

Illinois Property Tax Exemption Battle

Special Report

Illinois Property Tax Exemption Under Review

Potential Rating Pressure: The denial of the property exemption for certain not-for-profit hospital providers in Illinois by the Illinois Department of Revenue (IDOR) is a negative credit development that could further strain financial performance of providers in the state. Combined with expected funding cuts to Medicaid and Medicare programs, Fitch Ratings believes that the additional cost of property taxes could negatively affect the ratings for Illinois not-for-profit hospitals.

Lower Rated Credits Particularly Vulnerable: Fitch believes that lower rated entities will have a limited ability to absorb an additional expense in the form of a property tax. Lower rated credit profiles typically demonstrate less financial cushion, making any negative financial impact more severe.

Case-By-Case Review: Fitch will review the credit impact of property tax payments on a case-by-case basis, which will be dependent on the assessed valuation and tax rate, the credit profile of the organization, and management's plan to absorb the impact on operating profitability.

Sectorwide Implications Unknown: Fitch will continue to monitor developments in Illinois as well as other states for possible challenges to the property tax exemption granted to not-for-profit hospitals and health systems. Fitch believes that it is likely the exemption will continue to receive heightened scrutiny.

Related Research

[State Influence on Local Government Credit, May 20, 2011](#)

[Fitch Affirms Illinois' GO Bonds at 'A'; Outlook Stable, March 8, 2012](#)

[2012 Outlook: Nonprofit Hospitals and Healthcare Systems, Dec. 15, 2011](#)

[U.S. State Budgets and the Growing Pains of Medicaid Costs, Sept. 27, 2011](#)

[Impact of Potential Medicare Cuts on Nonprofit Hospitals, Nov. 16, 2011](#)

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Property Tax Exemption and Illinois Hospitals

On Aug. 16, 2011, the IDOR issued an initial ruling denying a property tax exemption to three not-for-profit hospitals in Illinois: Northwestern Memorial Prentice Women's Hospital (not rated by Fitch), Edward Hospital (not rated by Fitch) and Decatur Memorial Hospital (rated 'A+' with a Negative Outlook by Fitch). In addition, the IDOR announced that it is reviewing the property tax exemption granted to 15 other not-for-profit healthcare providers (which are unknown to Fitch at this time).

Although IDOR's decision is based on the grounds that these hospitals do not provide enough charity care to qualify for the exemption, the exact criteria or standards for the IDOR's decision were not disclosed. Subsequent to the IDOR's announcement, Illinois Governor Pat Quinn announced that the state would postpone its review of these exemptions until the state legislature had the opportunity to craft legislation that specifies qualifications for the exemption. In March, Governor Quinn ordered the IDOR to continue its reviews as the legislature was unable to resolve the issue.

In the case of Northwestern Memorial Hospital (NMH) Prentice Pavilion, the potential property tax liability could be significant. As disclosed in NMH's audited financial statements, in October 2011, NMH received from the Cook County Assessor's Office (the assessor) notices of intent to list omitted assessments for NMH Prentice Pavilion for 2008, 2009, and 2010, and the assessor has issued proposed assessments for the NMH Prentice Pavilion for 2011.

NMH has not received any tax bills for the NMH Prentice Pavilion for 2008 through 2011. However, management has estimated the property tax liability could be as much as approximately \$22 million, \$14 million, \$15 million, and \$15 million for fiscal years 2008, 2009, 2010, and 2011, respectively, based on the full amount of the assessor's assessments. The estimated annual tax amounts equate to roughly 1.0%–1.5% of total revenues and would have the effect of lowering NMH's operating margins by a like amount on an annual basis.

Fitch maintains ratings on 19 Illinois-based hospitals and health systems, which range between 'AA' and 'BBB+'. Using 2010 audited financial results, the operating margins of those 19 rated entities ranged between 10.3% and negative 1.9% with an average of 2.6%. Clearly, Fitch believes the higher rated borrowers are in better position to absorb the additional expense of property taxes, while for lower rated borrowers the impact may be more profound. If property tax assessments run from 1.0%-1.5% of total revenues, then the 2.6% average operating margin among the 19 Illinois providers rated by Fitch in 2010 would be cut in half.

Background

The exemption from property taxes is determined by each state. In Illinois, exemption from property taxes for not-for-profit organizations is based on a two-part test: first, the property must be owned by an institution of public charity and second, the property must be used exclusively for charitable purposes and not with a view to profit.

In March 2010, the Illinois Supreme Court ruled in favor of the IDOR's denial of an exemption from property taxes on Provena Covenant Medical Center in Urbana. In its ruling, the court used the rationale that a charitable purpose "tends to lessen the burdens of government and to affect the general welfare of the public." The ruling states that "conditioning charitable status on whether an activity helps relieve the burdens on government is appropriate. After all, each tax dollar lost to a charitable exemption is one less dollar affected governmental bodies will have to meet their obligations directly." However, an appropriate level of charity care was not the foundation of the ruling. The ruling was based on the fact that the exempt property was owned

by Provena Hospitals (parent company) but the charitable use was at the subsidiary level. The court chose not to define the level or amount of charitable benefit required to meet the threshold for exemption from property taxes. During this case, the court did make clear that satisfying the federal standard for tax-exempt status under the Internal Revenue Code Section 501(c)(3) is insufficient to establish property tax exemption under Illinois law.

Beyond Illinois

Many states and local municipalities are still under budgetary strain resulting from depressed tax revenues and declining intergovernmental transfers at a time of elevated demand for social services. States have been rethinking their financial contributions to local governments as a way to reduce budgetary shortfalls (see Fitch Research on “State Influence on Local Government Credit,” dated May 20, 2011, available on Fitch’s Web site at www.fitchratings.com).

The challenge to property tax exemptions for not-for-profit hospitals has not been limited to Illinois. In Ohio, a not-for-profit dialysis clinic was challenged similar to Provena Covenant Medical Center for not providing enough charity care to warrant exemption from property tax payments. Although the dialysis clinic lost its case, the outcome was favorable for not-for-profit hospitals and health systems in Ohio as the Ohio Supreme Court ruled that there is no minimum amount of free care that must be provided by a not-for-profit provider, as long as it has a nondiscriminatory policy for all who seek care. The court stated that “a provider is not required to forego government benefits to qualify for charitable status and that the facility may not accept so many paying patients that it cannot accommodate an ordinary number of indigent patients seeking admission.” While the Ohio Supreme Court ruling protected the property tax exemption of the not-for-profit healthcare providers, Fitch believes that challenges to the exemption from property taxes for not-for-profit hospitals and healthcare providers in other states is likely to come under greater scrutiny as states and local governments look for additional revenue sources.

Fitch-Rated Illinois Hospitals and Healthcare Systems

(As of April 11, 2012)

Hospital/Health System	Long-Term Rating	Rating Outlook/Watch	Short-Term Rating
Advocate Health Care Network	AA	Rating Outlook Stable	F1+
Alexian Brothers Health System	A-	Rating Watch Evolving	—
Carle Foundation	AA-	Rating Outlook Stable	—
Centegra Health System and Affiliates	A-	Rating Outlook Stable	—
Central DuPage Health and Affiliates	AA	Rating Outlook Stable	—
Children’s Memorial Medical Center	AA-	Rating Outlook Stable	—
Decatur Memorial Hospital	A+	Rating Outlook Negative	—
Elmhurst Memorial Healthcare and Subsidiaries	A-	Rating Outlook Stable	—
Hospital Sisters Services Inc.	AA-	Rating Outlook Stable	F1+
Little Company of Mary Hospital and Health Care Centers	A+	Rating Outlook Stable	—
Methodist Medical Center	A	Rating Outlook Stable	—
Northwestern Medical Faculty Foundation, Inc.	A+	Rating Outlook Stable	—
OSF Healthcare System	A	Rating Outlook Stable	—
Palos Community Hospital	AA-	Rating Outlook Stable	—
Resurrection Health Care and Affiliates	BBB+	Rating Outlook Stable	—
Rush University Medical Center Obligated Group	A-	Rating Outlook Positive	—

Fitch-Rated Illinois Hospitals and Healthcare Systems(continued)

(As of April 11, 2012)

Hospital/Health System	Long-Term Rating	Rating Outlook/Watch	Short-Term Rating
Silver Cross Health System	BBB+	Rating Outlook Stable	—
Southern Illinois Healthcare	A+	Rating Outlook Stable	—
Swedish Covenant Hospital	BBB+	Rating Outlook Stable	—
SwedishAmerican Health System	A	Rating Outlook Stable	—
University of Chicago Medical Center	AA-	Rating Outlook Stable	—

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