

# NERCHE BRIEF

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## **PILOTs and their Problems: A Third Way for Higher Education**

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This academic year, as the nation faces the uncertainties of an impending economic recession, colleges and universities can be sure of at least one thing: Local municipalities will place new, more intense demands on higher education to help shoulder the costs of unmet community needs.

Though the public role of private institutions has been an issue of simmering debate, it has reached a boil in recent years. The Massachusetts Legislature is asking state officials to study a proposed 2.5 percent annual tax on college or university endowments that exceed \$1 billion. This proposal is a more modest version of an idea put forth at the federal level by Senator Charles Grassley (R-Iowa) and Senator Max Baucus (D-Mont) which would require institutions with the largest endowments to spend at least 5% of those endowment funds each year. The states and the federal government are raising the question of higher education's responsibility to the public good at a time when a college or university education is increasingly perceived as a private benefit.

Resistance on the part of universities to providing community support often hinges on claims of institutional status and autonomy, a stance which many in the public no longer take for granted. The prospect of regulating the use of Harvard's \$35 billion endowment not only lays bare the vulnerability of the University, but also raises the question of whether the privileges of the University are deserved. Moreover, as Harvard's President [First Name] Faust says, it raises issues that "implicate what we might call Harvard's 'public boundary,' issues that cast into relief questions about the role and purposes of universities and of Harvard in particular."

President Faust's response to these questions represents a relic of the social trustee model— or what she calls "the model of 'voluntary accountability'" – which rests on the social exchange of status and autonomy for the university in return for specialized expertise aimed at social purposes. She offers this "proposition":

“The essence of a university is that it is uniquely accountable to the past and to the future – not simply or even primarily to the present .... A university looks both backwards and forwards in ways that must – that even ought to – conflict with a public’s immediate concerns or demands.” These principles seem to me to touch directly on the debates that have been swirling around us. They can help us understand and frame our public responsibilities and to embrace them as opportunities for leadership and creative action...we cannot treat our endowment as a lump sum to be spent on the projects of any given cohort of faculty or students, the demands of today’s politics, or even the vision of an individual Harvard president. <sup>1</sup>

Here, Faust expresses a view that is commonly held but rarely discussed. It implies that it is desirable for society to grant universities a unique status of autonomy in return for the specialized knowledge which universities dispense and which can serve the public good. The logic of this model implies that if university’s autonomy diminishes in any way, so too will its service to society.

This social compact, however, has worn thin. From the community’s perspective, increased independence of the university reflects less what the *public asks* of the university and more what the *university asserts* the public should get from it. Thus, the perception among many communities is that when the university defines the bounds of community service – rather than the other way around -- the community is not well served.

The social trustee model – and the distrust it has engendered – fuels an ongoing battle between institutions of higher education and those who question the ethics and even the legality of an untaxed accumulation of wealth, particularly at a time of financial crisis and economic hardship facing families and communities across the country. Proposals like those on Beacon Hill also represent a ratcheting up of political pressure on colleges and universities, especially as critics point to the limited number of institutions that make voluntary Payments In Lieu of Taxes (PILOTs) to their host communities or tap their endowment for increased financial aid to students.

PILOTs are in fact symptomatic of the growing distrust between colleges and their communities. There needs to be an innovative and creative approach to rebuilding this trust and working collaboratively for the common good.

Colleges and universities in cities like Boston, Cambridge, Providence, and New Haven have been the source of much needed revenue for their host communities and have provided a convenient model for other communities nationwide. But the common denominator among the communities benefiting from PILOTs is that there are institutions of higher education with a minimum endowment of \$2.6 billion (Brown University) and a maximum endowment of \$34.6 billion (Harvard). Variations on blanket PILOTs have involved an institution of higher education focusing attention on a specific department within a city government (e.g., The University of Pennsylvania and the Philadelphia city schools) or the city and the university agreeing to pay for specific services (e.g., Duke University and the City of Durham fire services).<sup>2</sup> In each example the colleges and universities, willingly or otherwise, make a symbolic though not insignificant contribution to the local community.

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<sup>1</sup> Faust, Drew, Commencement Address, Harvard College, June 5, 2008, Cambridge, MA

<sup>2</sup> Policy Matters Ohio, Report to Cuyahoga County Treasurer on PILOTs, December, 2004, Cleveland, OH

Other more pro-active initiatives have tried to bring the resources of the academy to bear on the general well-being of the community. In Worcester, Massachusetts, for instance, a three-year project known as the Worcester UniverCity Partnership attempted to establish a collaboration among the nine Worcester-based colleges and universities, the City of Worcester, non-profit organizations, and the business community. This experimental effort succeeded in raising the profile of local colleges' commitment to Worcester's economic betterment but failed to gain the traction needed to continue the project. Perhaps more notable, it failed to blunt the vocal community demands for PILOT payments from the local colleges.

While an increasing number of colleges and universities establish renewed and engaged relationships with their local communities (with some help from the federal government and the philanthropic world), we would like to suggest a formal way for higher education institutions to augment this collaboration. This method not only recognizes the plight many of our cities are facing; it acknowledges the enlightened self-interest that can ensure the long-term health and viability of both the host community and the institution.

This formal arrangement would involve the establishment of a "community investment fund" among local colleges, to be used for community initiatives consistent with the colleges' academic and civic missions – for example, education programs, health services, or social welfare programs. Colleges would agree to defer 1% of their endowment earnings to contribute to this community investment fund. Studies indicate that in 2007 the average return on investment for college endowments was approximately 17%. Further studies reveal that colleges typically spend approximately 4-5% of this earned income on current operating costs. In the eyes of many college officials this endowment income helps keep costs (i.e., tuition) down. Acknowledging the benefit derived from applying a portion of the earned income to operational expenses, this yields upwards of 11-12% of earned income available to help grow the principle of the endowment. In real numbers, if a college has an endowment of \$100 million, this would, in a good year, generate \$17 million in earned income. Allowing for even a more generous 5% application of earned income to current operational costs, the addition to the principle of the endowment would be slightly more than \$16 million. Deferring 1% of this earned income would result in an approximate \$500,000 contribution to a community investment fund while causing no discernible harm to the principle of the endowment.

In order to build support for such a fund, each participating college or university must be assured that the funded activities will be in keeping with its educational and outreach mission. The higher education institution must also play an active and reciprocal role in determining what initiatives or activities are funded. Mutually agreed upon initiatives that speak to the common good -- initiatives built around education, the arts, health, and social services -- could be appealing to the colleges, while helping the city to continue providing vital public services. A local foundation could also play a broker role, bringing the colleges and the city together to negotiate the best use of community investment funds.

A community investment fund has the potential to redress the resentment, lack of trust, and seemingly adversarial relationships between campuses and their local communities. In spite of the accomplishments of the colleges and their individual and collective contributions to economic development in Worcester, the aforementioned Worcester UniverCity Partnership struggled to get past the perceived defensive response to critics of the colleges and proponents of PILOT payments. There was never a sense of "we're in this together." A community investment fund created by the

colleges of Worcester and disbursed through shared authority of the campuses, the community, and city government may have created the needed sense of common purpose.

A community investment fund model provides a vehicle for enabling a college or university to build upon the enlightened self-interest of all parties and work in partnership with a local community to address debilitating social and economic problems. It speaks to an institution's sense of civic responsibility and rebuilds trust in the purpose of higher education – to serve the common good. And it involves higher education in the “here and now” of the communities of which they are a part, so that a better future is possible for both the community and the university.