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RETHINKING REVENUE

BOSTON'S PILOT (PAYMENT IN LIEU OF TAXES) PROJECT

How the City of Boston worked with local tax-exempt institutions to secure fair and sustainable financial support for city government



ABOUT THE AUTHOR

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gfoa.org/rethinking-revenue

ABOUT THE RETHINKING REVENUE PROJECT

Local government revenues must adequately fund the public services that a community desires without creating excessive inefficiencies or unfairness in the revenue raising system. However, local government revenue structures are largely based on assumptions that no longer hold today due to digitization, globalization, demography, political changes, and other trends. Furthermore, fairness is becoming an increasingly important concern for public finance. It follows that this concern should include how revenues are raised. For these reasons, the Rethinking Revenue project is taking a fresh look at how revenues are raised. The project will raise new and interesting ideas like those featured in this paper and will produce guidance for state and local policy makers on how to local government revenue systems can be modernized. We hope the ideas presented in this paper will spur conversation about the possibilities for rethinking revenue.

The Rethinking Revenue initiative is a collaborative effort involving:

- American Planning Association (APA)
- Government Finance Officers Association (GFOA)
- International City/County Management Association (ICMA)
- National Academy of Public Administration (NAPA) Center for Intergovernmental Partnerships
- National League of Cities (NLC)
- Center of Municipal Finance at the University of Chicago's Harris School of Public Policy,
- Government Finance Research Center at the University of Illinois at Chicago's College of Urban Planning and Public Affairs

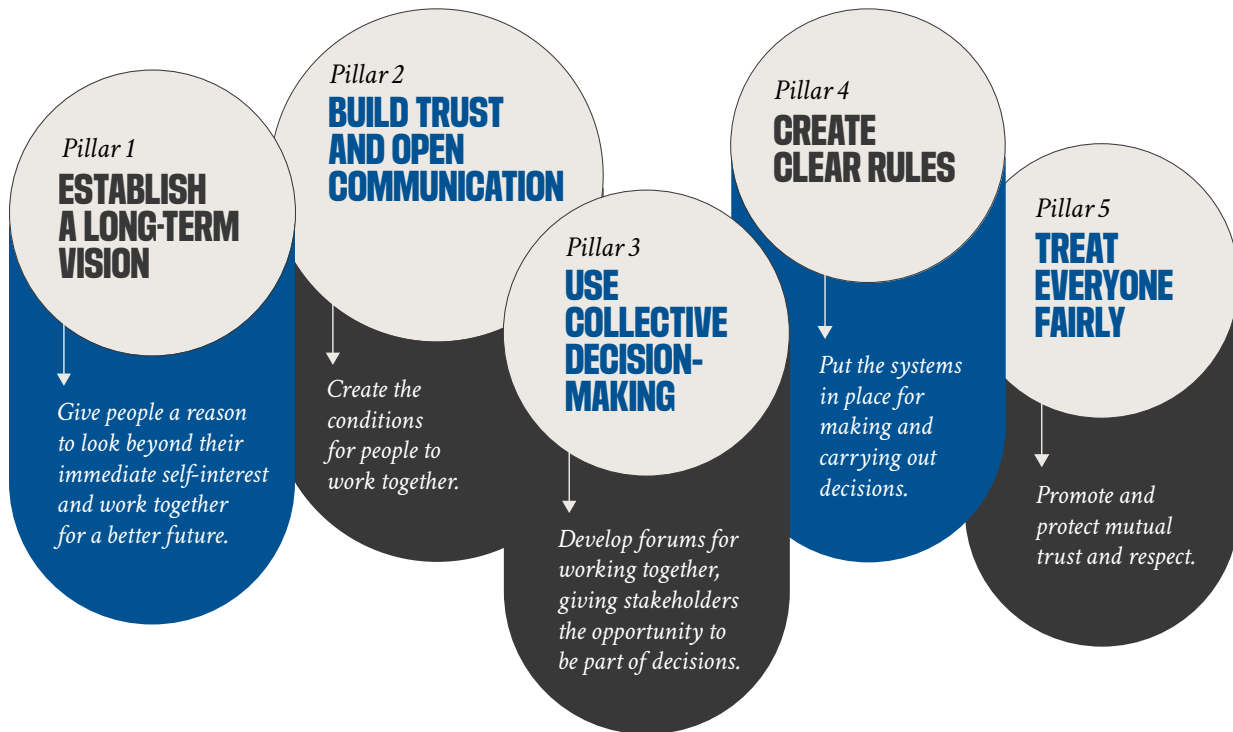


Many local governments have several tax-exempt properties within their boundaries. For those governments that rely on property taxes, tax-exempt properties can create a drag on the local budget: These properties pay no taxes but still must be served by local government. The City of Boston is one such government. Boston has several colleges, universities, and hospitals. As of 2007, the city's Assessing Department estimated that the 16 colleges and universities they examined totaled \$7.0 billion in property value, and the 12 hospitals examined totaled \$5.7 billion in property value. The Assessing Department estimated that, if taxed at the commercial rate in fiscal year 2009, these institutions combined would have generated \$345.0 million. By comparison, the commercial sector generated \$764.5 million in the same period.¹

Local governments like Boston have a conundrum: how to balance A) the contributions that tax-exempt properties make to the local government budget and community well-being by virtue of their pro-social missions versus B) the resources these properties consume from the local budget. This conundrum is what is known in economics as a “common-pool resource” problem. The local government budget is “owned” by everyone in the community, but any single person has the incentive to avoid contributing to the pool (the budget) while still using resources from the pool (services). Fortunately, the Government Finance Officers Association has developed a method, based on Nobel Prize-winning work, to solve common-pool resource problems: [Financial Foundations for Thriving Communities](#). The Financial Foundations framework consists of five “pillars” described below and shown in Exhibit 1.

- **Establish a long-term vision.** Give people a reason to look beyond their immediate self-interest and work together for a better future.
- **Build trust and open communication.** Create the conditions for people to work together.
- **Use collective decision-making.** Develop forums for working together, giving stakeholders the opportunity to be part of decisions.
- **Create clear rules.** Put the systems in place for making and carrying out decisions.
- **Treat everyone fairly.** Promote and protect mutual trust and respect.

EXHIBIT 1 | THE FINANCIAL FOUNDATIONS FRAMEWORK



In this paper, we will use the Financial Foundations framework to describe how Boston addressed this common-pool resource problem and gained about \$17 million in new cash payments in lieu of taxes (PILOTs) from tax-exempt properties *annually* and \$50 million in new in-kind contributions *annually*.^{1,3} This compares to Boston's operating budget of \$3.76 billion in 2022. We should recognize that Boston has enjoyed an unusual degree of success with its PILOT program among local governments. Other cities have tried to mimic features of the Boston program but with less success. By using the lens of the Financial Foundations framework, we hope to reach deeper into why Boston's program has worked. A deeper understanding should allow for more successful replications.

Boston did not start from zero. Over many years, it has arrived at a series of disparate agreements with owners of tax-exempt properties. For the sake of brevity, we will refer to these owners as nongovernmental

HOW DO TAX-EXEMPT PROPERTIES CREATE COSTS?

It is easy to appreciate that tax-exempt properties create costs when they use a service like police or fire. A less well-appreciated way tax-exempt properties create costs is that they reduce the effective density of the property tax base. Research has shown that all else being equal, denser areas are cheaper to serve than less dense areas.² For example, in denser areas, police, fire, and public transit vehicles have less distance to travel and there are fewer lane miles of roads to maintain. Local governments must still maintain the roads that abut a tax-exempt property, and fire stations must be built to maintain acceptable response times regardless of whether properties in their service area are tax exempt.

¹In fiscal year 2011, the City of Boston collected \$15.2 million from nonprofits. 2011 was the last year before the city started the new approach that is described in this paper. In fiscal year 2012, the first year under the new PILOT program, the city collected \$19.5 million. By fiscal year 2016, the PILOT program had matured and the city collected \$32.1 million or \$16.9 million more than in 2011. Collections have remained fairly steady from 2016 until the present time (\$34.4 million collected in fiscal year 2020). See endnote 2 for more information.

organizations (NGOs). City officials were pleased to be getting some contributions, but there was a sense that the success was uneven and that the city could do better.

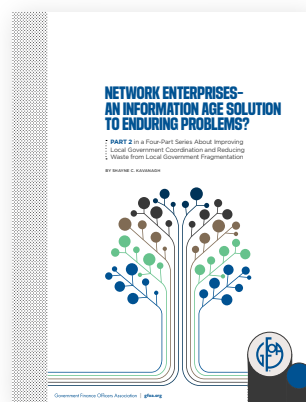
The starting point was a **clear vision** (*Pillar 1*). This started with acknowledging that NGOs create costs for the city but don't contribute their share to the budget. Further, not only do NGOs benefit from municipal services, they benefit from a thriving urban environment that the municipal government helps to maintain. These conversations were happening in 2009, so resource scarcity from the 2008 Great Recession emphasized the need to secure contributions from all stakeholders that benefited from city services. However, the vision can't be purely about filling the coffers of local government. As we will see, the PILOT program also recognized the contribution to the community made by NGOs and seeks to better coordinate the efforts of NGOs and the city government on pursuing shared goals. See the sidebar on this page for more on how to form a vision that NGOs (and others) can convene around.

Another part of the vision was **fairness** (*Pillar 5*). NGOs who already were making voluntary contributions to the city government felt the status quo was unfair: Participation by NGOs in making voluntary contributions was erratic, and the amounts of contributions they were making were inconsistent. So contributing NGOs felt that noncontributing NGOs were getting a free ride. To illustrate, two comparable institutions of higher education were paying markedly different amounts, with one institution paying over 10 times as much as the other!⁴

In response to these concerns, the city convened a PILOT Task Force that included representatives of NGOs. People will usually be more accepting of a solution that they helped develop rather than a solution imposed from the outside (*Pillar 3*, **use collective decision-making**). Over 15-months, the task force reviewed information about the cost of services the city provided to NGOs, the benefits that the community received from services provided by large universities and hospitals, the legal issues involved in PILOTs, and more. According to the task force's final report, "the core principles of a fair and balanced PILOT program are transparency and consistency."⁵ This parallels the second and fifth pillars of Financial Foundations: **build trust and open communication** and **treat everyone fairly**.

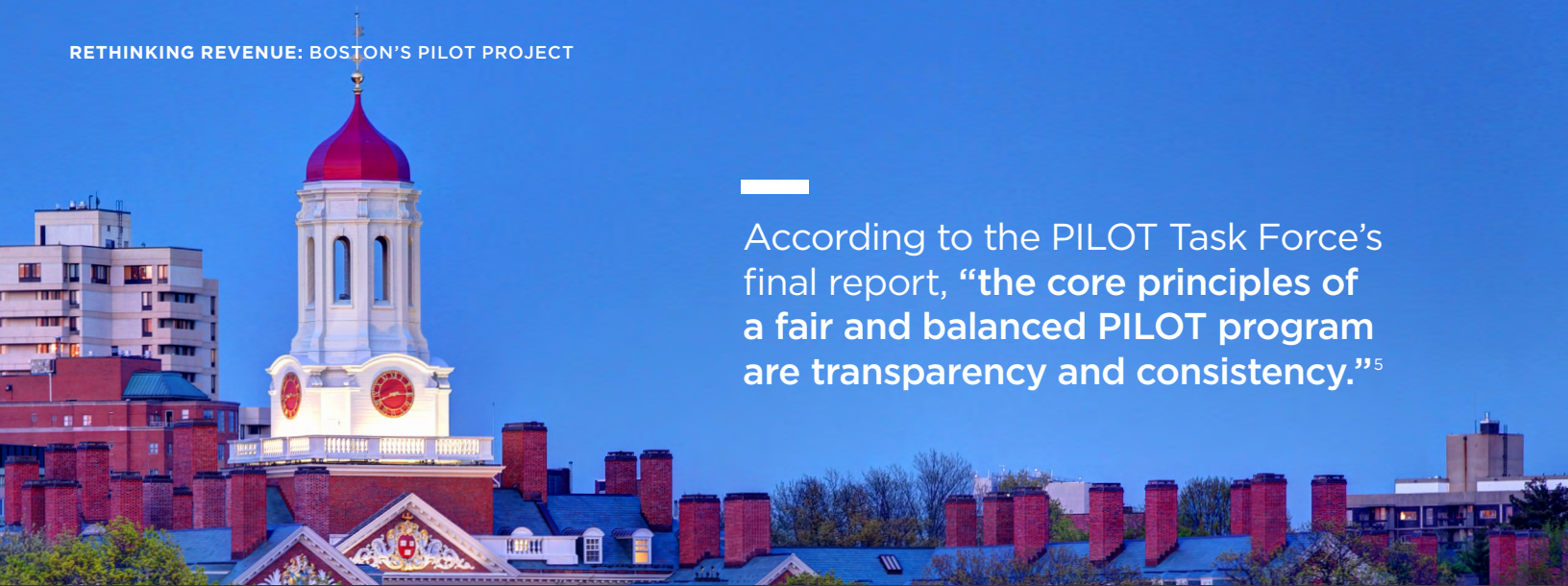
These principles supported the task force's five recommendations.

The first recommendation was that the PILOT program should remain voluntary. Giving NGOs the ability to opt in to the program supports a sense of fairness and collaborative decision-making. But this recommendation also speaks to another element of common-pool resource problems. There had been some talk among city officials of taking legal action to mandate contributions from NGOs.



A CLEAR VISION INSPIRES LOCAL NETWORKS

The GFOA report **"Network Enterprises—An Information Age Solution to Enduring Problems?"** describes how local governments can access networked forms of organization to solve community problems. Local governments have financial limits to what they can do within their authority and resources. Further, many problems of great concern to the public require the efforts of multiple sectors and may not fall within the core responsibility of one local government. A clear vision can convene a network for public, private, and nonprofit organizations to pursue a shared goal. This report shows how different approaches local governments have taken to establishing a vision and attracting others to that vision.



According to the PILOT Task Force's final report, “the core principles of a fair and balanced PILOT program are transparency and consistency.”⁵

Part of *Pillar 4*, **create clear rules**, is to develop incentives to shape behavior. The threat of a legal mandate to force contributions from NGOs likely played a role in encouraging NGOs to develop an arrangement that was not mandated but was an improvement on the status quo for the city.

The second recommendation was that the PILOT program should be applied to all NGOs, with an exception for small NGOs. The task force suggested \$15 million in assessed value as a threshold for participation in the program, including discounts for NGOs that were just over the threshold. This supports fairness by calling for consistent participation from larger NGOs while recognizing that smaller NGOs may not be able to afford contributions.

Third, the PILOT contributions should be based on the value of real estate owned by the NGOs. Working with the city staff, the task force concluded that an amount that accounted for police, fire, snow removal, and other essential services would be appropriate, while also providing a discount to NGOs relative to what a fully taxable property would pay. Based on this, the task force recommended PILOT payments be based on an amount equal to 25% of what a similar nonexempt property would pay. This provided a **clear rule** (*Pillar 4*).

Fourth, the benefits that the Boston community receives from NGO services should be recognized and qualify as PILOT credit. NGOs provide services that benefit the public. The task force felt it was **fair** to account for this in the PILOT payments. The task force also defined **clear rules** for what could qualify as a PILOT credit:

- The service must directly benefit the City of Boston residents.
- The service must support the city's mission and priorities. Put another way, the city would support such a service in its budget if the NGO did not provide it.
- The service should be quantifiable.
- The service should emphasize ways in which the city and the NGO can collaborate to address shared goals.
- Service credits should generally be limited to up to 50% of an NGO's PILOT contribution, with exceptions made for NGOs that have extraordinary capabilities to provide services that benefit the community. This rule recognizes that while service credits are important, the city also needs cash contributions to support the municipal services that NGOs use.

The fifth recommendation was that the program be phased in over at least five years. The amount of support expected from NGOs exceeded what most NGOs were providing to the city at the time. Phasing would give NGOs time to make the needed adjustments to their budgets. Also, the city agreed to a general principle of being consistent and transparent in its request for PILOT payments so that NGOs can plan appropriately.



The result of the task force's recommendations was for the city and NGOs to act as partners in creating a financially sustainable future for the city. The city makes a request of each NGO twice per year, based on rules just outlined, and, as needed, meets with NGOs to explain the request. At the meeting, the city acknowledges the value created by the NGO's contributions and explains why it is important for NGOs to stay active in the PILOT program: to support essential city services and to be a part of the community of NGOs that support the wider Boston community. The city also learns of any concerns the NGO might have and gets a sense of plans the NGO may have that could shape the nature of the NGO's future participation in the PILOT program.

Thus, the PILOT program is built on strong relationships and outreach between the city and the NGOs (***trust and open communication***, *Pillar 2*). This contrasts with the city's less successful approach to securing contributions from NGOs before. The old approach was legalistic, where there were a series of agreements between the NGOs and the city to make a contribution. These agreements resembled contracts but weren't binding on the NGOs because the legal basis for the city to demand such contributions was questionable. Further, the terms and conditions of these agreements weren't consistent from one NGO to the next. Hence, though contracts might have given the appearance of "clear rules," upon closer inspection, the rules were not all that clear. Though the new PILOT program has not secured 100% participation from all the eligible NGOs, the city has found that the "peer pressure" on NGOs to participate in a voluntary arrangement that NGOs themselves recommended is far more effective than the old approach. The city no longer maintains agreements with the NGOs and just makes the requests based on the rules that came out of the task force's recommendation.

The result of the task force's recommendations was for the city and NGOs to act as partners in creating a financially sustainable future for the city.

So, what lessons can other local governments take from Boston's experience?

First, an effort to secure PILOT support must be based on a clear vision. That vision shouldn't be limited to just financial support for the public budget. The City of Boston's vision emphasized NGOs' value in supporting the wider Boston community and the possibility of the city and NGOs to work together toward shared goals. It is worth recalling that the Great Recession provided additional urgency to reaching a better arrangement for PILOTs in Boston. In the absence of a recession, other local governments might be able to highlight other aspects of the environment that call for urgency. For example, recently there has been an interest in improving coordination between the city and NGOs in addressing high-profile issues like affordable housing and opioids.⁶

Second, a strategy based on trust and open communication likely has more potential than one rooted in a legalistic approach.⁷ As Boston's experience showed, there may not be a strong legal case, and the adversarial relationship that is implied with the legalistic approach invites NGOs to reject the (potentially flimsy) legal premise of the request for financial support. That said, if a local government has no history with receiving PILOTs from NGOs, a written agreement could provide useful clarity to both parties, if approached correctly (e.g., not adversarial, based on expectations from year to year).

Third, invite NGOs to help define the arrangement under which their PILOT contributions will be made. NGOs will look more favorably upon an arrangement they had a hand in creating. Also, this might help create a sense of peer pressure among NGOs to take part in the PILOT program.

Fourth, define clear rules that govern the size of the contributions that will be requested of NGOs. Boston's experience shows that it is important for the rules to recognize: 1) the nonfinancial, in-kind contributions made by NGOs to the local community; and 2) the local government needs some amount of cash contributions to fund essential municipal services.

Fifth, make sure NGOs feel fairly treated. Boston's experience shows that important elements of fairness include: consistency in how NGOs are treated under the PILOT system; recognizing the value of NGOs' nonmonetary contributions; and accommodations for smaller NGOs with less capacity to provide PILOTs.

Finally, it should be noted that Boston has not reached a state of PILOT perfection and has recognized the need for the PILOT program to be refined to remain vital and relevant. In the summer of 2021, Boston announced a new task force to revisit the PILOT program. The task force will build upon the program we described in this paper. It will continue a collaborative approach by working with NGOs and emphasizing trust and open communication. It will seek to address issues of fairness, where the contributions of some NGOs are disproportionate to the contributions of other NGOs. And the task force will refine and clarify the rules of the program to address the changing value of property owned by NGOs and the role of community service as an offset for cash contributions to the city.⁸

Additional Resources on PILOTs From the Lincoln Institute of Land Policy⁹

- [Nonprofit PILOTs, Policy Brief](#)
- [Payments in Lieu of Taxes: Balancing Municipal and Nonprofit Interests, Policy Focus Report](#)
- [Tax Battles: Cities Seek Higher Payments in Lieu of Taxes from Nonprofits, Land Lines Article](#)

Readers without access to the hyperlinks can find full citations in the endnotes

ENDNOTES

- ¹ Goodman, C. B. (2019). The fiscal impacts of urban sprawl: Evidence from U.S. county areas. *Public Budgeting & Finance*.
- ² Findings described in: City of Boston (December 2010). Mayor's PILOT Task Force: Final report & recommendations. This report references: City of Boston Assessing Department (2009). Property Tax Facts and Figures.
- ³ Rakow, R. W. (January 2013). Payments in lieu of taxes: The Boston experience. *Land Lines*. Lincoln Institute of Land Policy. <https://www.lincolnst.edu/publications/articles/payments-lieu-taxes>;
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- ⁴ The City of Boston lists the amounts paid by different institutions at: <https://www.boston.gov/finance/payment-lieu-tax-pilot-program#previous-years>
- ⁵ City of Boston (December, 2010). Mayor's PILOT Task Force: Final report & recommendations. https://www.cityofboston.gov/images_documents/PILOT_%20Task%20Force%20Final%20Report_WEB%20_tcm3-21904.pdf
- ⁶ Chesto, J. (Updated January 28, 2020). Changes may be coming to PILOT. The Boston Globe. <https://www.bostonglobe.com/2020/01/29/business/chesto-means-business/>
- ⁷ This finding is also supported by: Kenyon, D. A. & Langley, A. H. (November 2016). Nonprofit PILOTs (payments in lieu of taxes). Policy Brief. Lincoln Institute of Land Policy. <https://www.lincolnst.edu/publications/policy-briefs/nonprofit-pilots-payments-in-lieu-taxes>
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- ⁹ Kenyon, D. A. & Langley, A. H. (November 2016). Nonprofit PILOTs (payments in lieu of taxes). Policy Brief. Lincoln Institute of Land Policy. <https://www.lincolnst.edu/publications/policy-briefs/nonprofit-pilots-payments-in-lieu-taxes>
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