

Legislative Budget and Finance Committee

Tax-Exempt Property and Municipal Fiscal Status

**Report Presentation by Maryann Nardone
at May 6, 2009, Meeting**

Good Morning. Senate Resolution 363 of 2008 directed the Legislative Budget and Finance Committee (LB&FC), in cooperation with the Department of Community and Economic Development and the Local Government Commission, to study the impact of tax-exempt real property on the fiscal health of Pennsylvania municipalities.

Real estate property taxes are an important source of revenue for Pennsylvania cities, boroughs, and townships, generally accounting for anywhere from 9 to 28 percent of local municipal total revenue.

Pennsylvania counties are responsible for real property assessments. Since they do not have standard ways in which they define and record tax-exempt property, and since the State Tax Equalization Board (STEB) determines the aggregate market value of taxable real property, but not tax-exempt property; it is not possible to assign a value to tax-exempt properties in Pennsylvania. We were, however, able to obtain and analyze data for several municipalities from across the state, with a focus on fiscally distressed municipalities reporting a disproportionate share of tax-exempt property.

We found that in these municipalities, as has been reported nationally and in other states, governments and religious organizations are by far the major holders of tax-exempt property. Local government property, which we defined as property held by counties, municipalities, and public schools and authorities, accounted for 50 percent or more of all tax-exempt property in nine of the 11 fiscally distressed municipalities we reviewed. After local government, churches tend to account for the next highest share of tax-exempt property, often in the range of 10 to 20 percent. Federal and state property combined typically accounted for less than 10 percent of tax-exempt property. So taken together, governments and churches represent almost 75 percent or more of the tax-exempt property in the municipalities we reviewed.

National studies suggest that, when government and church property are excluded, major health care institutions and colleges and universities are among the next largest tax-exempt property holders. To consider their impact on Pennsylvania municipalities, we identified all municipalities with nonprofit general acute care hospitals and private and public four-year colleges and universities, which in the report we refer to as "host municipalities." We found that relatively few—183, or 7 percent—of Pennsylvania's municipalities host nonprofit acute care hospitals and public and private colleges and universities. Of the 183 municipalities, almost 85 percent host only one such major institution—typically a hospital. Philadelphia and Pittsburgh host the most institutions, though eight other municipalities (Allentown, Bethlehem, Erie, Lower Merion, Radnor, Scranton, Wilkes-Barre, and Williamsport) host three or more hospitals, colleges, or universities. Forty-one of the "host municipalities" also serve as their county's seat of government.

Interestingly, only about 25 percent of the 183 “host municipalities” have a high level of fiscal distress. In part, this is because many (41 percent) of the “host municipalities” are townships, which tend to be fiscally healthy. Over 80 percent (31 of 37) of the cities that host major medical and educational institutions, however, are experiencing a high level of fiscal distress. So a municipality’s fiscal health appears to have much more to do with the type of municipality, particularly whether it is a city or township, not whether it hosts a large nonprofit institution such as a hospital or university.

We also found that the fragile fiscal status of the cities that host a nonprofit hospital, college or university is often mirrored by the fiscal status of their institutions. Specifically, only six fiscally distressed municipalities—all of which are cities—(Easton, Erie, Lancaster, Philadelphia, Pittsburgh, and York) host at least one nonprofit hospital, college, or university that could be considered financially secure relative to its peers.

Much of our report discusses the wide variety of arrangements that exist between “host municipalities” and the nonprofit hospitals, colleges and universities within their jurisdictions. These include provision of public safety services through their own sworn police staff and/or through contracts, including contracts for police service with the local municipality (40 of 47 municipalities); payment of realty taxes (32 of 47) on property not used for the institution’s public charity purpose (e.g., doctor’s offices, faculty housing); payment of municipal fees (47 of 47); cash and in-kind contributions to the municipality (22 of 47); contributions to volunteer fire companies (30 of 47); and participation in community revitalization and other economic development initiatives (26 of 47). We also identified five municipalities that received payments in lieu of taxes (PILOTs) from one or more hospital or private university. However, as with realty tax payments by such institutions, school districts typically received two-thirds or more of these PILOT payments.

Our report also describes efforts of hospitals, colleges, and universities in several municipalities to emulate the success of the University City District in Philadelphia. Established by the University of Pennsylvania and other public and private partners in the late 1990s, this initiative is credited with reducing serious crime in the District by 20 percent and helping to bring nearly \$4.5 billion in investment to West Philadelphia.

Our review of other states found that only two, Connecticut and Rhode Island, provide state funding for local municipalities based on the presence of a non-profit hospital, college or university. In Connecticut, where public education is a municipal responsibility, \$120 million was distributed to municipalities in 2008. Connecticut and Rhode Island also make payments for certain state property, but not tax-exempt property held by local governments or religious organizations.

Delaware, New York, and Vermont also make payments for certain state or county property. New York expends about \$23 million for its “transitional payment” program, with the state’s capital receiving most of the funding.

Wisconsin has in place a \$22 million “municipal service program” that reimburses for fire, police and solid waste handling provided to state buildings, including public hospitals. The

payments are based on the part of the actual service cost that is reimbursed through local realty taxes, and the amount the state pays is further reduced whenever the state institution self-provides services.

Of course the Commonwealth of Pennsylvania also provides significant financial assistance for local municipalities through a variety of ways. These include earmarked state tax and fee revenues (\$630 million), property tax rebates (\$855 million), provision of police services for certain municipalities and state property (\$48 million), payments in lieu of taxes to certain municipalities (\$10 million), and financial support (\$623 million) for municipal community revitalization and economic development efforts.

The General Assembly has also provided municipalities with financial tools, including tools to assist financially stressed municipalities. The General Assembly, for example, authorized Allegheny County to impose a one percent sales tax earmarked for certain purposes. The formula specified in statute distributes revenues in such a way as to provide greater assistance to those municipalities with relatively low tax revenues and real estate values. As a consequence, in recent years Allegheny County municipalities in high fiscal distress received 67 percent of the regional revenue available for allocation, even though these municipalities are home to only 40 percent of the population.

During our review, we spoke with many municipal officials and community leaders who recognize the need to stabilize fiscally stressed municipalities, and in particular those third-class cities that host major academic and medical institutions that are central to both regional and state economic development strategies. Although our report has no specific recommendations for how to resolve these complex problems, we do review several of the proposals that have been offered for policymakers to consider.

One such proposal would mandate PILOTs agreements. We concluded the opportunity for local municipalities, in particular distressed municipalities, to obtain needed revenues through PILOT agreements appears limited given the high proportion of tax-exempt property held by local governments and religious organizations. PILOTs would also be of limited help because, at least on a statewide basis, more than two-thirds of municipalities with the highest levels of fiscal distress do not host either a tax-exempt medical or educational institution. Moreover, school districts, not municipalities, are the primary beneficiary when formal PILOT agreements are in place.

Another proposal is to develop a program for distribution of state funds to municipalities that host key Commonwealth institutions. Such a plan may be feasible in that relatively few (183) municipalities host nonprofit hospitals, colleges and universities, but it would still require a new source of funding, which is always challenging. Another challenge to this approach is that it would require some form of a standardized county assessment system, which undoubtedly would be both a costly and controversial undertaking.

A third proposal is to require tax-exempt organizations to pay an essential municipal services fee, such as for police and fire services. We found that many non-profit institutions already provide their own police services or contract with the municipality for such services. And in many municipalities, fire services are provided by volunteer fire companies, which often receive

donations from their local nonprofit institutions. An essential service fee would almost certainly have to take these various situations into account, which could become a significant administrative burden both for the nonprofit institution and the municipality.

The last proposal we discuss is regional revenue sharing, such as through a local sales tax. In our report, we cite a model for a voluntary county sales tax that was developed by the Lehigh Valley Partnership coalition that includes provisions for promoting shared services, providing additional help for fiscally distressed municipalities, and providing extra assistance to communities that host major tax-exempt institutions in the region. As I am sure you are aware, prior to the release of our report, the County Commissioners Association of Pennsylvania and the Governor endorsed the concept of a voluntary county sales tax, and it was our understanding that several models were being considered for possible presentation to the General Assembly.

On behalf of the Department of Community and Economic Development and the Local Government Commission staff, our colleagues in this endeavor, we would like to thank all of the state associations for the cooperation they provided. In particular, we thank the Pennsylvania Economy League for sharing its expertise and prior works, and the county and municipal officials, hospitals, and public and private colleges and universities who assisted our work.

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