NONPROFIT PILOTS

(PAYMENTS IN LIEU OF TAXES)

POLICY BRIEF

By Daphne A. Kenyon and Adam H. Langley

Local governments forgo roughly 4 to 8 percent of total property tax revenues each year due to the exemption for hospitals, universities, and other charitable nonprofits.[1]

In all 50 states, property owned by charitable nonprofits and used for a tax-exempt purpose is exempt from the property tax. Despite the benefits these institutions provide, including valuable services and jobs for residents, they also impose costs for police and fire protection, street maintenance, and other public services. The property tax exemption can fiscally strain local governments and shift a larger share of the property tax burden to home owners and businesses.

To help offset revenue losses from the property tax exemption, some local governments ask nonprofits to make voluntary payments in lieu of taxes (PILOTs).[2] PILOTs are typically far less than what nonprofits would pay if they were taxable, but they can contribute significantly toward the cost of the public services they consume.

As of 2012, at least 218 localities in 28 states had received PILOTs, amounting to more than $92 million per year.

Most PILOT revenue comes from "eds and meds" in the Northeast. Colleges contribute about two-thirds of PILOT revenue, and hospitals pay another quarter (figure 2). The Northeast accounts for roughly 75 to 80 percent of PILOT activity. Boston, Providence, New Haven, Baltimore, and Pittsburgh are some of the major cities that have received PILOTs (table 1).[3] Nonprofit property is highly concentrated in a small number of jurisdictions—namely college towns, state capitals, and central cities.

PILOTs go by many different names, including "service fees," "voluntary contributions," or simply "gifts." To add to the confusion, the term "payment in lieu of taxes" is also used to describe payments from businesses, state or federal government, public universities, and public authorities. This policy brief covers all voluntary payments made by private nonprofits as a substitute for property taxes, regardless of what they are called.

Figure 1

States with Localities That Receive PILOTs (2000–2012)

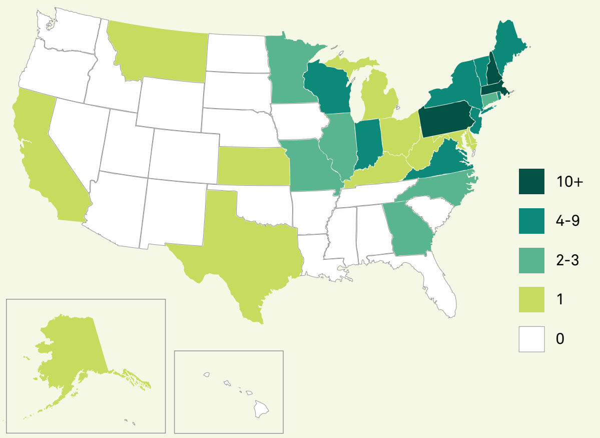
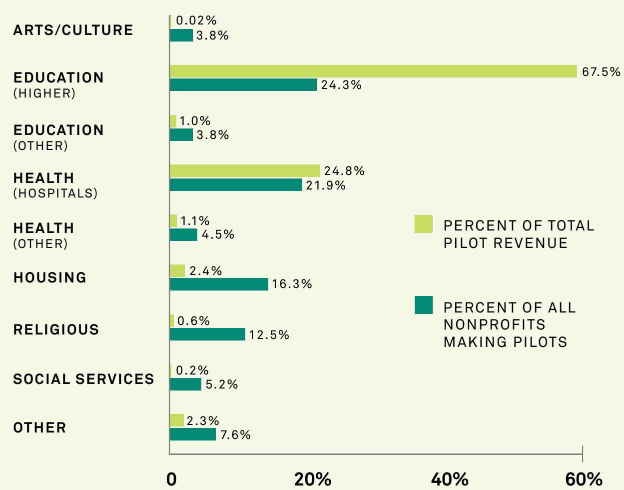


Figure 2

Types of Nonprofits That Make PILOTs



Source (figures 1 and 2): Langley, Kenyon, and Bailin (2012).

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Why Is There Growing Interest in PILOTs?

- **Anti-tax sentiment.** The current political environment has led local governments to seek alternative revenue sources rather than raise taxes.

- **The Great Recession.** Many local governments have faced severe fiscal pressures and have sought new revenue sources to compensate for declines in state aid, property taxes, and other revenue sources since the late 2000s.

- **The health and education sectors' increasing share of the U.S. economy.** A rise in the share of property owned by tax-exempt nonprofits has diminished the local property tax base. One analysis found that between 2006–2007 and 2011–2012, the share of total assessed value that was tax-exempt had grown in 16 of 20 large U.S. cities.[4]

- **Declining support for the nonprofit tax exemption.** As some hospitals aggressively pursue unpaid bills for uninsured patients, colleges raise tuition, and nonprofit executives receive very high compensation, some voters are questioning the charitable nature of these institutions.[5]

Why Do Nonprofits Choose to Offer PILOTs?

- **A sense of community responsibility or enlightened self-interest.** The success of many nonprofits depends on the success of their host community. PILOTs help to pay for policing and other services that improve the city's quality of life and benefit the nonprofit.

- **Coercive tactics.** One strategy used by local governments to gain leverage in PILOT negotiations is to request a PILOT when a nonprofit needs a building permit, zoning change, or some other approval from the city. Nonprofits may view these requests as extortion while others see the payments as bribery for special treatment. In some cases, nonprofits agree to PILOTs after the city or state has threatened to impose a new tax or fee. Finally, some nonprofits have made PILOTs to avoid challenges to the organizations' tax exempt status. These coercive tactics sometimes "work" in the sense that they lead to large PILOTs, but they backfire at least as often—driving nonprofits away from the negotiating table and leaving the city with no PILOT, a damaged reputation, and possible legal fees.

Table 1

U.S. Cities That Receive the Most PILOT Revenue

City	State	Year	PILOT REVENUE		Number of Nonprofits Making PILOTS
			Total $	% General Revenue	
Boston	MA	2015	27,925,183	0.84%	36
New Haven	CT	2015	10,936,010	1.49%	2+
Providence	RI	2016	8,233,374	0.94%	7
Cambridge	MA	2015	6,919,135	0.64%	15
Princeton	NJ	2015	3,610,000	5.93%	6
Erie*	PA	2015	2,862,897	0.44%	13
Baltimore	MD	2015	2,411,533	0.07%	15
Lancaster	PA	2015	1,614,344	2.08%	38
Lebanon	NH	2016	1,553,546	4.78%	1
Ithaca*	NY	2014	1,550,619	0.86%	2
Pittsburgh	PA	2015	419,000	0.07%	41 (in 2012)

Note: This table shows updated data for localities identified as receiving the most PILOT revenue in a 2012 survey that still receive a PILOT. (Langley, Kenyon, and Bailin 2012).

* Table shows combined PILOT revenue for the city, county, and school district.

** General revenue is from the Census Bureau's 2013 Survey of State and Local Government Finances, but adjusted for inflation to match year with PILOT revenue for each city.

PROs of PILOTs

- **Nonprofits should pay for public services they consume.** Nonprofits depend on a range of public services for their operations—police and fire protection, street maintenance, snow removal, and more. It is reasonable to expect nonprofits to offer PILOTs to help cover their share of these service costs. Otherwise, home owners and businesses will need to pay more taxes to cover these costs.

- **The benefits and costs of the property tax exemptions are distributed unevenly.** One common rationale for the nonprofit exemptions—the quid pro quo theory—is that because nonprofits provide public benefits, they deserve a tax subsidy. However, there is a geographic mismatch between the benefits and costs of nonprofit activities, with broadly dispersed benefits and highly concentrated costs. For example, a university's education and research activities often benefit an entire state and in some cases the whole world, but the cost of providing police and fire protection for the university is borne entirely by city taxpayers. PILOTs help address this spatial mismatch by diminishing the share of the cost borne by city taxpayers.

- **Greatest tax savings go to nonprofits with the most valuable properties, not those that provide the most valuable services.** Only about one-third of nonprofits own property, so the majority of nonprofits receive no tax savings from the property tax exemption. Among nonprofits that do own property, average tax savings for hospitals ($3.7 million) and higher education institutions ($2.9 million) are much greater than average savings for nonprofits that provide human services ($107,156), community improvement ($88,327), housing and shelter ($76,111), and all other types of organizations.[6] Thus, the nonprofit tax exemption is a very imprecise subsidy for encouraging charitable activities. Because most PILOT revenue comes from hospitals and colleges, PILOTs can help address this imprecision.

CONs of PILOTs

- **PILOT negotiations are often contentious, ad hoc, and secretive.** Local governments sometimes use very agressive tactics to try to compel nonprofits to make PILOTs. These measures can erode important relationships between governments and nonprofits and damage each side's reputation even if they ultimately generate zero revenue. In addition, the voluntary nature of PILOTs means the amount is usually determined in an ad hoc manner; similar nonprofits may pay very different amounts, and small nonprofits may pay more than much larger organizations. Finally, PILOTs are often determined in secretive private meetings in contrast to decisions about taxes that result from public debate.

- **PILOTs provide limited revenue.** PILOTs account for less than 0.25 percent of general revenues for 70 percent of localities with data, and more than 1 percent of revenues for just 11 percent of localities, according to the most comprehensive analysis of PILOTs to date.[7] Table 1 shows PILOTs as a percent of general revenue for localities receiving the most PILOT revenue in a 2012 survey. The revenue potential of PILOTs is usually far lower than the proceeds of higher tax rates, higher fees, or an expanded tax base.

- **PILOTs could lead nonprofits to raise fees or cut services.** The funds for PILOTs do not come out of a black box; nonprofits will need to increase revenues and/or cut spending to cover this cost. This response will vary across organizations. An increase in fees is one of the most likely responses to a PILOT because many nonprofits receive a large share of their revenue from fees and have some flexibility to raise prices without facing a significant drop in demand for their services. For example, a college could increase tuition or a hospital could increase some fees. It is also possible that a nonprofit would cut some charitable services that are not central to their core mission. However, as long as PILOTs are truly voluntary, it is unlikely that a nonprofit would make a major operational change or cut key services when it can simply say "no" to the PILOT request.

Recommendations

Keep PILOTs voluntary and avoid undermining the charitable tax exemption itself. Nonprofits sometimes worry that the term "payment in lieu of taxes" creates the impression that they should be paying taxes and could undermine their tax-exempt status in future court decisions. These organizations may prefer to call their payments "voluntary contributions" or "service fees." Many long-term contracts for PILOTs stipulate that they are voluntary and in no way alter the nonprofit's tax-exempt status.

Communicate respectfully. Collaboration between nonprofits and local government is the foundation for effective PILOTs. These payments are voluntary, so local officials must explain the need for a PILOT, demonstrate that they are trustworthy partners who will use the funds efficiently, acknowledge nonprofits' contributions to their community, and listen to their concerns. For example, in 2011, Providence faced a $110 million budget deficit and possible bankruptcy. Mayor Angel Taveras raised taxes, closed some public schools, reworked labor contracts, and suspended cost of living adjustments for its public pensions. He also said "shared sacrifice" meant that nonprofits should increase their PILOTs. It took longer than a year, but ultimately the city negotiated PILOTs worth an additional $48 million over 11 years from the city's seven largest nonprofits, which helped the city avoid bankruptcy.[8]

Justify the amount of the PILOT. The amount of a PILOT should reflect the cost of providing services to a nonprofit and use some basis to calculate a payment. In Boston, for example, about 25 percent of the City's budget goes to core public services that directly benefit nonprofits—police and fire protection, street cleaning, and snow removal—so a PILOTs Task Force determined that the contribution should equal 25 percent of what a nonprofit would owe if fully taxable.[9]

Earmark PILOTs for public services consistent with a nonprofit's mission. Some nonprofits worry that making an unrestricted contribution to local government violates their mission or will upset donors. An alternative is to target a PILOT to fund activity that directly benefits the nonprofit or otherwise supports its mission. In Worcester, Massachusetts, earmarking funds broke an impasse in PILOT negotiations. University funds were used for the City's public library and improvements to public parks near their campuses.[10]

Pursue long-term PILOT agreements. Renegotiating PILOTs every few years imposes costs on all parties and can become contentious. Long-term agreements, ranging from 5 to 30 years, provide a predictable revenue stream for local governments and a known budget number for nonprofits. Typically, these contracts specify a payment in the base year, an inflator so that PILOTs keep up with inflation, and a number of years for payment.

Reduce cash PILOTs if a nonprofit agrees to provide new services to local residents. Most nonprofits strongly prefer to provide services rather than make cash PILOTs, but local governments typically prefer cash, which can be used to fund their highest priorities. City officials and nonprofit leaders can identify which services would be most valuable for local residents and most appropriate for each nonprofit to provide. Boston's PILOT program allows nonprofits to reduce their cash contributions by up to half for providing certain community benefits.

Acknowledgment

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NOTES

1 Daphne A. Kenyon and Adam H. Langley, *The Property Tax Exemption for Nonprofits and Revenue Implications for Cities* (Washington, DC: Urban Institute, 2011).

2 For a comprehensive report on PILOTs, see Daphne A. Kenyon and Adam H. Langley, *Payments in Lieu of Taxes: Balancing Municipal and Nonprofit Interests* (Cambridge, MA: Lincoln Institute of Land Policy, 2010).

3 Adam H. Langley, Daphne A. Kenyon, and Patricia C. Bailin, "Payments in Lieu of Taxes by Nonprofits: Which Nonprofits Make PILOTs and Which Localities Receive Them" (Cambridge, MA: Lincoln Institute of Land Policy, 2012).

4 Mike Maciag, "Tax-Exempt Properties Rise as Cities Cope with Shrinking Tax Bases," *Governing*, November 2012.

5 Kenyon and Langley (2010), see footnote 2.

6 Joseph J. Cordes, "Assessing the Nonprofit Property Tax Exemption: Should Nonprofit Entities Be Taxed for Using Local Public Goods?" in *Value Capture and Land Policies*, ed. Gregory K. Ingram and Yu-Hung Hong (Cambridge, MA: Lincoln Institute of Land Policy, 2012).

7 Langley, Kenyon, and Bailin (2012), see footnote 3.

8 Emily Badger, "An Uneasy Peace for a Cash-Strapped City and Its Prestigious Nonprofits," *The Atlantic Cities*, December 19, 2013.

9 Ron Rakow, "Payment in Lieu of Taxes: The Boston Experience," *Land Lines*, January 2013.

10 Daphne A. Kenyon and Adam H. Langley, "Payments in Lieu of Taxes by Nonprofits: Case Studies," *State Tax Notes*, July 18, 2011.

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