

CITY OF BOSTON  
TAX-EXEMPT PROPERTY  
STEERING COMMITTEE GUIDELINES



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## I. INTRODUCTION

### A. *Overview*

The Massachusetts State Constitution, written in 1780, empowered the legislature to promote the arts, sciences, and natural history of our country by granting "reasonable exemptions" to institutions that embrace these pursuits. As the governmental, educational, medical, and cultural center of New England, Boston is uniquely affected by its tax-exempt institutions. The impact of these exemptions is highlighted by the large amount of tax-exempt property (over 50% of the City's land area is exempt) which results in a substantial erosion of Boston's tax base. (See Appendix A and B.)

Boston must be meticulous in managing its tax base due to the following fiscal realities:

- \* the over-reliance on the property tax as the only major source of tax revenue;
- \* the implementation of Proposition 2½;
- \* increasing demands for costly municipal services which require additional revenues;
- \* the rapid decline in federal fiscal assistance;
- \* and a precarious state revenue forecast that threatens the state's ability to provide fiscal relief.

Throughout the City's history, Boston has responded to the rising cost of servicing the growing base of tax-exempt property by increasing property taxes. However, the enactment of Proposition 2½ in fiscal year 1982, first drastically cut property tax revenues, and then limited their future growth to 2½ percent a year. Boston is no longer able to combat the effects of tax-exempt property by increasing revenues from its taxable base.

### B. *Purpose*

The increase in the amount of tax-exempt property and the corresponding decrease in Boston's tax capacity necessitates policy guidelines to manage the tax base effectively. The intent of these policy guidelines is to outline a fair, open, and equitable process for managing the tax base through a payment in lieu of tax (P.I.L.O.T.) program. These guidelines represent the product of an ongoing process evolving from extensive dialogue between city officials and representatives of tax-exempt institutions. With a standardized format, the nature of the relationship between the tax-exempts and the City of Boston augurs well for mutual cooperation.

### C. *Benefits of Tax-Exempt Institutions*

The City of Boston appreciates the contributions of those institutions which currently fulfill the financial and community service portions of their payment in lieu of tax agreements. In Fiscal Year 1991 an unprecedented 27 institutions paid over \$11.4 million to the City in recognition of consumed municipal services. In addition, an estimated \$6.8 million in community services demonstrated the exempt-institutions' commitment to city residents.

Tax-exempt institutions bestow many benefits upon Boston, the Commonwealth, and the entire nation. Since many of the benefits associated with tax-exempt institutions are intangible, they are difficult to quantify. In addition to these intangible benefits, tax-exempts offer various community services such as scholarships, free use of institutional facilities, and patient care to the medically indigent. Tax-exempts provide services that contribute to the overall welfare of our city. To the extent that tax-exempts care for the poor, educate the unenlightened, and uplift the spirit, the City appreciates and recognizes the benefits of tax-exempt institutions.

Tax-exempt institutions also significantly contribute to the region's economy. The health and education industries, two of the fastest growing sectors of the Boston economy, employ more than 93,000 metropolitan area residents. A 1987 study by the Boston Redevelopment Authority reveals that Boston's hospitals employ a total of 41,135 people or 6.9 percent of all jobs. This study also revealed that hospitals and medical schools occupy an estimated 1.5 million square feet of research space and have a combined research budget estimated at \$334.7 million. Boston's institutions of higher education employed over 27,000 people in 1983. A Boston College study estimated that the university had a direct economic impact (including expenditures by the university, its employees, students, and visitors) of over \$78 million on the City's economy. A recent report by the arts community estimated that nonprofit cultural institutions had a direct economic impact of over \$500 million and are among the City's largest employers.

While tax-exempt institutions have a positive impact on Boston's economy, it must be remembered that municipal government is unable to reap directly the benefits of this economic activity. Since the City relies on the property tax as its primary source of tax revenue, Boston is not allowed to tax incomes, expenditures, or financial assets and, as a result, cannot capitalize on the contributions tax-exempt institutions make to its vibrant economy.

#### *D. Costs of Tax-Exempts to Boston*

While Boston benefits from its reputation for excellence cultivated by its tax-exempt institutions, it must contend with the increasing municipal costs of these facilities. First, the City must absorb the explicit cost of providing municipal services to tax-exempt institutions. Exempt institutions such as colleges, universities, hospitals, museums, and other educational and cultural entities annually attract thousands of students, patients, visitors, and tourists. Boston must bear the entire cost of providing public services to these institutions and their constituents; yet, for the most part the City is restricted from receiving compensating revenues directly from non-residents who take advantage of the resources of the City and its institutions.

Second, Boston must also absorb the implicit opportunity costs associated with the loss in revenue due to the exempt status of the property. If privately-owned exempt properties alone were fully taxable, Boston would realize a substantial increase in property tax revenue. The loss of revenue associated with these state mandated exemptions results in both a restricted revenue base and a higher tax effort for the City's taxpayers, thus imposing significant economic costs on the City.

### E. *Reconciliation of Benefits and Costs*

While the benefits associated with tax-exempt institutions extend far beyond the City's borders, Boston residents must bear the entire costs associated with these institutions. Where possible, a portion of the municipal costs associated with tax-exempt institutions should be borne by the constituents of these institutions. The implementation of a standardized payment in lieu of tax system will enable the City to address the cost-benefit gap.

### F. *The Tax-Exempt Property Steering Committee (T.E.P.S.)*

As a result of a mayoral initiative, the Tax-Exempt Property Steering Committee was established in 1985 to formulate and implement policy guidelines for a revised payment in lieu of tax program. The T.E.P.S. Committee consists of representatives from those city departments which have historically been involved in the P.I.L.O.T. negotiating process. These departments include Administrative Services, Assessing, the Boston Redevelopment Authority, the Economic Development and Industrial Commission, Law, the Mayor's Office, Public Facilities, and Treasury. The T.E.P.S. Committee negotiates the specific payment in lieu of tax agreement when a tax-exempt institution wishes to expand, build upon, or significantly alter its holdings. The T.E.P.S. Committee issues general guidelines to be followed in negotiating all payment in lieu of tax agreements and is responsible for approving, by majority vote, all such agreements. In addition, the T.E.P.S. Committee monitors the progress of all P.I.L.O.T. agreements and publishes an annual report on tax-exempt property. Finally, the T.E.P.S. Committee is involved in all discussions concerning changes in city ordinance and state legislation dealing with tax-exempt property.

## II. GUIDELINES

### A. *Initiatives*

In order to protect itself against the additional loss of taxable property, the City of Boston proposes the following initiatives:

1. An owner of a currently taxable property who requests tax-exempt status will be encouraged to make a voluntary annual payment to the City;
2. Discussions regarding a voluntary annual payment to the City will commence at the time a tax-exempt organization institutes proceedings to either expand or improve its property;

This incremental process focuses on the expansion and replacement of tax exempt property, rather than seeking payments on existing facilities. This policy has the pragmatic advantage of allowing exempt institutions to include the cost of any payment in the financial planning of new facilities. In addition, this policy includes institutions that, through their intent to expand, express a favorable financial position. Therefore, as exempt institutions expand, improve, and replace their facilities, the City will address the fiscal impact of these properties without imposing extreme financial pressures on exempt institutions.

In addition to these initiatives which address privately owned tax-exempt properties, the Tax Exempt Property Steering Committee also proposes two additional initiatives regarding state-owned properties:

3. The Commonwealth of Massachusetts will be asked through legislation to compensate the City for certain state-owned properties at a level beyond the inadequate amount currently provided under existing laws;
4. Independent State Authorities, such as the MBTA, Massport, MDC and Turnpike Authority, will be asked to negotiate or increase in lieu of tax payments in recognition of the economic costs they impose on the City.

As the single largest owner of property within the City, state government has a responsibility to compensate the capital city for the municipal costs associated with state facilities. The Steering Committee urges the General Court to consider these important legislative proposals that will reduce the burden that state-owned properties impose on cities and towns.

## B. *Payment in Lieu of Taxes*

The following procedures outline the payment in lieu of tax negotiation process: (See Appendix C)

1. When an institution demonstrates its intent to expand, improve, replace or acquire a facility, the institution will be sent a Payment In Lieu of Tax Agreement Application Form. (See Appendix D.) The institution will provide relevant data regarding its property, its revenue raising capability, intended use, etc. When available, the institution will submit its master plan to the T.E.P.S. Committee;
2. Representatives of the tax-exempt institution and representatives from the T.E.P.S. Committee will meet to discuss the formulation of a payment in lieu of tax agreement;
3. After this initial meeting, the T.E.P.S. Committee will draft the payment in lieu of tax contract. The T.E.P.S. Committee will follow a standardized format drafting the agreement; (See Appendix E and F.)
4. After the agreement is approved by the institution and the T.E.P.S. Committee, the contract is then executed.

## C. *Guidelines for Establishing the Payment in Lieu of Tax Amount*

Historically, payment in lieu of tax amounts have been negotiated using payment schedules based on factors such as the cost of the municipal services consumed by the institution, the revenue if taxable on the property, and the income produced by the facility. The wide range of methodologies employed indicates the difficulty of having any one formula which accurately weighs all the specific information needed for an equitable payment in lieu of tax agreement. Rather than advocate the use of a single payment mechanism which may not provide the flexibility needed in negotiating an equitable payment in lieu of tax, the T.E.P.S. Committee instead recommends consideration of the following criteria in determining the in-lieu of tax amount:

### **1. The Cost of Providing Municipal Services to the Institution**

This is an important measurement of one of the primary costs of tax-exempt properties. While it may be unreasonable to expect a full tax payment from most institutions, tax-exempts should make a contribution toward the essential municipal services that they consume. The estimation of the cost of servicing an exempt institution provides an excellent starting point for negotiating an in-lieu of tax amount.

## **2. The Revenue of the Property If Taxable**

This is a measurement of the second cost associated with tax-exempt property — the revenue the municipal government foregoes due to the exempt status of the property.

The Boston Municipal Research Bureau has recommended that the payment for municipal services reflects the percentage that essential services (fire protection, police protection, public works) comprise of the City's operating budget. These services consume approximately 25 percent of the City's budget, therefore, the Tax Exempt Property Steering Committee advocates that 25 percent of the revenue the City would receive if the facility were fully taxable provides a rational basis for a payment in lieu of tax amount.

## **3. Building or Campus-wide Agreement**

If an institution plans multiple alterations to its entire campus, a preferable form of payment in lieu of taxes would be a campus agreement. A campus agreement allows for a predetermined formula to be applied to future additions.

If an institution plans only a single alteration to its campus, then a building agreement is more appropriate. Such an agreement would allow for payment for the specific building.

## **4. The Nature of the Public Benefit Provided by the Institution**

While it is difficult to quantify many of the benefits associated with these institutions, it is possible to evaluate certain aspects of the institution's benefits and consider these in the payment in lieu of tax amount. For example, factors such as servicing primarily Boston residents, or contributing specifically to the Boston economy will be taken into consideration when formulating the payment in lieu of tax agreement.

## **5. The Revenue Producing Capabilities of the Institution**

This factor is used to determine the extent to which exempts can and should pass the cost associated with the payment onto the beneficiaries of the institution. For example, an institution that is able to charge for its services or is able in some other way to pass the cost associated with the payment for municipal service payment onto the beneficiaries of the exempt institution is better able to make a payment in lieu of tax.

## **6. Credits for Services Provided by Tax-Exempt Institutions**

Many institutions prefer offering community services (i.e., scholarships, free use of an institution's facilities) to making actual payment in lieu of taxes to the City. The City will evaluate requests for credits for community services on a case-by-case basis. However, such credits should not exceed 25 percent of the dollar value of a payment for municipal service agreement and will occur at the discretion of the T.E.P.S. Committee.

## **7. Escalator Clause**

Payment in lieu of tax agreements will include an escalator clause to ensure that today's dollar is worth the same tomorrow, mitigating the effects of inflation. The T.E.P.S. Committee recommends the use of the Implicit Price Deflator for State and Local Governments, produced by the Bureau of Labor Statistics of the U.S. Department of Commerce (I.P.D.). The I.P.D. measures the purchasing power of state and local government, therefore, it is clearly the most relevant measure of inflation for payment for municipal service agreements. (See Escalator Clause in Appendix F.)

### III. SUMMARY

Once again, the City of Boston thanks those institutions which contribute to our community. City government and exempt institutions must maintain a cooperative partnership to ensure Boston's fiscal health.

The problems associated with tax-exempt property are some of the most complex and controversial fiscal issues that face the City of Boston. The City recognizes the many contributions that tax-exempt institutions make to Boston. However, given that the property tax is Boston's only major source of tax revenue and that this source is restricted by Proposition 2½, the large percentage of exempt property imposes significant economic costs on the City. Thus, these guidelines provide a fair, open, and equitable process for the effective fiscal management of Boston's tax base.