

# EVALUATING PAYMENTS IN LIEU OF TAXES ACCORDING TO DESIRABLE FEATURES OF A TAX SYSTEM

*Daphne A. Kenyon, Ph.D. and Adam H. Langley, Lincoln Institute of Land Policy*

## INTRODUCTION

**P**AYMENTS IN LIEU OF TAXES (PILOTS) ARE PAYMENTS that tax-exempt nonprofits make voluntarily as a substitute for property taxes.<sup>1</sup> In all cases, a primary characteristic of a PILOT is that it is voluntary; that is, no law requires such a payment. Although state requirements vary, charitable nonprofits are exempt from property taxation for property they own and use for an exempt purpose in all 50 states.

Municipalities typically negotiate PILOTS with individual nonprofits. Municipalities may encourage nonprofits to make PILOTS through either a “carrot” or a “stick” approach. For example, nonprofits may agree to make PILOTS because they realize they share an interest in the fiscal health of the local government. For example, Cambridge, Massachusetts (2010, p. 1) sends annual letters to tax-exempt nonprofits explaining how important PILOTS are for the city’s ability to provide adequate public services that benefit the nonprofits themselves, in addition to the broader community, and arguing that “it is only fair to expect exempt property owners to make some contribution towards the cost of public services.” Alternatively, some nonprofits may feel pressured to make a PILOT because they know local agencies have the power to grant or withhold zoning changes, building permits, and the like. In a few cases municipalities have threatened to revoke a nonprofit’s tax exemption (e.g., Peterborough, New Hampshire) or levy a tax or fee in order to obtain a PILOT or increase PILOT payments (e.g., Providence, Rhode Island) (MacDowell Colony, 2008; Marcelo, 2009).

## GROWING INTEREST IN PILOTS

Press accounts suggest growing interest in PILOTS, particularly in the current fiscal climate. Cities are strapped for funds and expect to face revenue gaps for the next couple years (Hoene and Pagano, 2010). But raising taxes is tough. As Donald Boyd of the Rockefeller Institute notes,

the U.S. is in the midst of an extraordinary antitax climate (Powell, 2011). Add to the mix growing scrutiny of the nonprofit sector and it is no surprise there is heightened interest in voluntary payments by nonprofits.

Since 2000, PILOTS have been used in at least 117 municipalities in 18 states. Seventeen of those states account for 35 cities and towns with PILOTS. The bulk of PILOTS were found in Massachusetts where 82 out of 351 municipalities collect PILOTS. Table 1 presents PILOT contributions to municipal revenues for selected U.S. cities. Although the total revenues collected are sometimes significant, we do not know of any municipality where PILOTS account for more than five percent of the total budget.

To gather information on PILOT usage, we started with a 1998 survey of municipal finance directors and key community leaders in 73 large cities across the United States, which found PILOTS in seven large cities in six states (Baltimore, Boston, Detroit, Indianapolis, Minneapolis, Philadelphia, and Pittsburgh) (Leland, 2002). Google’s search engine and a comprehensive literature review were then used to ascertain that PILOTS were still collected in those large cities, and to compile a longer list that included smaller municipalities that host a nonprofit that plays a major role in the town’s economy such as Lebanon, New Hampshire, which receives payments from the Dartmouth-Hitchcock Medical Center.

## TYPES OF PILOTS

PILOT agreements typically result from negotiations between local government officials and individual nonprofits, but some municipalities have established systematic PILOT programs that attempt to obtain more consistent payments from a wide range of nonprofits. Sometimes PILOTS are one-time payments, but other times PILOTS are made through long-term contracts that run as long as 20 years, such as in Providence, Rhode Island, where PILOT agreements with four col-

*Table 1*  
**PILOT Contributions to City Revenues, Selected Cities**

<i>City</i>	<i>Revenue Generated</i>	<i>City Budget</i>	<i>Year</i>	<i>Revenue Generated as Share of Total Budget</i>
Baltimore, MD	5,000,000	1,493,018,000	FY2001	0.33
Boston, MA	15,685,743	2,380,000,000	FY2009	0.66
Bristol, RI	2,100,000	44,017,031	FY2009	4.77
Butler, PA	15,000	8,442,098	FY2010	0.18
Cambridge, MA	4,508,000	466,749,012	FY2008	0.97
Detroit, MI	4,160,000	2,460,000,000	FY1998	0.17
Lebanon, NH	1,280,085	42,312,510	FY2010	3.03
Minneapolis, MN	158,962	1,400,000,000	FY2009	0.01
New Haven, CT	7,500,000	648,585,765	FY2010	1.16
Pittsburgh, PA	4,416,667	496,611,848	FY2007	0.89
Providence, RI	3,686,701	444,544,123	FY2010	0.83

Source: Authors' research.

Note: In the cases of Baltimore, Bristol, and Pittsburgh the total payment was divided by the number of years for an estimated annual payment.

leges and universities currently run to 2023 (City of Providence, 2010).

In many cases, the amount of PILOTs is determined in an *ad hoc* manner during negotiations without any apparent basis. But some municipalities do use a basis to decide appropriate PILOT amounts, with several different approaches used. Some ask tax-exempt institutions to pay a specific proportion of the property taxes they would owe if taxable. For example, Boston has set a goal for nonprofits to pay 25 percent of what they would pay if taxable, with this figure chosen because roughly one-quarter of the city's budget is devoted to core public services that directly benefit nonprofits like police protection and street maintenance. Others base the PILOT on some measure of the size of the nonprofit's property, such as square footage or street frontage, or the size of its economic activity, such as the number of employees or dormitory beds. Municipalities often estimate the cost of providing specific public services to an institution and request a PILOT to cover this cost.

It is important to note the term PILOT is sometimes used to refer to arrangements not analyzed in this paper, such as payments from the state or federal government to local governments to compensate them for forgone property tax revenues on

publicly owned property or partial property tax payments made by businesses under economic incentive programs. We consider all voluntary payments made by nonprofits in lieu of property taxes as PILOTs even if the nonprofits refuse to label them as such. For example, on occasion nonprofits are willing to make voluntary contributions or gifts to local governments but insist they not be termed payments "in lieu of taxes," because they believe the term creates the impression that they should be paying taxes and thus could undercut the nonprofit's tax-exempt status.

#### PILOTs COMPARED TO TAXES

Since PILOT revenue may substitute for tax revenue, it may be useful to compare PILOTs to desirable features of a tax system, such as equity, low administrative costs, predictability, and transparency. Because PILOTs are voluntary, they can easily fail to be either horizontally or vertically equitable as shown in table 2, which presents PILOTs made by colleges and universities in Boston in 2009's fiscal year. Harvard and Northeastern University each have approximately the same property value, but Northeastern's payment was just over \$30,000 and Harvard's payment

*Table 2*  
**PILOTs and Estimated Property Tax Revenue if Taxable (FY2009),  
 for Universities and Hospitals in Boston**

<i>Institution</i>	<i>Exempt Value (FY09) (\$)</i>	<i>Revenue if Taxable (\$)</i>	<i>PILOT Amount (\$)</i>	<i>PILOT as % Revenue if Taxable</i>
<b>Educational Institutions</b>				
Boston University	2,115,919,700	57,362,583	4,892,138	8.53
Harvard University	1,477,225,500	40,047,583	1,996,977	4.99
Suffolk University	237,230,300	6,431,313	375,290	5.84
Berklee College of Music	161,741,600	4,384,815	361,222	8.24
Boston College	561,952,500	15,234,532	293,251	1.92
Mass College of Pharmacy	106,910,300	2,898,338	227,980	7.87
Tufts University	151,760,200	4,114,219	152,159	3.70
Emerson College	177,826,400	4,820,874	139,368	2.89
Showa Institute	54,718,800	1,483,427	120,966	8.15
Wentworth Institute of Tech	207,977,400	5,638,267	40,747	0.72
Northeastern University	1,351,225,100	36,631,712	30,571	0.08
Simmons College	152,572,500	4,136,240	15,000	0.36
New England Law Boston	15,888,500	430,737	13,125	3.05
Emmanuel College	165,162,000	4,477,542	0	0.00
Fisher College	16,719,000	453,252	0	0.00
Wheelock College	60,362,200	1,636,419	0	0.00
<b>Medical Institutions</b>				
Mass General Hospital	1,457,667,100	39,517,355	2,200,964	5.57
Brigham and Women's Hospital	815,886,700	22,118,688	1,315,822	5.95
Tufts Medical Center	581,770,900	15,771,809	1,015,628	6.44
Mass Bio-Medical Research Corp	146,236,500	3,964,472	818,728	20.65
Children's Hospital	691,857,800	18,756,265	250,000	1.33
Boston Medical Center	300,928,700	8,158,177	221,644	2.72
Beth Israel Deaconess Med Ctr	823,114,100	22,314,623	167,000	0.75
Dana Farber Cancer Institute	226,522,000	6,141,011	131,475	2.14
Spaulding Rehab Hospital	86,751,700	2,351,839	77,534	3.30
Caritas St. Elizabeth's Med Ctr	252,504,700	6,845,402	0	0.00
Faulkner Hospital	181,881,400	4,930,805	0	0.00
NE Baptist Hospital	144,781,500	3,925,026	0	0.00
<b>Total</b>	<b>12,725,095,100</b>	<b>344,977,325</b>	<b>14,857,589</b>	<b>4.31</b>

Source: City of Boston (2010, 65-66).

Notes: PILOT includes three categories: cash PILOT (91.6% of total), community service credits (5.3%), and property taxes paid on properties that would normally qualify as exempt based on their use (3.2%)

was nearly \$2 million. Similarly, one can compare New England Law to Emmanuel College. Despite the fact that Emmanuel College has 10 times the property value of New England Law, Emmanuel makes no PILOT whereas New England Law pays \$13,000 approximately.

A good revenue system also expends as little as possible in administrative or compliance costs to raise revenue. However, municipalities may face significant upfront administrative costs to obtain relatively small PILOTs, including considerable time spent by senior government officials to reach agreements and to assess exempt properties. Nonprofits may face similar costs in resisting payments. This is one reason the best PILOT programs are conceived as partnerships. According to the Boston Assessing Office, their costs of administering the PILOT program are minimal, but Boston has a longstanding PILOT program with existing “buy-in” from many prominent nonprofits.

With respect to predictability, some PILOT efforts pass the test and others do not. *Ad hoc*, short term PILOTs fail the criterion of predictability, because payments can vary significantly year-to-year. However, some long-term arrangements, such as the long-term agreements in Boston, do generate predictable revenue streams.

One of the weakest characteristics of PILOTs is transparency. By their very nature they tend not to be transparent, because they are voluntary payments based on negotiations between municipalities and nonprofits. The most egregious example is Pittsburgh, Pennsylvania, where nonprofits agreed to make voluntary payments into a fund, but only under the condition that the amounts of the individual payments not be revealed.

#### **OTHER ARGUMENTS AGAINST PILOTs**

As the discussion above makes clear, when judged against traditional tax policy criteria, PILOTs do not fare well. In addition, nonprofits raise two other arguments against PILOTs. One is the timing of PILOT requests, which often come during economic downturns when municipalities are pressed for revenue. However, during downturns nonprofits often face revenue shortfalls of their own, sometimes as a result of their role helping governments provide health care or human services. It appears particularly harsh for state and local governments to reduce or delay payments to nonprofits, and then ask for PILOTs in addition.

Nonprofits also argue that PILOTs can lead organizations to raise fees, cut services, or reduce employment. Obviously, money for a PILOT must come from somewhere and the final incidence of the payment should be taken into account. The evaluation of this argument depends first on the nature of the nonprofit. If a PILOT is made by a wealthy college that can raise fees on high-income students, perhaps the incidence question is not too troubling, but if a PILOT is made by a soup kitchen and that nonprofit reduces its services, the judgment regarding the incidence of the payment would be very different. Of course, since PILOTs are voluntary payments, a nonprofit presumably would decline to make a PILOT if doing so would have severe consequences, such as forcing the nonprofit to drastically cut services or relocate.

#### **ARGUMENTS IN FAVOR OF PILOTs**

There are several arguments in favor of PILOTs, on both equity and efficiency grounds. Perhaps the most basic rationale for having nonprofits make PILOTs is that these organizations directly benefit from public services provided by municipalities, such as police protection, fire protection, and public works, and thus should make payments to offset their cost.

A second argument is that PILOTs provide essential revenue for some municipalities. For example, in fiscal year 2009 nonprofit organizations in Boston contributed \$15.7 million in PILOTs. This was more than enough to fund snow removal for an entire winter or to pay about half the budget for the city’s library system (City of Boston 2008; 2010).

A third argument relates back to the rationale for the property tax exemption for nonprofits. The property tax exemption is often justified as a subsidy to encourage the activity of nonprofits. However, others criticize subsidy because it primarily benefits nonprofits with the most valuable landholdings rather than those providing the greatest public benefits, and it provides no benefits for nonprofits that rent. Furthermore, there is often a geographic mismatch between the benefits provided by the tax-exempt nonprofit and the cost of the exemption in terms of property tax revenues. The benefits are often broadly dispersed, such as the benefits provided by a prestigious college that accrue to families across the nation, while the cost of the property tax exemption is borne by residents

of the host municipality. Therefore PILOTs can be conceived as partial rollbacks of the property tax exemption for nonprofits and can be supported because of the problems with that tax subsidy.

### MODEL PILOT PROGRAMS

Two local PILOT programs and one state program can serve as useful models for other states and municipalities.

Boston has one of the longest standing programs and the most revenue-productive PILOT programs in the country. The bulk of the \$15.7 million derived from PILOTs in fiscal year 2009 came from educational and medical institutions. Until now, the city's policy was to initiate a conversation with the objective of reaching a PILOT agreement whenever a nonprofit expanded its real estate holdings, particularly when it acquired previously taxable property and applied for a tax exemption or began new construction. The city negotiated agreements based on such factors as the size and usage of the property, with PILOT agreements extending between 10 and 30 years.

In January 2009, Mayor Thomas Menino initiated a PILOT Task Force to review the program. The stated goal was to make the program more equitable, as various nonprofits currently pay very different percentages of the property tax they would be liable for if they were taxable. The likely major objective was to increase the amount of revenue obtained from nonprofits. This may be accomplished in two ways: by expanding the types of nonprofits included in the PILOT program beyond colleges/universities and hospitals to cultural institutions and secondary schools, and by moving closer to the city's goal of raising 25 percent of what nonprofits would pay if they were taxable. The task force issued its final report in December 2010, which included recommendations on which nonprofits should be targeted for PILOTs, how to phase in new agreements to reach the 25 percent goal, and a policy for reducing a nonprofit's suggested cash PILOT in return for providing specific community benefits. The city has accepted the recommendations and will soon begin the process of reaching new PILOT agreements with roughly 40 of the city's largest nonprofits. It is unclear exactly how much new PILOT revenue the city will obtain or if horizontal inequities in the amount of PILOTs will be significantly reduced. However, the task force was a model of cooperation between

local government and nonprofits with representation and participation from colleges, universities, hospitals, community organizations, businesses, labor organizations, and government (Lustig 2010; Ryan 2010).

A second PILOTs model is the agreement between Yale University and New Haven, Connecticut. In this instance, the PILOT is an agreement between a single nonprofit institution and a city. Among other models of town-gown cooperation, Yale's efforts stand out for their magnitude. A study of resurgent U.S. cities concluded that, "Yale emerged as the engine of New Haven's revitalization" (Kodrzycki and Munoz, 2009, p. 21). Not only does Yale make the largest PILOT of any college or university in the country, \$7.5 million per year beginning in 2010, but Yale is actively involved with public officials and corporate leaders in fostering New Haven's economic development in many other ways. For example, Yale serves as an incubator for the biomedical center, funds an organization that taps the city's civic resources to solve its social problems (The Center for the City), has redeveloped several blocks of the city's retail center, and pays a stipend for Yale employees who buy homes in the city (Kodrzycki and Munoz, 2009, p. 23).

Finally, an alternative to a municipal PILOT program is for the state to reimburse municipalities for revenue foregone because of the property tax exemption afforded to nonprofits. One of the strongest arguments in favor of a state-funded PILOT program is that the property tax exemption for nonprofits is created by the state, and typically provides benefits to citizens beyond municipal borders. Another argument is that statewide programs can be more systematic than local programs. Currently both Connecticut and Rhode Island have state-funded PILOT programs, although Connecticut's has traditionally been better funded and both have lost funding during the current fiscal crisis. But these state programs present a potential model for the future, when state revenues rebound.

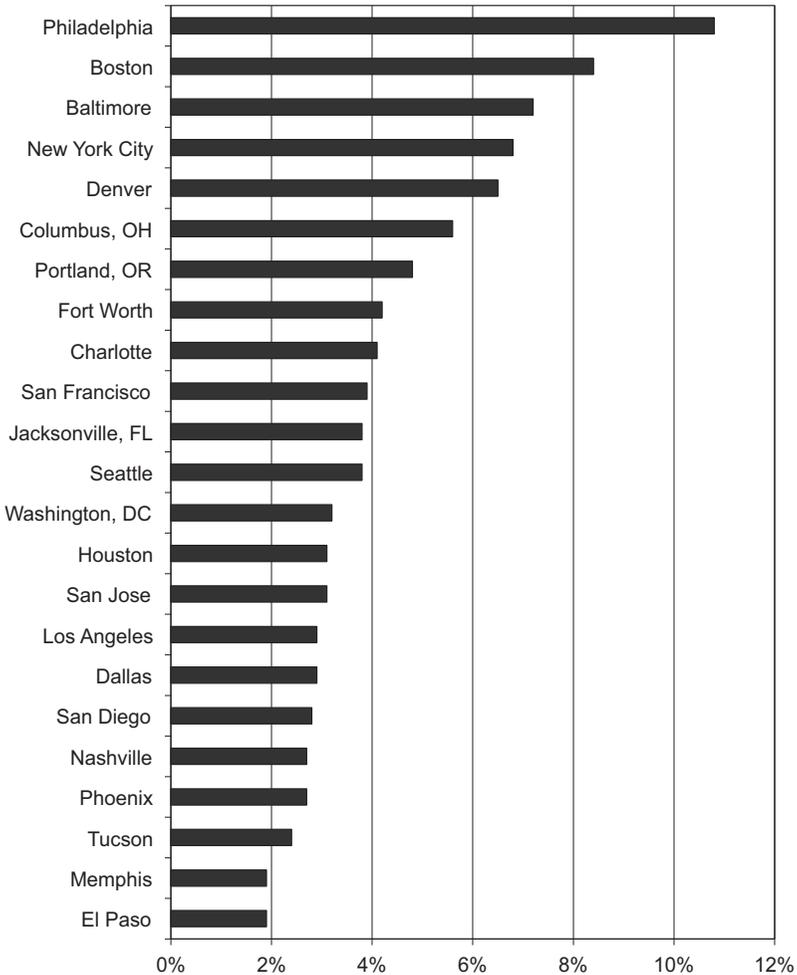
### PILOT POTENTIAL

The potential for PILOTs to raise significant revenue varies widely across municipalities. One reason for this variation is the highly unequal distribution of nonprofit property across municipalities. In order to make it worthwhile to embark on a systematic PILOT program like Boston's, a

significant share of the municipality’s property value would have to be owned by nonprofits. As figure 1 illustrates, the share of total property value owned by nonprofits in large U.S. cities varies markedly, with over 10 percent of Philadelphia’s total property value owned by nonprofits but less than three percent of property value owned by nonprofits in San Diego, Nashville, Phoenix, Tucson, Memphis, and El Paso.

Two states, Massachusetts and Minnesota, have examined the revenue potential of PILOT programs and each has found that the revenue potential varies considerably for different municipalities. The results of Minnesota’s study (2000) are summarized in table 3. For the vast majority of Minnesota’s cities and towns there was no revenue potential from a program that focused on charitable institutions and hospitals, but property tax revenue

Figure 1: Value of Nonprofit Tax Exemption as a Percent of Total Property Value



Source: Lipman (2006a)

Note: These statistics should be viewed as rough estimates. Policymakers should exercise caution when drawing conclusions from these data, because the quality of assessments of exempt property is wide-ranging and often unreliable (Lipman 2006b).

*Table 3*  
**Revenue Potential of PILOTs in Minnesota**

<i>Number of Cities and Towns</i>	<i>Potential Increase in Property Tax Revenue</i>
2,105	0, No potentially taxable nonprofits
447	Less than 1%
125	1-5%
17	5-10%
6	Greater than 10%

Note: Revenue would be collected from charitable institutions and hospitals but not governments, churches or colleges. A tax rate of 0.38% was assumed.  
Source: Minnesota Budget Project and Project Tax Study Project (2000)

could increase by more than 10 percent under an active PILOT program for six municipalities. Unfortunately the Minnesota study did not examine the revenue potential of extending PILOTs to colleges and universities.

The importance of PILOT revenue also depends on a municipality's reliance on property taxation. It is no surprise that current PILOT programs are concentrated in the Northeast, a region of the United States especially dependent on property taxes. Massachusetts has the most municipalities with PILOTs by far, but New Hampshire, Rhode Island, Connecticut, New York, New Jersey, and Pennsylvania all have two or more municipalities with PILOTs. Outside the Northeast, only Indiana has more than one municipality that collects PILOTs (Kenyon and Langley, 2010).

### CONCLUSION

Recent years have seen heightened interest in payments in lieu of taxes by nonprofit organizations. In the current fiscal climate, PILOTs offer one revenue option for municipalities. However, this option is not appropriate for all cities and towns; it is most appropriate for those that are highly reliant on the property tax and which have a significant share of total property value owned by tax-exempt nonprofits. It is best for municipalities to work collaboratively with nonprofits when seeking PILOTs. Both Boston's PILOT program and the agreement between Yale University and New Haven are examples of successful collaborative PILOT agreements. Finally, state and local governments should consider alternative revenue sources, such as user fees, charges, special assessments, and

even taxes. Voluntary agreements such as PILOTs are unlikely to attain the desirable features of a sound tax system, such as vertical and horizontal equity and revenue sufficiency.

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### Note

- <sup>1</sup> There are various definitions of PILOTs, but this paper follows the definition used by Evelyn Brody (2005). This paper relies heavily on Kenyon and Langley (2010) but provides updates as both the Boston and Providence tax-exempt institutions task forces released their reports after the Kenyon and Langley report went to press.

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