Providence is fortunate to host a diverse array of nonprofit institutions that enhance the quality of life and economic well being of our City and our State. Governments support and encourage the social benefits nonprofits provide through the tax code. With that said, nonprofits impact local government finances, so in many cities nonprofit institutions and municipal governments they develop a network of cooperative agreements to help fund City services.

Because the City of Providence faces both an existential financial crisis and a distorted property tax structure, the City Council organized a Revenue Study Commission. The Property Tax Subcommittee has identified a need for additional revenues from other sources to begin to resolve these distortions. The Commission's Nonprofit Subcommittee was assigned the task of studying the impact of the nonprofits on the City's finances, and exploring what constructive role the nonprofits do and could play in comparison to those played by their peers in other cities.

This Report will address that issue in six parts.

First, the Report will calculate the net cost to the City of services it provides to nonprofit institutions net of the State aid program that provides partial compensation for these services.

Second, the Report review the pros and cons of the concept of agreements with nonprofits for payments in lieu of taxes (also known as "PILOT agreements").[1]

Third, the Report will present findings from Boston and New Haven, cities that have reached agreements with nonprofits that could provide a basis for Providence's nonprofits.

Fourth, the Report will propose a formula or approach to allocate this burden among Providence nonprofits to close this gap.

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[1] People discussing this topic sometimes use the acronym "PILOT" also to refer to State programs that provide aid in lieu of taxes. As discussed further at p. 8 below, we will refer to State aid programs in this Report as "grants in lieu of property taxes" or GILOTs.

Fifth, the Report will identify other ways to seek appropriate relief from the nonprofits should they prove not to be amenable to PILOT agreements that are fair to the City.

Finally, the Report will make recommendations for improvements to the current program.

1. <u>The net financial impact nonprofits impose on the City of Providence.</u>

The City of Providence has an annual budget exceeding $613 million, a majority of which is devoted to the public schools. Providence's private property owners and businesses pay taxes to fund this entire budget, regardless of whether they have children in the public schools or make actual use of the City's other services. Businesses (which, as some nonprofits do, perform such useful social functions as providing employment to Providence residents and purchasing goods and services from other Providence businesses) and homeowners (who, as some nonprofits do, frequently engage in volunteer activities for the good of the City) pay taxes to fund the entire City government because this is a basic obligation of citizenship. Government services do not, for the most part, constitute an "a la carte" menu for taxpayers to accept or refuse based on their personal situation; instead, we all combine our resources to fund a single government that benefits everyone.

Notwithstanding this basic social contract, this Report recognizes the value of providing a subsidy to nonprofits by exempting them from supporting those government programs (most notably the public schools) that do not affect their institutions directly.[2] For these reasons, the Report will limit its calculation of the City's services provided to nonprofits to the following areas: Public Safety, Planning and Development and Public Works. As indicated in Table 1

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[2] It is worth noting that these City programs may provide important indirect benefits to nonprofits; for example, if a professor bases her decision to work at a college or university in part because of the opportunity of sending her children to the Providence public schools, this is a benefit to the university's faculty recruiters.

appended to this report, we calculate these programs together have an annual cost of $164.7 million. In its November 20, 2010 Report, the Commission to Study Tax Exempt Institutions estimated the nonprofit institutions' share of City services at 22-25% of the total, based upon their ownership of 23% of the City's land. We therefore estimate the nonprofits' collective share of this gross cost as $36.3 million to $41 million.[3]

Fortunately for the City of Providence, the State of Rhode Island funds a program to offset a portion of the burden of serving major nonprofits. This program currently provides approximately $23 million annually.[4] As a result, the current funding gap is approximately **$13.3 million to $18 million per year.** Of this amount, a group of colleges currently fund a program that provides contributions to the City of $2 million each year under a 2003 Memorandum of Understanding ("MOU"). Those payments will be considered at p. 11 below as a credit against the recommended PILOT contributions calculated in this Report.

2. Addressing the gap through voluntary agreements.

There are policy reasons to support the use of PILOT agreements to address the municipal

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3 The November, 2010 Report developed a lower estimate of the cost of City services to nonprofits by choosing not to include several categories of services contained in Table 1, below. We believe that the more inclusive set is more accurate.

4 The major nonprofits note that the Rhode Island grant program of $23 million is targeted to offset the burden of hosting hospitals and postsecondary educational institutions. They believe this creates a mismatch, because the $23 million "credit" is being applied to all nonprofits, not just the major ones. On the other hand, the City's major nonprofits are different because their inventory of real property includes assets such as 2 Dudley Street that would be fully taxable in virtually every other jurisdiction (*see* n. 5, below), but are exempt in Rhode Island. In a perfect world, one might choose to remove the smaller nonprofits from the equation and increase from the recommended 20% up to 100% the recommended PILOT for these profit-making properties. Instead, this Report will make neither refinement but assume that one roughly cancels out the other.

financial burden caused by nonprofits, but there are disadvantages as well. The Lincoln Institute of Land Policy published a report in 2010 entitled PAYMENTS IN LIEU OF TAXES BALANCING MUNICIPAL AND NONPROFIT INTERESTS (referred to below as the "Lincoln Report") that provides an exhaustive list of the pros and cons at Chapter 4, pp. 29-34, from which we select and excerpt the following key items:

a. Arguments in support of PILOTs.

- Perhaps the most basic reason to expect nonprofits to make PILOT contributions is that these organizations directly benefit from the public services provided by municipalities, and thus should make payments to offset their cost.

- PILOTs can address inequities among nonprofits created by the charitable property tax exemption. This exemption benefits large institutions that own real property, while smaller ones that rent do not gain the benefit of the exemption.

- PILOTs also can help level the playing field between profits and nonprofits with regard to development. It is well established that property taxes are capitalized into selling prices. Within a given area, nonprofits have a financial incentive to locate in municipalities with high tax rates, because their decisions are based solely on selling prices, not property taxes.[5]

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[5] The distortions just mentioned are even worse in the small minority of jurisdictions in which all property owned by the nonprofit, including income-producing property, retains the exemption. In the great majority of jurisdictions, property used in a profit-making venture is taxable. *See* Lincoln Report, p. 12. Thus, for example, the Massachusetts Institute of Technology, a nonprofit institution, is also by far the largest property taxpayer in Cambridge due to its ownership of property used by biotechnology firms, for rental housing, and other noneducational activities. *Id.*, p. 13. Rhode Island's courts have interpreted the State law granting tax exemptions particularly broadly to allow nonprofits to retain the exemption for income-producing properties so long as the nonprofit uses the income to fund its operations. The clearest example of this practice is the high-rise medical office building at 2 Dudley Street, which houses medical practices at market-based rents. *See Rhode Island Hosp. v. City of Providence*, 693 A.2d 1040 (R.I. 1997). Lifespan contends that its payment of taxes on a nearby physician office building mitigates this impact, but we have not had the opportunity to verify this or review the rest of Lifespan's portfolio of income-producing, tax exempt real estate.

For these reasons, PILOTs provide relief for cities in a way that improves the relationship with nonprofits, earning everyone great praise. A leading example of PILOTs that work well is Yale's relationship with New Haven, described in further detail below.

b. Arguments against PILOTs

With that said, PILOT's also bring policy disadvantages.

- PILOTs can be ad hoc, secretive, and contentious. (Providence's 2003 Memorandum of Understanding, or "MOUT" with 4 colleges and universities was more transparent than many PILOTs are.) Many of the problems with PILOTs result from the fact that they are voluntary payments. As a result, PILOTs are haphazard—the level of PILOT amounts normally depends more on the philosophies of municipal officials and individual nonprofits than on property values or the level of public services consumed by nonprofits. Consequently there are huge horizontal inequities, with similar nonprofits making very different PILOTs even within the same municipality.

- In Providence, that inequity is apparent in the varied response that different types of nonprofit institutions have in response to the City's previous requests for PILOTs. In Boston, for example, the city's major educational institutions and hospitals have both entered into voluntary agreements, with educational institutions contributing more than $8 million annually, and hospitals as a group contributing more than $6 million annually. In contrast, in Providence, the hospitals have not participated in the current round of PILOTs.

- PILOTs provide limited and unreliable revenue. It can be difficult for municipalities to negotiate long-term PILOT agreements that provide a reliable revenue source, even from nonprofits willing to make significant financial contributions. Municipalities above all seem to be seeking a predictable revenue stream that they can count on for budgeting purposes, but nonprofits justifiably fear agreeing to long-term commitments. It is important for local governments interested in voluntary contributions from nonprofits, but not interested in challenging the property tax exemption itself, to make this intent explicit in the contracts signed between nonprofits and municipalities that form the basis of ongoing PILOT agreements.

- PILOTs could lead nonprofits to raise fees, cut services, or reduce employment. For example, in response to making a $2 million PILOT, a group of Providence colleges and universities ceased their participation in HELP, an urban health and education program. (On the other hand, other HELP participants ceased their participation without making any countervailing PILOT payment.)

One can conceive of voluntary PILOT programs that can maximize the advantages while minimizing the disadvantages. For example, it may make sense to develop an open process for setting the parameters for PILOT agreements prior to entering into negotiations. As described in further detail below, this is exactly the process Boston began last year.

3. Experience from other cities.

The Lincoln Report contains information concerning PILOT programs in a number of municipalities. This Report will focus on two, namely Boston and New Haven.[6]

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[6] There was much discussion regarding the applicability of the proposed changes to the Boston PILOT program to the City of Providence. Lifespan does not believe the Boston example applies easily because, in its view, the Boston market has evolved very differently from the Providence market. Lifespan noted that Massachusetts has universal access to healthcare, reducing or eliminating the need for hospitals to provide uncompensated care, and that the uninsured population in Massachusetts was 5% versus 12% in Rhode Island according to according to the Kaiser Foundation in 2009. Lifespan also noted that in Rhode Island the ongoing deterioration of the state's economy requires hospitals to provide increased uncompensated care while experiencing the elimination of subsidies once available to help offset uncompensated care provided to Rhode Islanders, many of whom reside in Providence. Lifespan also noted that the reimbursement methodology and regulatory environment in Massachusetts and Rhode Island are significantly different. As a result, Lifespan maintains that Rhode Island providers experiences vastly lower reimbursement rates from commercial third party payors than providers in Massachusetts. Lifespan and other hospitals will have the opportunity to make their case on this point as part of a broader discussion that will address all of the different features of the two cities and the financial condition of the City of Providence, including but not limited to the other issues noted elsewhere in this Report.

a. Boston

Boston has one of the longest standing PILOT programs and the most revenue productive program in the country. In FY2009 Boston obtained $15.7 million in PILOTs from all tax-exempt nonprofits. (Lincoln Report, p. 21.)

Educational and medical institutions contributed $14.9 million of this total. The two leading educational institutions were Boston University and Harvard, which made PILOT payments of $4.89 million and $1.48 million respectively. The three top hospitals were Massachusetts General, Brigham and Women's Hospital and Tufts Medical Center. Collectively, they paid more than $4.5 million, or more than $2,100 per bed. *Id.*[7] These contributions are helpful, but they amount to 4.3% of what these organizations would pay if their property were taxable at the commercial rate. In contrast, Boston has estimated that the financial burden these institutions impose on the City equals around 24.6% of what they would pay in taxes; therefore, the current Boston PILOT program recovers less than one-fifth of the appropriate amount. Lincoln Report, pp. 21-3.

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[7] It is worth noting that these figures apparently are based on the number of licensed beds, which may be higher than the number of actual beds in active use. With that said, there is no reason to believe that the proportion of active beds as a fraction of the total of licensed beds is categorically different for Boston hospitals as compared to Providence hospitals, although Providence hospitals will have the opportunity, during negotiations, to present such a case if it in fact exists. Rhode Island Hospital has 719 (licensed) beds. Under the pre-2010 Boston plan of $2,100 per (licensed) bed, it would contribute a PILOT in excess of $1.5 million. The top 5 hospitals in Providence have a total of 1,140 licensed beds, which under the pre-2010 Boston plan would yield a total PILOT in excess of $3 million. As described below, Boston is raising its goal for PILOT payments from all nonprofits, including hospitals. Lifespan notes that the Boston PILOTs for hospitals were not assessed on a per-bed basis; however, this still provides a measure of the relative size of the institutions to compare against the amount of the PILOT they agreed to pay.

In January, 2009, Boston Mayor Thomas Menino initiated a PILOT Task Force to review the current PILOT program, with the likely but not explicitly stated goal of raising additional revenue from nonprofits. One goal is to broaden the base, because several major institutions each make annual payments to the city over $1 million, many nonprofits make no PILOT, and among those institutions that make a PILOT, there is a broad range.

The PILOT Task Force issued recommendations in April 2010 that cover many important features for a systematic PILOT program. These include the following:

- Limit the solicitations to nonprofits that own exempt property valued at $15 million or higher.
- Make an initial request equal to 25% of what the nonprofit would pay if its exempt property were fully taxable.
- Discuss with nonprofits the benefits they provide the community, and for those which are direct benefits that offset amounts the City otherwise both would pay and would choose to pay, allow an offset with a maximum total value of one-half of the initial request.

This fall, Boston sent a letter to 40 nonprofits pursuant to this program. Eric A. Lustig, The Boston PILOT Task Force One Year Later: Proposed Change and Its Aftermath, 46 NEW ENGL. L. REV. 14 (2011).

Massachusetts does not have a state-funded PILOT program to assist cities in supporting the nonprofits they host. On the other hand, the Massachusetts property tax exemption permits municipalities to tax property held by nonprofits that is used for profitmaking purposes.

b. New Haven

Yale entered into its first PILOT agreement with New Haven in 1991. Its current agreement calls for an annual contribution of $7.5 million annually. In addition, since the mid-1980s, Yale has been actively involved with public officials and corporate leaders in fostering New Haven's economic development. A study of resurgent U.S. cities concluded that universities can make a substantial difference in a city's economic future, noting that, "Yale emerged as the engine of New Haven's revitalization." Yale has The Center for the City, an organization aimed at tapping New Haven's civic resources to tackle its social problems; redevelopment of several blocks of the city's retail center; and paying a stipend for Yale employees buying homes in the city. Lincoln Report, pp. 25-26.

Connecticut has a state-funded program to make PILOTs to municipalities for exempt property owned by nonprofit educational and medical institutions. Sometimes these are called GILOT programs (grants in lieu of taxes) to distinguish them from the types of PILOTs described previously. Under Connecticut's program, the state's goal is to provide state funding equal to 77% of the revenues from nonprofits that the municipalities wold receive absent an exemption. The program is not fully funded; currently, currently cities and towns receive a State payment equal to around 55%-60% of the tax revenue they would receive without the tax exemption. *Id.* Like Massachusetts and unlike Rhode Island, Connecticut's tax exemption does not extend to property owned by nonprofits that is used in a profitmaking capacity.

Yale University provides a role model for Providence institutions. Yale knows that its success in its core mission depends critically upon New Haven's financial well-being. As a result, Yale made the farsighted decision to invest, each year, millions of hard-earned cash dollars directly in the New Haven municipal government, even though New Haven receives State aid for nonprofits at more than twice the level that Providence does, and even though New Haven nonprofits pay property tax on income-producing property while Providence institutions do not.

4. <u>Allocating the funding among Providence's nonprofits.</u>

Having identified the funding gap, the next step is to identify the parties best able to help the City address the gap, and to apportion that gap fairly among the eligible parties. The Commission recommends that the City focus its PILOT effort on the nine major nonprofit institutions identified in the November, 2010 Report.

These nine institutions each own property at current valuations in excess of $100 million, and they are the only Providence nonprofits that own property in excess of this threshold. As a group, these nine institutions own approximately $3 billion in property at current valuations. This total represents slightly more than two-thirds of the property values of land held by Providence nonprofits in the aggregate ($4.4 billion).[8] Many of the smaller nonprofits are churches or present other difficult issues that make negotiation of PILOTs unfeasible. Also, churches or cemeteries do not use City services with the same intensity as the major nonprofits. Also, it is unlikely that any of these smaller institutions own tax-exempt property that is devoted to a profit-making purpose, which is an issue with many of the larger institutions as noted above.

As did Boston, we recommend using values of tax-exempt properties as a starting point for this analysis. The current valuations may be imprecise. If the City adopts the Subcommittee's recommendations, it may be appropriate to review that methodology and refine or enhance it as appropriate, allowing for some input from the affected institutions as part of that process.

Using existing property values and the major institutions listed in the November, 2010 Report as a starting point, we can calculate the current nominal amount due as follows:

Name	Exempt property value ($ million)	Nominal property tax due ($ million)
Brown University	997	27.03
Johnson & Wales	262	7.10
RISD	219	5.94

[8] This figure does not include land owned by governments, Amtrak or the military.

Providence College	289	7.83
Women & Infants	141	3.82
Miriam Hospital	183	4.96
RI Hospital	748	20.28
Butler Hospital	119	3.23
Roger Williams Hospital	112	3.04
Total	3,070	83.23

As noted above, the City's funding gap is $13.3-$18 million per year. Allocating this proportionately among the nine listed institutions would require each to pay 16%-22% of their property tax bill as indicated in the attached table:

Name	Exempt property value ($ million)	Nominal property tax due ($ million, 15% exemption to residential rate)	16% of nominal tax ($ million)	22% of nominal tax ($ million)
Brown University	997	27.03	4.32	5.95
Johnson & Wales	262	7.10	1.14	1.56
RISD	219	5.94	0.95	1.31
Providence College	289	7.83	1.25	1.72
Women & Infants	141	3.82	0.61	0.84
Miriam Hospital	183	4.96	0.79	1.09
R.I. Hospital	748	20.28	3.24	4.46
Butler Hospital	119	3.23	0.52	0.71
Roger Williams Hosp.	112	3.04	0.49	0.67
Total		83.23	13.31	18.31

There are other factors that the parties can consider in negotiating a PILOT agreement. The Lincoln Report (p. 45) provided a rubric that the Subcommittee modified slightly as follows:

Set a target for contributions	This can be based on a percentage of local government spending on services directly benefitting the nonprofit with adjustments for increases in the cost of living.
Use a basis to calculate payments	Possible bases include property values, square footage or cost of services provided.
Make adjustments for community benefits.	The specific content of allowable benefits is subject to much discussion.
Consider soliciting PILOTs when property is taken off tax rolls.	Providence has a program for this currently in place.
Use a threshold to determine which nonprofits to include.	The Subcommittee proposes a threshold of property holdings of at least $100 million.
Reach multiyear PILOT agreements	Long term agreements reduce uncertainty on both sides.
Align PILOT programs with the institution's mission whenever possible.	

The issue of offsetting community benefits requires careful thought. As mentioned above (p. 3, *supra*), four Providence educational institutions currently contribute together $2 million under the MOU. This payment is clearly an offsetting benefit that would justify a dollar-for-dollar credit.

Other community benefits are less clear. For example, the Lincoln Report, at p. 40, offers a chart of possible eligible and ineligible offsets. That list would need to be adapted to local conditions here in Providence, but it is possible to offer some basic examples of the issue. Property taxes voluntarily paid on property being used for an exempt purpose should qualify for an offset, but property taxes paid on property that is not actively used for an exempt purpose should not. Job training for local residents can qualify for an offset, but generalized job creation should not. In Rhode Island, health care is a State responsibility through the Rite Care and RIPAE programs. As a result, general free health care programs are a State priority and not a basis for a municipal PILOT offset. In short, the Subcommittee proposes two initial questions to consider when a nonprofit proposes that a particular program (that does not provide cash directly to the City) qualifies as an offset:

a. Would the nonprofit provide the same service or benefit if it were located in a different City? If it would, this does not qualify as an offset, as the purpose of the PILOT is to compensate the host community for the fiscal impact of providing services to the nonprofit.

b. Does the proposed offset provide budgetary relief to the City of Providence? If it does, then this program does qualify as an offset.

These two questions provide opposite boundaries from which to evaluate a proposed offset with plenty of room in between to consider each specific situation.

5. Alternative relief

For the reasons stated in the Lincoln Report, the best alternative is a PILOT agreement that is acceptable to both sides.

In the absence of a reasonable PILOT system, Providence can consider deriving revenues from fees charged to nonprofits for government services.

The simplest program would involve charging a fee to nonprofits while not charging taxpayers for such services as public safety. Municipal service fees are charged only to nonprofits to pay for government services that taxable entities pay for with property taxes or other general revenues, such as police protection and road maintenance. Since 1973 Minneapolis has levied street maintenance fees against nonprofits based on the square footage of exempt properties. In 2010 this fee is expected to generate $775,000 in revenue from 1,600 tax-exempt organizations including churches and cemeteries. This option is rarely used because of legal challenges.

The more common approach is to charge a user fee to everyone. In this way, municipalities reduce the proportion of their budgets financed by property taxes and bring in additional revenue from nonprofits. For example, a municipality can convert a garbage collection program from taxpayer support to user fees, charging that fee to nonprofit organizations as well as other property owners. There are some charges that fall between a user fee (which can be charged to nonprofits) and a tax (which cannot). Fees that fall in this gray area may result in court cases with results that vary by state. For example, a West Virginia court ruled that a fire and flood protection fee was not a tax, but a Massachusetts court ruled a Boston fire protection fee to be an unconstitutional tax. In deciding these issues, courts consider such issues as whether the fee is paid by all organizations or only tax-exempt nonprofits, whether property values are the basis used to calculate the fee, and whether the level of payment is directly tied to the amount consumed by the nonprofit (i.e., garbage removal) or not (i.e., fire protection). Both nonprofits and other entities usually have to pay special assessments, which are based on property values and used to pay for improvements that benefit specific properties in a municipality. For example, special assessments may be used to pay for sewer hookups in a certain part of a city or town.

These alternatives are less desirable, as they involve reconfiguring city government for taxpayers in order to achieve revenue from nonprofits; however, they can be done if the nonprofits fail to engage constructively in a voluntary program.

To conclude, Providence can look to Boston and New Haven as successful examples of relationships between a city in need and the nonprofits who can be a part of a solution. Although the Mayor has not yet announced any final agreements with the City's nonprofits, it is the Subcommittee's hope that further discussions will yield better results, so that our City's nonprofits can claim the same mantle of civic responsibility found in their great sister institutions in our sister cities.

6. Recommendations

The Subcommittee recommends that Providence revise its current PILOT program as follows:

- In the FY 2012 budget, the City set a target of $7 million in additional PILOT payments above the current funding level of $2 million. This would result in a total PILOT program of $9 million. This does not offset the cost of providing City services to nonprofits.

- The Subcommittee recommends raising the global PILOT target to $13.3 to $18 million to offset the cost of City services provided to nonprofits.

- The Subcommittee recommends that PILOTs be set in an amount equal to 16% to 22% of the amount otherwise due for property tax, subject to offsets for a carefully defined class of benefits to the City of up to one-half of the indicted PILOT payment.

Table 1: Calculation of City programs that serve nonprofits

Department	FY 2012 Budget ($ million)
Commissioner of Public Safety	$1.40
Police	$62.07
Fire	$61.90
Communications*	$8.71
Emergency Management*	$0.56
Planning & Development	$5.26
Traffic	$1.38
Public Works Admin.	$0.72
Highway	$3.81
Snow Removal	$1.94
Sewer*	$.75
Forestry*	$1.19
Subtotal	$149.69
Indirect Costs (+10%)*	$14.97
Total	$164.66

*Categories not included in the November, 2010 Report.