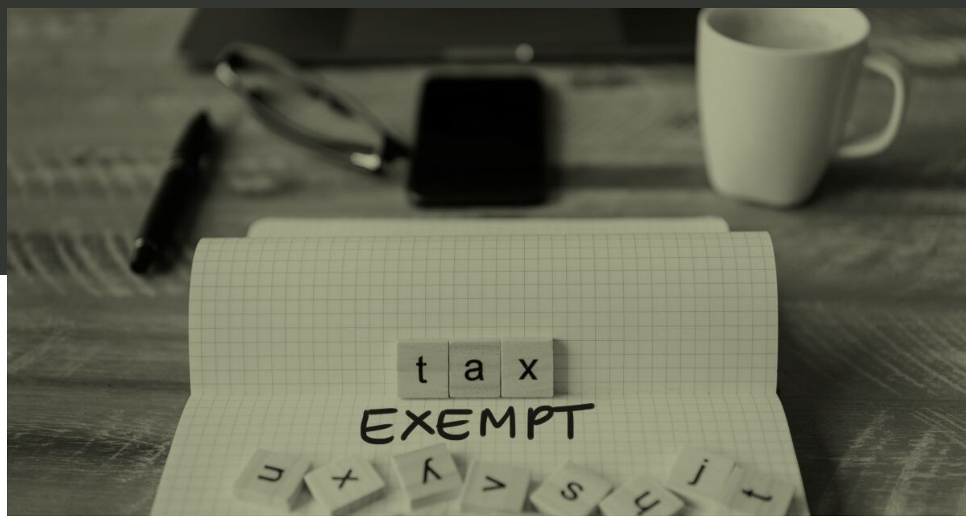

In recent years around the nation, local governments have faced critical budget shortfalls. At the same time, the need for public services and assistance has skyrocketed due, at least in part, to growing economic inequality.

Legislators and officials have tried to squeeze every possible nickel and dime out of the taxpaying base of individuals and entities. But in many localities, the biggest players and property owners are the "eds and meds": the major health care and higher education institutions. Not only are they exempt from *income* tax (federal, state, *and* local), they are generally relieved of property-tax obligations as well.

For municipalities, having a significant swath of its (otherwise taxable) real estate in tax-free status creates huge financial stresses. Not only do the local governments lose the considerable *property-tax* revenue but these eds and meds use a large – sometimes disproportionate – percentage of government services. The burden to pay for them – including police and fire protection – falls back on the non-exempt business and individual property owners.

Nonprofits, Property Taxes, and PILOTS

Local governments have become remarkably creative in crafting ways to help ameliorate their revenue woes.

With so much of their real estate owned by property-tax-exempt groups, they have become laser-focused on possible solutions involving those same nonprofit entities. We've reported on this phenomenon for several years. For instance, in *Local Governments Eager to Snag Revenue from Nonprofits* (April 12, 2016), we wrote: "Nearly every week, all across the country, different levels of government devise strategies — sometimes ingenious, occasionally pernicious — to get tax revenue from already-strapped nonprofits…."

One example is a clever *backdoor* way to collect money from tax-exempt organizations. The strategy – simply put – is to change the terminology: Don't call a revenue-raising device a "tax." Instead, call it a "fee." These local governments are now adding so-called fees "for … anything … they can think of." For instance, 501(c)(3)s in Pewaukee, Wisconsin, now pay a "fee" for a fire hydrant and a separate one for extra streetlight use.

Another approach is a direct assault on the historically hallowed property-tax *exemption* itself. Since taxation and any exemption from it are matters of legislative grace, why not restrict or narrow the circumstances under which a landowner gets a free pass? After all, part of what the large eds and meds are doing on their vast real-estate holdings is no different than ordinary commercial activities. Government moves to tax the landholdings of nonprofits generally trigger fierce resistance and lawsuits. In *Princeton U. Settles Property Tax Exemption Challenge* (February 7, 2017), we described *unsuccessful* challenges in New Jersey.

A middle-ground solution is the use of "PILOTS"; that is, "payments in lieu of taxes." These are voluntary agreements between nonprofit organizations and local governments to help pay for key public services including police and fire protection along with public works, all of which benefit the large nonprofits and their constituents. Generally, PILOT agreements include terms with standard payment formulas; sometimes, though, the parties negotiate the terms on a case-by-case basis.

PILOTS are generally viewed as sensible and fair compromises for all concerned: the government, the nonprofits, and the local community. But getting from the original agreement to pay to the *actual payment* of the promised amounts can sometimes be a challenge. And recent news stories suggest that, in several cities, controversies over payments-in-lieu-of-taxes arrangements are boiling over.

Boston's PILOT Model

These days, there's serious PILOT trouble in Boston. This metropolitan area had pioneered the payments-in-lieu-of-taxes model, in large part because of its concentration of prestigious educational institutions and medical centers. The need for a creative and equitable revenue solution was urgent; "…something like half of the real estate in Boston is in the hands of either a governmental entity which is tax exempt, or a nonprofit entity which is tax exempt…."

In 2010, a city task force developed the Boston PILOT Program. There was a phase-in period of five years. It worked in the beginning with "full nonprofit participation," having apparently, "struck a 'reasonable balance' of the needs and responsibilities of the various parties." The PILOT Program applied to nonprofits with over $15 million in real estate assets. These groups were expected to turn over 25% of the property tax rate for their landholdings. Nonprofit organizations subject to the 25% payment were eligible to reduce half of the PILOT payment if they could show "offsetting community benefits."

But there's a kicker. While the PILOT Program *agreement* is legally binding, the payments – strictly speaking – are "voluntary." The large Boston nonprofits including the many world-renowned eds and meds are all "expected to contribute" but, generally, only the healthcare-sector groups have made the payments. This "med" compliance rate has been over 94 percent.

But the universities – among the most prestigious in the world – "have been less cooperative." For 2017, there was only about 60% compliance from this sector which happens to include some institutions with multi-billion-dollar endowments. (Harvard has the largest endowment in the world of over $39 billion and pays its seven investment managers a total of $58 million.) That year, Harvard paid just $3.2 million of its expected $6 million PILOT obligation; Boston College paid just $335,000 of its $1.4 million amount due.

A 2018 editorial in the Boston Herald savaged these institutions for not paying up, "thus depriving Bostonians of valuable city services and opportunities." At a July 2018 meeting of the Boston City Council, "an array of nonprofits and community groups in that city banded together as the PILOT Action Group to demand that Boston's major charitable institutions step up and keep their promises…."

In 2018, Harvard increased its contribution to about $9.8 million, but that payment was only 79% of the PILOT-agreement total payment obligation. And even that compliance effort was tweaked to take full advantage of the wiggle room built into the Boston PILOT model which allows an institution partial, in-kind, credit against the full amount due for certain "community benefits." So Harvard's PILOT "payment" that year was only four-fifths of the amount it had voluntarily agreed to contribute and of that just-under $10 million, only $3.6 million was in cash. The remaining $6.2 million was a credit for "community benefit," a "category over which the nonprofit, not the city, has definitional control."

In a report by a watchdog group in summer 2019, data showed that "not even 25 percent of the eligible nonprofits" – that is, those with real estate holdings over $15 million – "paid the full amount."

Now, in early 2020, the city and its taxpaying inhabitants (individuals and businesses alike) are fed up and have had enough. The Model PILOT Program is "slated for serious reform." Boston's Mayor Marty Walsh "has made it known that he wants 100-percent participation, three of the [… city council members …] have filed a reform ordinance, and the new city council president Kim Janey promised during her inaugural address that she will convene a committee to evaluate the program."

Other PILOT Trouble Spots

Boston is not the only metropolitan area rethinking the PILOT model, this so-called "solution" to extracting a contribution from services-gobbling but tax-exempt "eds and meds."

In Baltimore, the powers-that-be are reconsidering the PILOT deal made several years ago. See *Activists rally for Hopkins, other nonprofits to 'pay their fair share' as Baltimore council reviews tax deal* (December 19, 2019). The problem in Baltimore is a serious change of circumstances; newly enacted state mandates now impose drastically larger amounts to be spent on public education. While the PILOT agreement was fair and reasonable in light of earlier fiscal realities, that's no longer the case.

And in Providence, Rhode Island – where tax-exempt organizations own 40 percent of the real estate – there is trouble for the city's treasury and for the future of the city's PILOT agreement. Specifically, a firm called Lifespan – the state's largest hospital group which also happens to be its largest employer – ran a $55-million deficit in the 2018-2019 fiscal year. The group will not be able to decide until late spring whether it can pay its scheduled $400,000 annual PILOT payment. Of course, the city budget of Providence has already included it as "expected revenue." Officials are now saying they may want to "… go back to the table and make sure" for the future that PILOT payments "… aren't voluntary…."

Conclusion

The PILOT model seemed a fair compromise when first launched but now it's clear there are drawbacks to the voluntary nature of these agreements. For cash-strapped municipalities with heavy concentrations of tax-exempt institutions with vast landholdings, this solution of payments-in-lieu-of-taxes may or may not be the answer.

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