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A SYSTEM OUT OF BALANCE

A REPORT OF
THE COMMISSION ON REVENUE,
SUSTAINABILITY & EFFICIENCY

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By a resolution approved on March 28, 2011, the Providence City Council created the Commission on Revenue Sustainability and Effectiveness. The Commission was charged with reviewing and making recommendations to improve the City's revenue structure. In establishing the Commission, the City Council stated that "the City's ability to attract new businesses and homeowners is dependent on the predictability and equity of its revenue structure." The City Council further noted that "the City's revenue structure increasingly burdens residents and encumbers economic expansion."

The resolution charged the Commission with the responsibility to issue a report to the City Council on the City's revenue structure, which shall include recommended changes to taxes, exemptions, rates and base changes.

The nine member Commission began its work in April, 2011 and organized itself into three subgroups—Property Tax Structure, Non-Property Tax Revenues and Non Profit Institutions. The Commission received information from staff of the Providence Plan, the Rhode Island League of Cities and Towns and the City Assessor. The Commission received testimony from interested parties including: the Providence Foundation, Providence Apartment Association, Cox Communications, Verizon, Bliss Properties, and Regency (Richard Laplin) and through its deliberation received information from Brown University, the Rhode Island Association of Independent Colleges and Universities, Rhode Island Hospital and others.

City's Fiscal Condition

The Commission understood that it was undertaking its review of the revenue structure during a period of fiscal stress. In January 2011, it was projected that the City was facing a $110 million deficit. To address this deficit the City's Fiscal Year 2012 Budget was reduced by $23.3 million compared to the previous year's spending levels and property tax rates were increased and the motor vehicle exemption was reduced. On November 30, 2011 the Office of the Internal Auditor issued a three-year financial forecast. This financial forecast projected a structural budget deficit of $ 21.2 million for the period July 1, 2012 through June 30, 2013, and $37.2 and $58.8 million respectively in fiscal years 2014 and 2015. Furthermore, preliminary projections by the Office of Internal Auditor estimate a potential current fiscal year operating shortfall of $15-20 million.

In carrying out its assignment, the Commission had to determine whether it should take into consideration the City's projected deficit in making recommendations on long term revenue reform or benchmark its analysis to the Fiscal Year 2012 adopted budget. The Commission decided to base its findings and recommendations on the latter for the following reasons.

- The Commission was not charged with reviewing the efficiency of municipal spending and proposing economies. Therefore, if the revenue program was predicated on balancing future budgets, the Commission might have suggested tax increases before the Administration proposed options to balance the budget.
- The Commission found that the City's tax burden was an impediment to economic growth and increasing taxes could compromise any needed structural revenue reforms to promote economic growth.
- The Commission's analysis of the revenue system could not be effectively undertaken if the spending target was constantly changing.

Principles of Sound Revenue Policy and Providence

The formulation of the Commission's revenue reform plan attempted to enhance the hallmarks of sound tax policy: equity; economic efficiency and competitiveness; predictability and transparency and intergovernmental fiscal policy and balance. These qualities of a tax system should characterize the City's revenue system as a whole and take into account each of the component parts of the City's revenue sources. The Commission found that the City's present revenue program does not meet many of the benchmarks of a quality revenue policy. This failure can be attributed to both past municipal policies and practices as well as State intergovernmental fiscal policies that have penalized Rhode Island's capital city.

Equity is achieved when taxpayers with like resources are taxed similarly and when the burden of taxation falls proportionately on various income groups. Given the dependence of Rhode Island's cities and towns on the property tax it is difficult to relate the City taxes to the ability of its citizens to pay. However, equity also requires that similarly situated taxpayers should pay equal taxes. This concept is known as horizontal equity. The Commission found significant instances where the City's revenue structure did not meet this standard.

Economic efficiency is another benchmark of a high quality revenue system. The revenue system should not impose burdens in such a way to discourage economic activity. Economic efficiency means that the tax system should not impede or reduce the productive capacity of the City's economy. Data presented in this report documents that property taxes borne by businesses located in Providence are among the highest in urban areas in the United States. Analysis by the Commission also shows that businesses would have significantly lower property tax bills if they located in neighboring communities.

A quality revenue system should be both predictable and transparent. The lack of predictability and transparency was evident when the City enacted its Fiscal Year 2012 Budget. Due to the city's open-ended classification system, the property tax increase varied by the type of property. For example, the tax rate on owner occupied residential property was increased by approximately 5.0%, while the tax rate on commercial property was increased by more than 9.0%. Transparency is also crucial for a quality revenue system. Providence's complex set of classifications, tax stabilization agreements, and exemptions have resulted in a system that lacks transparency.

Intergovernmental fiscal policy and balance also must be considered when evaluating a municipality's revenue structure. Tax burdens should be spread over a reasonable array of revenue sources in order to limit undesirable economic effects and to promote stability. Providence's revenue structure, like that of many municipalities in Rhode Island, can be described as a "system out of balance." In Fiscal Year 2012, 51% of all general and school revenues the City receives comes from one source—the property tax. To achieve a balanced revenue base, an aggressive revenue diversification strategy should be pursued. This, however, will require cooperation from both the General Assembly and non-profit institutions as well as the City developing a more systematic approach to indentifying opportunities to enhance non-property tax revenues.

Summary of Key Recommendations

The Commission on Revenue Sustainability and Effectiveness maintained a productive dialogue between the three subgroups and the Commission as a whole. As the subgroups were investigating and developing ideas on the structure of the property tax and revenue diversification, the Commission vetted those ideas as they coalesced and agreed on a series of proposals that would form a long-range revenue strategy for the City of Providence.

The Commission's recommendations, which are discussed in greater detail in the report, include the following.

1. Restructure the property tax system as a catalyst for economic renewal and growth. To achieve greater equity and transparency as well as better positioning the City to successfully compete for investment and jobs, the Commission recommends the following salient reforms to the property tax structure:

    - Adopt a property classification system where commercial and industrial property is taxed at twice the effective residential property tax rate and tangible property at three times the effective residential property tax rate; and,

- Maintain the effective owner occupied residential property tax rate but refigure the system to reduce the current homestead exemption from 50% to 10% for owner occupied residences, and eliminate the homestead exemption for non owner occupied property.

2. The Commission's plan calls for a phase in approach to implement the reformed property tax structure given the City's current fiscal positions and the uncertainties that will be faced in achieving revenue diversification. The phase in approach is described as follows:

   - Adopt a property classification system where commercial and industrial property is taxed at 2.075 times the effective residential property tax rate and tangible property at 3.3 times the effective residential property tax rate; and,

   - Maintain the effective owner occupied residential property tax rate but refigure the system to reduce the current homestead exemption from 50% to 37.5% for owner occupied residences, and eliminate the homestead exemption for non owner occupied property.

3. Implement a comprehensive revenue diversification agenda in order to implement a property tax restructuring that is vital to improving the Providence economy. The Commission's revenue diversification suggestions include the following;

   - Determining the net costs to the City for services it provides to non-profit institutions with property valued in excess of $100 million and proposing a voluntary formula to allocate costs; and,

   - Pursuing an intergovernmental fiscal fair play agenda that would include accelerating the funding of the school aid formula which is scheduled to be fully funded until 2017; and,

   - Implementing state of the art practices to identify non-property revenues that the City can assess and collect without State approval, including a systematic program to maintain an inventory of potential revenues and programs to keep fees level current with operating costs.

Providence's property tax structure is out of balance and an impediment to the future economic growth of the capital city. The City's current property tax structure is the result of actions taken over a period of time by policy makers to temper the shifting of the tax burden from commercial and industrial property, to residential taxpayers. For example, over the last decade the relative growth in residential values has exceeded the increases to commercial and industrial values.

Table 1: Tax Certification Comparison 2001 vs. 2011

Type of Property	Total Assessed 2001	% of Total Levy	Total Assessed 2011	% of Total Levy	Variance 2001 vs 2011	% Change 2001 vs 2011
Total Residential Property Types	$3,646,526,700	51%	$6,794,209,523	57%	$3,147,682,823	86%
Total Commercial (Residential Use)	$526,482,600	7%	$770,881,846	7%	$244,399,246	46%
Total Commercial Property Type	$2,035,921,600	29%	$2,780,954,102	23%	$745,032,502	37%
Total Tangibles	$632,987,000	9%	$850,313,705	7.20%	$217,326,705	34%
Total Excise (Motor Vehicle/Trailer)	$258,320,200	4%	$644,247,338	5.40%	$385,927,138	149%
Grand Total	**$7,100,238,100**	**100%**	**$11,840,606,514**	**100%**	**$4,740,368,414**	**67%**

In 2001, residential property accounted for 51% of the property tax levy and commercial property 29%. Ten years later, residential and commercial property equaled 57% and 23% of the respective property tax levies (See Table 1). Over the last decade (2001-2011), the value of residential property increased 86%, rising from $3.6 billion to $6.8 billion. During this same period, commercial property values increased 37%, rising from $2.0 billion to $2.8 billion.

Absent the enactment of a generous homestead exemption and classification plan, the relatively modest growth in the value of business property would have exacerbated the transfer of the property tax burden on to homeowners. These changes to the City's property tax system have resulted in comparatively high commercial and industrial property tax burdens, making Providence unattractive to investors. This has hampered economic development and accelerated urban decay.

According to information presented to the Commission from the staff of the Rhode Island League of Cities and Towns, Providence, along with Central Falls and West Warwick, has a unique property tax classification and homestead exemption plan. Providence's plan is characterized by an extraordinarily high homestead exemption; a unique rental property homestead exemption; and relatively high commercial, tangible property and motor vehicle property tax rates.

How Do Taxes in Providence Compare to the Other 38 Cities and Towns in Rhode Island?

Residential Real Estate:

The Commission determined that the first step in developing a new and more equitable tax structure was to evaluate the competitiveness of Providence's current tax structure compared to the other thirty-eight cities and towns in the Rhode Island, as well as other major urban cities throughout the nation. The Commission developed models to compare the tax burden for owners of $150,000 owner-occupied properties and $300,000 non-owner occupied properties. Table 2 shows the tax burden on property owners in selected cities and towns in Rhode Island for a $150,000 owner-occupied property and a $300,000 non-owner occupied property.

Table 2 - Property Tax Burden: $150,000 Owner-Occ.; $300,000 Non-Owner Occ.

Municipality	Residential Real Estate Tax Rate*	Owner-Occupied Homestead	$150, 000 Assessment	Non-Owner Occupied Homestead	$300, 000 Assessment
Providence	$31.89	50.00%	$2,391.75	15.00%	$8,131.95
Cranston	$20.26	0.00%	$3,039.00	0.00%	$6,078.00
East Providence	$20.09	15.00%	$2,561.48	0.00%	$6,027.00
Lincoln	$21.65	35.00%	$2,110.88	0.00%	$6,495.00
Pawtucket	$17.78	0.00%	$2,667.00	0.00%	$5,334.00
Smithfield	$15.85	0.00%	$2,377.50	0.00%	$4,755.00
Warwick	$17.69	0.00%	$2,653.50	0.00%	$5,307.00

*FY2012 Tax Rates

As shown in Table 2, residential real estate taxes on Providence owner-occupied properties are competitive with those levied in other municipalities. However, property taxes levied on non-owner occupied properties are high when compared to other communities throughout Rhode Island.

Commercial Real Estate:

With a higher property tax burden, businesses pay a heavy premium to be located in Providence. In some instances, this higher tax burden is unavoidable because a Providence location is an important factor to the success of the business. In other cases, Providence's commercial tax burden is an obstacle to locating in the city.

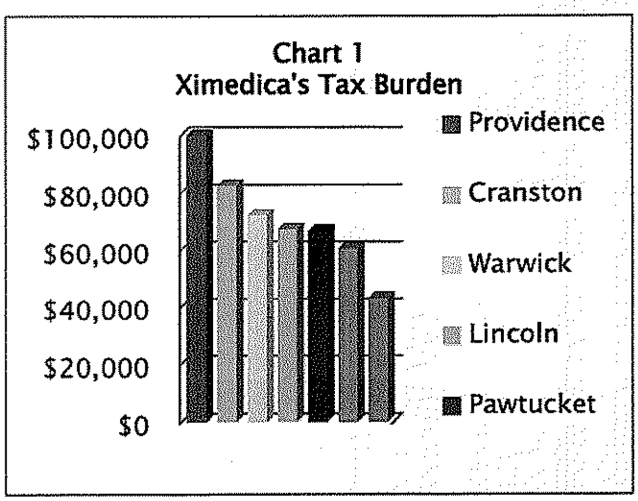

Table 3 shows the tax burden for seven (7) businesses that are located in the city of Providence, their current annual tax burden, and their tax burden if they were located in Warwick, Cranston, East Providence, Lincoln, Smithfield or Pawtucket, Rhode Island. Chart 1 focuses on the tax burden of one Providence-based business, Ximedica, and its tax burden if it were located in one of the other six municipalities mentioned above. Ximedica's annual tax obligation, if it were located in Cranston, would fall 17.3% from what the company currently pays to Providence. If Ximedica were located in Smithfield, the company's annual tax bill would fall 56.9% compared to what they currently pay in Providence. Amongst these six municipalities, Cranston has the second highest commercial tax obligation, whereas Smithfield has the lowest commercial tax obligation.

Table #3: Commercial Tax Comparison

City/Town	One Citizens Plaza	Howard Building	Old Canteen Restaurant	La Salle Bakery	Ximedica	Umicore	Hilton Providence
Providence	$1,376,416	$580,507	$21,308	$14,005	$99,773	$132,076	$834,556
Cranston	$1,138,212	$480,043	$17,620	$11,582	$72,026	$109,219	$602,470
East Providence	$833,340	$351,463	$12,901	$8,479	$67,194	$79,964	$562,048
Lincoln	$926,974	$390,953	$14,350	$9,432	$66,624	$88,949	$557,279
Pawtucket	$919,109	$387,636	$14,228	$9,352	$43,031	$88,194	$359,938
Smithfield	$593,638	$250,368	$9,190	$6,040	$60,407	$56,963	$505,275
Warwick	$993,641	$419,071	$15,382	$10,111	$82,506	$95,346	$690,127

The Lincoln Institute of Land Policy and the Minnesota Taxpayers Association in April 2011 published its "50-State Property Tax Comparison Study." As shown in Table 4, the study found that Providence had the second highest commercial property tax burden among the fifty-three urban communities included in the report for commercial properties valued at $100,000, $1.0 million and $25.0 million.

Restoring Balance to the Providence Tax Structure

Table 4: Urban Cities with Commercial Tax Rankings in Top Five or Bottom Five

	$100,000		$1,000,000		$25,000,000	
City, State	Tax	Rank (of 53)	Tax	Rank (of 53)	Tax	Rank (of 53)
Detroit, MI	$4,814	1	$48,141	1	$1,203,536	1
Providence, RI	$4,769	2	$47,695	2	$1,192,373	2
Des Moines, IA	$4,528	3	$45,282	3	$1,132,041	3
Philadephia, PA	$4,082	4	$40,817	4	$1,020,413	4
New York, NY	$3,968	5	$39,681	5	$992,014	5
Honolulu, HI	$1,061	49	$10,613	49	$265,329	49
Virginia Beach, VA	$965	50	$9,650	50	$241,253	50
Seatle, WA	$939	51	$9,394	51	$234,861	51
Wilmington, DE	$884	52	$8,838	52	$220,957	52
Cheyenne, WY	$782	53	$7,824	53	$195,605	53

Source: Lincoln Institute of Land Policy and the Minnesota Taxpayers Association: "50-State Property Tax Comparison Study" - April 2011

The Commission recognizes that there will be potential winners and losers in any plan to reform the City's property tax structure. Providence has an extremely liberal owner–occupied homestead exemption (50%) in comparison to other municipalities in Rhode Island and the region. As a result, it is extremely difficult to reverse history and identify property tax restructuring alternatives that improves Providence's economic competiveness and balances the property tax system without shifting an additional burden to homeowners. A sharp reduction to the homestead exemption or revision to the current classification plan, while maintaining the current tax levy, would cause a shift in tax liability from non-owner occupied and commercial property taxpayers to homeowners.

To provide for a more affordable, balanced, and competitive property tax structure, the Commission is recommending a three-step tax classification plan, as well as significant reductions to the residential homestead exemption. As discussed below, the Commission's recommendation will not shift additional tax burden to owner occupied residential property, and will result in an estimated $35-40 million reduction in the property tax levy. This loss of revenue is caused by a reduction of the tax burden on commercial property and non-owner occupied residential property.

Unfortunately, the Commission was not able to identify $35-40 million in revenues to make up for this loss. Therefore, as discussed below, this report suggests a first step to achieve a fairer and more competitive property tax system. The cost of implementing the first step is estimated to be between $15-18 million.

Reformed Property Tax Structure

The following property tax structure is typical of a tax system that enhances equity, competitiveness, and balance within the City's tax structure, and represents the long–term objectives of property tax reform that the City should attempt to achieve.

- Implement a classification system where commercial and industrial property is taxed at twice the rate of the owner occupied residential property rate, and tangible property is taxed at three times the owner occupied residential rate;

- Reduce the current homestead exemption for owner occupied property from fifty-percent (50%) to ten-percent (10%), and eliminate the current fifteen-percent (15%) exemption for non-owner residential properties.

Under this plan the commercial rate would be twice the effective owner-occupied residential rate ($15.95) or $31.90 per thousand, and the tax rate for tangible property would be $47.85 per thousand. Commercial and tangible tax rates are currently $36.75 and $55.80 per thousand, respectively. The Commission believes that these changes to the existing property tax structure will improve the overall economic competitiveness and balance of the City's property tax structure. More specifically, these changes would:

- Make Providence more business friendly by reducing both the commercial tax rate and the tangible tax rate by 13.2% and 14.2% respectively;

- Maintain the effective owner-occupied residential tax rate;

- Reduce non-owner occupied taxes by 34.6%.

Tables 5, 6 and 7 shown below compare the current property tax burden for each classification of real estate taxes in the various neighborhoods of the city against the tax burden of the Commission's typical tax structure proposal.

Table 5: Impact of Commission's Typical Tax Structure - Single Family Residential Property

Neighborhood	Median Assessment	Current Average Annual Taxes *		Commission's Tax Proposal **		Variance ($) Actual vs. Commission	
		Owner Occupied	Non-owner Occupied	Owner Occupied	Non-owner Occupied	Owner Occupied	Non-owner Occupied
Blackstone	$489,000	$7,797	$13,255	$7,797	$8,660	$0	($4,595)
Charles	143,100	$2,282	$3,879	$2,282	$2,534	$0	(1,345)
College Hill	623,100	$9,935	$16,890	$9,935	$11,035	$0	(5,855)
Downtown	246,900	$3,937	$6,693	$3,937	$4,373	$0	(2,320)
Elmhurst	164,200	$2,618	$4,451	$2,618	$2,908	$0	(1,543)
Elmwood	112,200	$1,789	$3,041	$1,789	$1,987	$0	(1,054)
Federal Hill	168,000	$2,679	$4,554	$2,679	$2,975	$0	(1,579)
Fox Point	353,400	$5,635	$9,579	$5,635	$6,259	$0	(3,321)
Hartford	131,300	$2,094	$3,559	$2,094	$2,325	$0	(1,234)
Hope	282,800	$4,509	$7,666	$4,509	$5,008	$0	(2,657)
Lower South Prov.	99,700	$1,590	$2,703	$1,590	$1,766	$0	(937)
Manton	129,150	$2,059	$3,501	$2,059	$2,287	$0	(1,214)
Mount Hope	272,450	$4,344	$7,385	$4,344	$4,825	$0	(2,560)
Mount Pleasant	137,000	$2,184	$3,714	$2,184	$2,426	$0	(1,287)
Olneyville	101,650	$1,621	$2,755	$1,621	$1,800	$0	(955)
Reservoir	110,900	$1,768	$3,006	$1,768	$1,964	$0	(1,042)
Silver Lake	124,300	$1,982	$3,369	$1,982	$2,201	$0	(1,168)
Smith Hill	100,550	$1,603	$2,726	$1,603	$1,781	$0	(945)
South Elmwood	117,300	$1,870	$3,180	$1,870	$2,077	$0	(1,102)
Upper South Prov.	123,000	$1,961	$3,334	$1,961	$2,178	$0	(1,156)
Valley	108,600	$1,732	$2,944	$1,732	$1,923	$0	(1,020)
Wanskuck	134,700	$2,148	$3,651	$2,148	$2,386	$0	(1,266)
Washington Park	110,250	$1,758	$2,988	$1,758	$1,953	$0	(1,036)
Wayland	466,850	$7,444	$12,655	$7,444	$8,268	$0	(4,387)
West End	100,400	$1,601	$2,721	$1,601	$1,778	$0	(943)

* Residential Rate = $31.89; Owner Occupied Homestead Exempt = 50%; Non-Owner Exemption = 15%

** Residential Rate = $17.71; Owner Occupied Homestead Exempt = 10%; Non-Owner Exemption = 0%

Table 6: Impact of Commission's Typical Tax Structure - 2-5 Family Non-owner Occupied

2-5 Family Residential, Non-Owner Occupied Residential				
Neighborhood	**Median Assessment**	**Current Average Annual Taxes ***	**Commission's Tax Proposal ****	**Variance ($) Actual vs. Commission**
Blackstone	$396,350	$10,744	$7,019	($3,724)
Charles	$163,600	$4,433	$2,897	($1,536)
College Hill	$546,500	$14,809	$9,679	($5,131)
Downtown	$374,000	$10,135	$6,624	($3,511)
Elmhurst	$191,150	$5,180	$3,385	($1,795)
Elmwood	$131,200	$3,555	$2,324	($1,232)
Federal Hill	$192,600	$5,219	$3,411	($1,808)
Fox Point	$375,800	$10,183	$6,655	($3,528)
Hartford	$147,800	$4,005	$2,618	($1,388)
Hope	$314,750	$8,529	$5,574	($2,955)
Lower South Prov.	$121,200	$3,284	$2,146	($1,138)
Manton	$158,600	$4,298	$2,809	($1,489)
Mount Hope	$281,400	$7,625	$4,984	($2,642)
Mount Pleasant	$149,850	$4,061	$2,654	($1,407)
Olneyville	$128,400	$3,479	$2,274	($1,205)
Reservoir	$126,300	$3,422	$2,237	($1,186)
Silver Lake	$148,800	$4,032	$2,635	($1,397)
Smith Hill	$139,600	$3,783	$2,472	($1,311)
South Elmwood	$133,250	$3,611	$2,360	($1,251)
Upper South Prov.	$123,400	$3,344	$2,185	($1,158)
Valley	$137,300	$3,721	$2,432	($1,289)
Wanskuck	$166,900	$4,523	$2,956	($1,567)
Washington Park	$127,350	$3,451	$2,255	($1,196)
Wayland	$455,700	$12,349	$8,070	($4,278)
West End	$131,850	$3,573	$2,335	($1,238)

* Residential Rate = $31.89; Non-Owner Exemption = 15%

** Residential Rate = $17.71; Non-Owner Exemption = 0%

Table 7: Impact of Commission's Typical Tax Structure Commercial Property

Commercial Property				
Neighborhood	**Median Assessment**	**Current Average Annual Taxes ***	**Commission's Tax Proposal ****	**Variance ($) Actual vs. Commission**
Blackstone	$471,500	$17,328	$15,036	($2,291)
Charles	$457,600	$16,817	$14,593	($2,224)
College Hill	$799,800	$29,393	$25,506	($3,887)
Downtown	$1,392,400	$51,171	$44,404	($6,767)
Elmhurst	$333,900	$12,271	$10,648	($1,623)
Elmwood	$354,350	$13,022	$11,300	($1,722)
Federal Hill	$411,200	$15,112	$13,113	($1,998)
Fox Point	$571,900	$21,017	$18,238	($2,779)
Hartford	$400,800	$14,729	$12,782	($1,948)
Hope	$624,300	$22,943	$19,909	($3,034)
Lower South Prov.	$295,800	$10,871	$9,433	($1,438)
Manton	$600,600	$22,072	$19,153	($2,919)
Mount Hope	$733,050	$26,940	$23,377	($3,563)
Mount Pleasant	$266,350	$9,788	$8,494	($1,294)
Olneyville	$285,350	$10,487	$9,100	($1,387)
Reservoir	$343,700	$12,631	$10,961	($1,670)
Silver Lake	$279,200	$10,261	$8,904	($1,357)
Smith Hill	$398,200	$14,634	$12,699	($1,935)
South Elmwood	$222,050	$8,160	$7,081	($1,079)
Upper South Prov.	$530,250	$19,487	$16,910	($2,577)
Valley	$380,150	$13,971	$12,123	($1,848)
Wanskuck	$340,400	$12,510	$10,855	($1,654)
Washington Park	$384,900	$14,145	$12,274	($1,871)
Wayland	$659,200	$24,226	$21,022	($3,204)
West End	$271,750	$9,987	$8,666	($1,321)

* Commercial Tax Rate = $36.75

** Commercial Tax Rate = $31.89

First Step to Property Tax Reform

The Commission recognizes that any property tax plan must be affordable, practical, and make the City more attractive to investors. The recommended first step to restructuring Providence's property tax system is outlined below. The Commission believes that this option represents a positive first step or a down payment to reforming the property tax structure. The salient provisions of this option are as follows:

- Establish a residential rate of $25.52 with the application of a 37.5% Homestead Exemption on owner-occupied properties, which maintains the current effective rate;

- Eliminate the homestead exemption for non-owner occupied residential properties, which is currently 15%. The effective rate would be $25.52 compared to the current effective rate of $27.11;

- Assess a commercial tax rate at 2.075 the effective residential rate ($33.10) and a rate on tangible property at 3.3 times the effective residential rate ($52.63). The current commercial and tangible rates are $36.75 and $55.80, respectively.

Implementation of this option will have the following impacts on the various classes of property:

- Makes Providence's business tax burden less uncompetitive by reducing both the commercial tax rate and the tangible tax rate by 9.9% and 5.7% respectively;

- Reduces the property tax rate on non-owner occupied property by 5.9%;

- Maintains the effective owner-occupied residential tax rate.

Tables 8, 9 and 10, show the impact of this incremental plan for each neighborhood for owner and non-owner occupied property as well as commercial property. This analysis is predicated on the median property value in each neighborhood.

Table 8: Impact of Commission's First Step Tax Plan - Single Family Residential Property

Neighborhood	Median Assessment	Current Average Annual Taxes *		Commission's Tax Proposal **		Variance ($) Actual vs. Commission	
		Owner Occupied	Non-owner Occupied	Owner Occupied	Non-owner Occupied	Owner Occupied	Non-owner Occupied
Blackstone	$489,000	$7,797	$13,255	$7,797	$12,479	$0	($776)
Charles	143,100	$2,282	$3,879	$2,282	$3,652	$0	(227)
College Hill	623,100	$9,938	$16,890	$9,938	$15,902	$0	(989)
Downtown	246,900	$3,938	$6,693	$3,938	$6,301	$0	(392)
Elmhurst	164,200	$2,619	$4,451	$2,619	$4,190	$0	(261)
Elmwood	112,200	$1,790	$3,041	$1,790	$2,863	$0	(178)
Federal Hill	168,000	$2,680	$4,554	$2,680	$4,287	$0	(267)
Fox Point	353,400	$5,637	$9,579	$5,637	$9,019	$0	(561)
Hartford	131,300	$2,094	$3,559	$2,094	$3,351	$0	(208)
Hope	282,800	$4,511	$7,666	$4,511	$7,217	$0	(449)
Lower South Prov.	99,700	$1,590	$2,703	$1,590	$2,544	$0	(158)
Manton	129,150	$2,060	$3,501	$2,060	$3,296	$0	(205)
Mount Hope	272,450	$4,346	$7,385	$4,346	$6,953	$0	(432)
Mount Pleasant	137,000	$2,185	$3,714	$2,185	$3,496	$0	(217)
Olneyville	101,650	$1,621	$2,755	$1,621	$2,594	$0	(161)
Reservoir	110,900	$1,769	$3,006	$1,769	$2,830	$0	(176)
Silver Lake	124,300	$1,983	$3,369	$1,983	$3,172	$0	(197)
Smith Hill	100,550	$1,604	$2,726	$1,604	$2,566	$0	(160)
South Elmwood	117,300	$1,871	$3,180	$1,871	$2,993	$0	(186)
Upper South Prov.	123,000	$1,962	$3,334	$1,962	$3,139	$0	(195)
Valley	108,600	$1,732	$2,944	$1,732	$2,771	$0	(172)
Wanskuck	134,700	$2,148	$3,651	$2,148	$3,438	$0	(214)
Washington Park	110,250	$1,758	$2,988	$1,758	$2,814	$0	(175)
Wayland	466,850	$7,446	$12,655	$7,446	$11,914	$0	(741)
West End	100,400	$1,601	$2,721	$1,601	$2,562	$0	(159)

* Residential Rate = $15.95; Owner Occupied Homestead Exempt = 50%; Non-Owner Exemption = 15%

** Residential Rate = $25.52; Owner Occupied Homestead Exempt = 35%; Non-Owner Exemption = 0%

Table 9: Comparison of Commission's First Step Tax Plan - 2-5 Family Non-owner Occupied

2-5 Family Residential, Non-Owner Occupied Residential				
Neighborhood	**Median Assessment**	**Current Average Annual Taxes ***	**Commission's Tax Proposal ****	**Variance ($) Actual vs. Commission**
Blackstone	$396,350	$10,744	$10,115	($629)
Charles	$163,600	$4,435	$4,175	($260)
College Hill	$546,500	$14,814	$13,947	($867)
Downtown	$374,000	$10,138	$9,544	($593)
Elmhurst	$191,150	$5,181	$4,878	($303)
Elmwood	$131,200	$3,556	$3,348	($208)
Federal Hill	$192,600	$5,221	$4,915	($306)
Fox Point	$375,800	$10,187	$9,590	($596)
Hartford	$147,800	$4,006	$3,772	($234)
Hope	$314,750	$8,532	$8,032	($499)
Lower South Prov.	$121,200	$3,285	$3,093	($192)
Manton	$158,600	$4,299	$4,047	($252)
Mount Hope	$281,400	$7,628	$7,181	($446)
Mount Pleasant	$149,850	$4,062	$3,824	($238)
Olneyville	$128,400	$3,480	$3,277	($204)
Reservoir	$126,300	$3,424	$3,223	($200)
Silver Lake	$148,800	$4,033	$3,797	($236)
Smith Hill	$139,600	$3,784	$3,563	($221)
South Elmwood	$133,250	$3,612	$3,401	($211)
Upper South Prov.	$123,400	$3,345	$3,149	($196)
Valley	$137,300	$3,722	$3,504	($218)
Wanskuck	$166,900	$4,524	$4,259	($265)
Washington Park	$127,350	$3,452	$3,250	($202)
Wayland	$455,700	$12,352	$11,629	($723)
West End	$131,850	$3,574	$3,365	($209)

* Residential Rate = $31.89; Non-Owner Exemption = 15%

** Residential Rate = $25.52; Non-Owner Exemption = 0%

Table 10: Comparison of Commission's First Step Tax Plan - Commercial Property

Commercial Property				
Neighborhood	**Median Assessment**	**Current Average Annual Taxes ***	**Commission's Tax Proposal ****	**Variance ($) Actual vs. Commission**
Blackstone	$471,500	$17,328	$15,607	($1,721)
Charles	$457,600	$16,817	$15,147	($1,670)
College Hill	$799,800	$29,393	$26,473	($2,919)
Downtown	$1,392,400	$51,171	$46,088	($5,082)
Elmhurst	$333,900	$12,271	$11,052	($1,219)
Elmwood	$354,350	$13,022	$11,729	($1,293)
Federal Hill	$411,200	$15,112	$13,611	($1,501)
Fox Point	$571,900	$21,017	$18,930	($2,087)
Hartford	$400,800	$14,729	$13,266	($1,463)
Hope	$624,300	$22,943	$20,664	($2,279)
Lower South Prov.	$295,800	$10,871	$9,791	($1,080)
Manton	$600,600	$22,072	$19,880	($2,192)
Mount Hope	$733,050	$26,940	$24,264	($2,676)
Mount Pleasant	$266,350	$9,788	$8,816	($972)
Olneyville	$285,350	$10,487	$9,445	($1,042)
Reservoir	$343,700	$12,631	$11,376	($1,255)
Silver Lake	$279,200	$10,261	$9,242	($1,019)
Smith Hill	$398,200	$14,634	$13,180	($1,453)
South Elmwood	$222,050	$8,160	$7,350	($810)
Upper South Prov.	$530,250	$19,487	$17,551	($1,935)
Valley	$380,150	$13,971	$12,583	($1,388)
Wanskuck	$340,400	$12,510	$11,267	($1,242)
Washington Park	$384,900	$14,145	$12,740	($1,405)
Wayland	$659,200	$24,226	$21,820	($2,406)
West End	$271,750	$9,987	$8,995	($992)

* Commercial Tax Rate = $36.75

** Commercial Tax Rate = $33.10

Property Tax Stabilization Agreements

Providence's non-competitive property tax structure has forced the City to enter into tax treaties or tax stabilization agreements with real estate developers and other commercial and industrial enterprises. In 2012, based upon information provided by the City Assessor, 35 businesses within the City had entered into tax stabilizations or tax treaty agreements. If such agreements were not made, the combined property tax liability of the requesting businesses would total $10.3 million. As a result of the tax stabilization agreements, these companies paid an aggregate property tax totaling $3.5 million. The result was a tax expenditure of $6.8 million, not including tax increment financing or other preferential tax agreements the City entered into for other economic reasons (i.e. Providence Place Mall). While tax stabilization agreements may be economically necessary in certain cases, it should be remembered that they are being funded by other residential and commercial taxpayers who are not the beneficiaries of such agreements, or by reductions in revenues necessary to fund public services including education and public safety. The Commission believes that the most effective way to minimize the use of tax stabilization agreements is to implement a more balanced and competitive property tax structure.

The Commission reviewed the City's Non-Property Tax Revenue (NPT) sources and attempted to evaluate the effectiveness of the City's collection of these revenues and to identify strategies by which the City might optimize them.

The City of Providence is overly dependent upon property taxes to finance municipal services. In fiscal year 2012, nearly 51% of the city's revenue will be generated by property taxes, 40% from state and federal aid, and the balance of 9% from other locally generated revenues including fines, interest income, and charges for services. According to the Census Bureau, and as shown in Table 11, property taxes account for an average of 48.5% of municipal general revenues for the six New England states.[1]

Table 11 – Property Taxes as a Percentage of General Revenues

State	Local Revenues (000)	Property Tax Revenues (000)	%
Connecticut	$15,235,047	$8,789,283	57.7
Maine	4,506,296	2,139,955	47.5
Massachusetts	27,454,978	12,162,493	44.3
New Hampshire	5,076,433	2,818,612	55.5
Rhode Island	3,934,572	2,126,178	54.0
Vermont	2,414,048	372,384	15.6
Total	$58,621,374	$28,408,905	48.5

The Commission evaluated seven categories of existing and potential new NPT revenue sources. The first six include: (1) local option broad-based income and sales taxes; (2) a local payroll tax; (3) state-enacted taxes for municipal purposes; (4) a local-option gross earnings utilities tax; (5) enhanced local fees, fines, and charges; and (6) market-based revenue opportunities (MBROs).

As we discuss below, these six categories can be viewed as forming a continuum. At one end, implementation of local income and broad-based sales taxes would be expected to provide two of the largest potential sources of NPT revenues. At the other end, MBRO revenue may represent the least significant source of additional possible revenue.

A seventh category of NPT revenue that the Commission evaluated was state aid.

[1]U.S. Census Bureau, 2009-11.

Local Option Broad-Based Income and Sales Taxes

Local option taxes are levied with state approval by participating municipalities. According to the National Conference of State Legislatures, forty-three (43) states authorize local option sales and/or income taxes.[2] Three quarters of states (38) permit local sales taxes, which accounted for approximately 12% of their local revenue. One third (18) permit local income and/or payroll taxes, which taxes generated approximately 5.0% of local tax revenue. Within the six New England states, only Vermont authorizes any such taxing authority – by allowing local sales taxes.

The expansion of local income and sales taxing authority can have important economic, fiscal, and social implications for individual taxpayers, businesses, and the local economy. On the plus side, there is a potential for revenue diversification and property tax relief, shifting some of the tax burden off of residents and onto non-residents. On the other hand, there are significant disadvantages that caused the Commission to conclude that the disadvantages outweigh the benefits of revenue diversification.

For example, a local option income or sales tax may adversely affect the City's economic competitiveness and business climate, while not guaranteeing lower property taxes. Would a retailer in Providence be at a competitive disadvantage if it had to collect a higher tax than a retailer in Cranston or Warwick? If a local income tax were permitted, how would the situs of a taxpayer be determined? Income is mobile and local government efforts to tax mobile bases such as corporate profits and personal income usually have negative unintended consequences.

Local Payroll Tax

A local payroll tax is usually levied as a percentage of a worker's gross salary and wages. For example, a one-percent payroll tax on an annual income of $50,000 would translate to a $500 tax bill. Similar to a local option income tax, a payroll tax could render the city less competitive in attracting and retaining jobs and investments. A local payroll tax is not levied in either Massachusetts or Connecticut. In addition, a local payroll tax could not be piggybacked on the State's progressive income tax and thus could represent significant collection and enforcement issues for the City. Therefore, the Commission does not believe that it would be a prudent revenue diversification option for the City of Providence.

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[2] NCSL, "Local Option Taxes," January 2008.

State-Enacted Taxes for Municipal Purposes

Another approach to municipal revenue diversification would be to expand state imposed taxes that dedicate their proceeds to municipalities. This option would avoid some of the administrative and economic competitiveness issues associated with many local option broad-based taxes discussed above.

In addition to the seven-percent sales tax, the State of Rhode Island assesses an additional one percent (1.0%) of gross receipts tax on retail sales of meals and beverages from eating and/or drinking establishments. Eating establishments are defined to include all entities preparing food, including caterers. This tax is collected by the Rhode Island Division of Taxation and distributed to the city or town where the meals and beverages are delivered. In FY2012, Providence expects to collect $4.1 million from this source.

Increasing the meals and beverages tax from 8.0% to 10.0% would provide an opportunity for the City to diversify its revenue base without having a potentially adverse impact on the local economy. For example if a family has a $30 dinner bill they would currently pay a sales tax of $2.40. Under the proposal their tax bill would be increased by $0.60 to a total of $3.00. The proceeds from such a tax increase are projected to total over $8.0 million in additional revenue to Providence.

Unlike a broad-based sales tax, the meals tax applies to a far more narrow range of goods and services. In addition, this tax generates a portion of its revenue from non-residents. Furthermore, it is collected by the State and remitted to the cities and towns, thereby permitting efficient administration.

Such an increase would result in the City having a higher meals and beverage tax than cities and towns in Massachusetts and Connecticut. Owners of eating and drinking establishments might object to such an increase given the current period of economic uncertainty. However, additional revenue from an increase to the meals and beverage surtax would be applied, at least in part, to replace revenues lost from downward adjustments to City property tax rates. Those downward adjustments would benefit commercial real estate owners and tenants, including restaurant owners.

The Subcommittee could only recommend an increase in the meals and beverages tax if there were a guarantee that the proceeds would be dedicated to reforming the property tax structures in order to enhance the City's competitive position.

The Commission studied the hotel occupancy tax but does not believe it should be increased for the following reasons. The combined state and local tax on hotel occupancy is 13%; there is competition to attract large conventions to the City; and increasing the tax would not generate sufficiently significant revenues.

Local Option Gross Earnings Taxes on Utilities

The fourth potential category of new revenue sources was a local option gross earnings tax on public utilities. Public utilities include providers of electricity, natural gas, and telecommunications. At present, only the State is authorized to levy gross earnings taxes on public utilities. Pursuant to state regulation, those costs are passed along in substantial part directly to the utilities' customers and appear as itemized charges on customers' monthly statements.

By way of a general overview, the state gross earnings tax applies to providers of electricity, natural gas, and telephone service at varying rates. Providers of other telecommunications services are subject to a gross earnings tax or the corporate income tax. Sales taxes are also applied to certain telecommunications services. For FY2011, the last full year for which information is available, the State received revenues of nearly $103 million from its gross earnings taxes on the public utilities.

The State also applies a franchise tax, the Public Service Corporation Tax, with respect to certain of the tangible personal property of telecommunications companies. That property is exempt from taxation by local municipalities and towns. The State remits the revenues from this tax, after deducting administrative fees, to the local cities and towns of origin. In fiscal year 2012, it is projected that Providence will collect $1.9 million from the State as its share of this tax.

Tangible personal property of public utilities other than telecommunications companies is taxed directly by the municipalities and towns in which it is located. The rates of those tangible personal property taxes vary by municipality and town, as discussed in Part II above.

Our neighboring states of Massachusetts and Connecticut tax their public utilities through the use of net income, gross earnings, franchise, and sales and use taxes. In view of the numerous and differing taxation methodologies of the utilities tax laws within Rhode Island, Massachusetts, and Connecticut, it is beyond the resources of this Commission to evaluate accurately for purposes of comparison the relative tax burdens on the utilities within the three states. Nor is the Commission in a position to evaluate accurately the relative burdens on residential and commercial users before and after any potential changes. For these reasons, the Commission recommends that the City address possible changes to the utilities tax structure as a longer term inquiry.

Local Fees, Fines, and Charges

A significant component of the City's NPT revenue arises from the fees, fines, and charges that City departments collect. These items include parking fines, fees for permit applications, and charges for private police details – among many others. As shown in Table 12, based upon the City's reporting categories the Commission estimates that in FY2012 the City will collect nearly $34 million from this revenue category.

Table 12: Revenues from Fees, Fines, and Charges

Source	Revenue
Licenses and Permits	$5,913,000
Fines and Forfeits	9,400,000
Charges for Services	4,693,000
Interest Income	5,525,000
Tuition	585,000
Rentals	20,000
Departmental Fees	7,428,500
Total	**$33,564,500**

Source: 2012 Approved Budget, p. 1

In 2004, the firm Public Financial Management (PFM) prepared a comprehensive examination of the City's finances and management. The PFM Report described an inventory of fees, fines, and charges that it said had been developed which included: (1) the current NPT revenue items; (2) the current rates of those items; (3) the revenue that those items currently generated; (4) the statutory bases for those items; (5) the dates that the rates of those items were last changed; and (6) the persons who were responsible for collecting them.

The City's Director of Administration advised the Commission that the inventory described in the PFM Report does not exist and no centralized inventory is maintained. Published City budget reports did not provide sufficient detail for the Commission to prepare a substitute inventory of the kind the PFM Report described and which is needed for a meaningful evaluation.

Therefore, we recommend that the City establish an inventory of all of its fees, fines, and charges in the form contemplated by the PFM Report.

We further recommend that the City establish a procedure to (1) bring those fees, fines, and charges up to date, and (2) keep those items current – by indexing them to rates of inflation and by comparing them to those of other jurisdictions. To the extent that State approval may be required before a change can be made to an individual fee, fine, or charge, then the City should also establish a procedure for bringing such issues promptly to the State administration's attention.

Market-Based Revenue Opportunities (MBROs)

Market-Based Revenue Opportunities (MBROs) refer most commonly to short- and longer-term marketing agreements that a municipality or town enters into with one or more third-party sponsors. For example, an MBRO might include a third-party's agreement to provide park benches and similar equipment at no cost, together with a monetary payment, in exchange for the right to place advertisements on the benches or other equipment. According to Boston.com, Boston's street furniture MBRO program generated over $2 million for the city in FY2010. San Diego is another municipality that has utilized MBRO partnerships to generate similarly valuable third-party services and revenue.

Based the experience of Boston and San Diego, the potential revenue available from additional such agreements appears to be significant. Therefore, the Commission recommends that the City explore MBRO agreements.

State Aid

State aid shown in Table 13 comprises approximately $246 million, or nearly 40% of the City's FY2012 budget of $613.8 million. The majority of state aid (83%) supports the operation of the Providence Public Schools.

Table 13: Categories of State Aid

Revenue	FY2012
State Aid to Education	$177,121,396
School Debt Construction	27,199,913
State PILOT Payment	23,109,815
Distressed Cities Revenues	5,143,906
Telephone Franchise Tax	1,879,801
Medicaid Reimbursement	4,250,000
Meals and Beverages Tax	4,100,000
Excise (Auto) Tax Reimbursement	1,617,922
Room Tax	1,350,000
Total	$245,772,753

Source: 2012 Approved Budget, p. 22

In FY2011 the General Assembly enacted a School Aid Funding Formula aimed at providing a more equitable distribution of state aid based upon both student need and the community's ability to pay. This legislation provided for a seven year phase-in to fully fund the School Aid Formula. When fully implemented in 2017, Providence's share of School Aid is projected to total approximately $223 million. In the next fiscal year (2013), it is projected that the City's general operations aid will total approximately $190 million, which is $33 million less than what the State determined would be the City's fair share if the formula were fully funded.

To address the inequities resulting from the phase-in of the School Aid Formula, the Commission urges that the City work with Governor Chafee and the General Assembly to accelerate the full and equitable School Aid Formula.

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. Research by non-profit institutions is an important economic engine for Providence and the state of Rhode Island. Much of this research is concentrated in the Jewelry District and surrounding area known as the Knowledge District. For research activity to grow it requires investment in new laboratories and high-tech equipment. The tax-exempt institutions are uniquely positioned to make these investments and thus grow the economy. The City wants to encourage these investments but at the same time must diversify its revenue structure in order to compete for private investments.

Governments support and encourage the social benefits non-profits provide through the tax code. With that said, non-profits 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 non-profits on the City's finances, and exploring what constructive role the non-profits 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 reviews the pros and cons of the concept of agreements with non-profits for payments in lieu of taxes (also known as "PILOT agreements").[3]
- Third, the Report will present findings from Boston and New Haven, cities that have reached agreements with non-profits that could provide a basis for Providence's non-profits.
- Fourth, the Report will propose a formula or approach to allocate this burden among Providence non-profits to close this gap.

[3]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 in this Report, the state of Connecticut refers to such state aid programs as "grants in lieu of property taxes" or GILOTs.

- Fifth, the Report will identify other ways to seek appropriate relief from the non-profits 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.

The net financial impact non-profits impose on the City of Providence.

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 non-profits 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 non-profits 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 non-profits by exempting them from supporting those government programs (most notably the public schools) that do not affect their institutions directly.[4] For these reasons, the Report will limit its calculation of the City's services provided to non-profits to the following areas: Public Safety, Planning and Development and Public Works. As indicated in Table 17 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 non-profits' collective share of this gross cost as $36.3 million to $41 million.[5]

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[4]It is worth noting that these City programs may provide important indirect benefits to non-profits; 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.

[5]The November, 2010 Report developed a lower estimate of the cost of City services to non-profits by choosing not to include several categories of services contained in Table 17, below. We believe that the more inclusive set is more accurate.

Fortunately for the City of Providence, the State of Rhode Island funds a program to offset a portion of the burden of serving major non-profits. This program currently provides approximately $23 million annually.[6] 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.

Addressing the gap through voluntary agreements

There are policy reasons to support the use of PILOT agreements to address the municipal financial burden caused by non-profits, 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:

- **Arguments in support of PILOTs**

  - Perhaps the most basic reason to expect non-profits 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 non-profits 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.

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[6]The major non-profits 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 non-profits, not just the major ones. On the other hand, the City's major non-profits 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 non-profits 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.

- PILOTs also can help level the playing field between profits and non-profits with regard to development. It is well established that property taxes are capitalized into selling prices. Within a given area, non-profits have a financial incentive to locate in municipalities with high tax rates, because their decisions are based solely on selling prices, not property taxes.[7]

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

- **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 "MOU" 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 non-profits than on property values or the level of public services consumed by non-profits. Consequently there are huge horizontal inequities, with similar non-profits making very different PILOTs even within the same municipality.

- In Providence, that inequity is apparent in the varied responses that different types of non-profit institutions made 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.

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[7] 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 non-profits 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.

- 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 non-profits 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 non-profits justifiably fear agreeing to long-term commitments. It is important for local governments interested in voluntary contributions from non-profits, but not interested in challenging the property tax exemption itself, to make this intent explicit in the contracts signed between non-profits and municipalities that form the basis of ongoing PILOT agreements.

- PILOTs could lead non-profits to raise fees, cut services, or reduce employment. For example, in response to making $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.

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.[8]

- **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 non-profits. (Lincoln Report, p. 21.)

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[8]Lifespan rejects the applicability of the Boston model to Providence, based on the history of the Chapin Hospital and its evolution into Rhode Island Hospital, the Bay State's universal health care system and the higher hospital reimbursement rates that prevail in Massachusetts. On the other hand, Boston taxes the property held by its city's hospitals that generates a profit and/or is not devoted to the hospitals' core mission while Providence does not; therefore, the total income Boston receives from its hospitals is significantly higher than what is indicated on the table above, while Providence currently essentially no income from its hospitals from either sources. Lifespan will have the opportunity, during PILOT negotiations, to make its case concerning the applicability of the Boston model to Providence.

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.*[9] 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.

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 non-profits. One goal is to broaden the base, because several major institutions each make annual payments to the city over $1 million, many non-profits 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 non-profits 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 non-profits 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.

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[9]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 non-profits, 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.

This fall, Boston sent a letter to 40 non-profits 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 non-profits they host. On the other hand, the Massachusetts property tax exemption permits municipalities to tax property held by non-profits that is used for profitmaking purposes.

- **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 non-profits that the municipalities would 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 non-profits 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 non-profits at more than twice the level that Providence does, and even though New Haven non-profits pay property tax on income-producing property while Providence institutions do not.

Allocating the Funding Among Providence's Non-profits

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 non-profits 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 non-profits in the aggregate ($4.4 billion).[10] Many of the smaller non-profits 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 non-profits. 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.

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

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:

Table 14

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

Table 15

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:

Table 16

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 non-profits 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, 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:

- 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.

- Does the proposed offset provide budgetary relief to the City of Providence? If it does, then this program qualifies 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.

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 non-profits for government services.

The simplest program would involve charging a fee to non-profits while not charging taxpayers for such services as public safety. Municipal service fees are charged only to non-profits 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 non-profits 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 non-profits. 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 non-profits) 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 non-profits, 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 non-profits 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 non-profits; however, they can be done if the non-profits 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 non-profits who can be a part of a solution. Although the Mayor has not yet announced any final agreements with the City's non-profits, it is the Subcommittee's hope that further discussions will yield better results, so that our City's non-profits can claim the same mantle of civic responsibility found in their great sister institutions in our sister cities.

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 non-profits.

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

- 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 17: Calculation of City programs that serve non-profits

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.