

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

CHF-Kutztown LLC

V.

Berks County Board of Assessment Appeals and Kutztown Area School District

Appeal of: Berks County Board of Assessment Appeals

[illegible]

: No. 1663 C.D. 2009
: Argued: March 16, 2010

BEFORE: HONORABLE DAN PELLEGRINI, Judge
HONORABLE P. KEVIN BROBSON, Judge
HONORABLE JAMES R. KELLEY, Senior Judge

OPINION NOT REPORTED

MEMORANDUM OPINION
BY JUDGE PELLEGRINI

FILED: April 13, 2010

The Berks County Board of Assessment Appeals (Board) appeals from an order of the Court of Common Pleas of Berks County (trial court) reversing the decision of the Board and granting the request of CHF-Kutztown, LLC (CHF) for a real estate tax exemption as a purely public charity. Because we find there is not substantial evidence to conclude CHF met all of the constitutional and statutory requirements to qualify as a purely public charity, we reverse.

The facts of this case are not in dispute. CHF is an Alabama non-profit corporation founded to assist Kutztown University of Pennsylvania (University) with its student housing needs. It was organized and is wholly owned by a national entity known as Collegiate Housing Foundation, of which Kutztown

University is a member. According to its Articles of Organization, CHF was organized exclusively for educational and charitable purposes, including “[t]o assist Kutztown University to provide housing for its students by financing, developing, constructing and/or operating a student housing project for Kutztown University.” (R. at 48). To that end, CHF purchased a 4.9 acre parcel of land in Kutztown Borough, Berks County, through tax free and taxable bond financing, upon which was the already built Sacony Commons – a 53-unit apartment style student housing complex with the capacity to house 159 students. CHF and the University entered into an Affiliation Agreement providing that upon the retirement of its financing debt, CHF would donate its interest in the property and Sacony Commons to the University in fee simple. CHF presently owns, operates, and through its hired manager, Kutztown University Student Services, Inc., manages Sacony Commons.

On September 2, 2008, CHF filed an Application for the Exemption of Real Estate for the property at issue with the Berks County Assessment Office (Office). The Office rejected the request and after a hearing on the matter, the Board upheld the decision and maintained the assessed value of the premises at \$5,243,200. CHF then appealed to the trial court¹ claiming it qualified for a tax exemption as a “purely public charity” under both the Pennsylvania Constitution and the Institutions of Purely Public Charity Act (Charity Act).² Article VIII, Section 2 of the Pennsylvania Constitution authorizes the General Assembly to

¹ The Kutztown Area School District intervened in the appeal in support of the decision of the Board.

² Act of November 26, 1997, P.L. 508, 10 P.S. §§371—385.

exempt from taxation “[i]nstitutions of purely public charity, but in the case of any real property tax exemptions only that portion of real property of such institution which is actually and regularly used for the purposes of the institution.” Pa. Const. art. 8, § 29(a)(v). To qualify for a statutory tax exemption such as the one CHF was seeking, an entity must first meet the constitutional requirements of being a “purely public charity.” *National Church Residences of Mercer County v. Mercer County Board of Assessment Appeals*, 925 A.2d 220, 224 (Pa. Cmwlth. 2007). Whether these requirements are met is an issue solely for the courts to decide. *Id.* at 225.

In *Hospital Utilization Project v. Commonwealth*, 507 Pa. 1, 487 A.2d 1306 (1985) (*HUP*), the Supreme Court of Pennsylvania set forth the definitive test for determining whether an entity qualifies as a “purely public charity” under the Pennsylvania Constitution, stating:

[A]n entity qualifies as a purely public charity if it possesses the following characteristics.

- (a) Advances a charitable purpose;
- (b) Donates or renders gratuitously a substantial portion of its services;
- (c) Benefits a substantial and indefinite class of persons who are legitimate subjects of charity;
- (d) Relieves the government of some of its burden; and
- (e) Operates entirely free from private profit motive.

HUP, 507 Pa. at 21-22, 487 A.2d at 1317. Once an entity qualifies as a “purely public charity” under the Constitution, it must then qualify for tax exempt status

under the Charity Act. *Lock Haven University Foundation v. Clinton County Board of Assessment Appeals and Revision of Taxes*, 920 A.2d 207 (Pa. Cmwlth. 2007). Section 5 of the Charity Act states that an institution qualifies as a “purely public charity” if it meets the criteria set forth in subsections (b) through (f), which track the language of the five-prong *HUP* test stated above.³ Each of these subsections also provides specific guidance as to how the criteria can be satisfied. The issue before the trial court was whether CHF met two of the five prongs of the constitutional and statutory tests, specifically whether it “donates or renders gratuitously a substantial portion of its services,” and whether it “benefits a substantial and indefinite class of persons who are legitimate subjects of charity.”

At trial, CHF presented the testimony of Dennis G. Dunn (Mr. Dunn), owner of Higher Education Solutions, LLC (HES) and former on-site property manager for Sacony Commons. Mr. Dunn testified that through CHF’s Affiliation

³ 10 P.S. §375(a). Section 5(a) of the Act provides as follows:

An institution of purely public charity is an institution which meets the criteria set forth in subsections (b), (c), (d), (e) and (f). . . .

(b) Charitable purpose – The institution must advance a charitable purpose.

(c) Private profit motive – The institution must operate entirely free from private profit motive.

(d) Community service – The institution must donate or render gratuitously a substantial portion of its services.

(e) Charity to person – The institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity.

(f) Government service – The institution must relieve the government of some of its burden.

Agreement the University agreed to consider Sacony Commons as part of its student housing stock and allow CHF to market to its students. HES was responsible for the billing and collection of rent, as well as payments on debts and utilities at the property. According to Mr. Dunn, HES was under University guidelines with respect to how the property was managed so it could only charge University-approved rental fees and it was only permitted to rent to registered students of Kutztown University or its faculty members. He testified that CHF's agreement with the University made conditions much more restrictive than renting in the marketplace because CHF was restricted in who it could rent to, renting to students was a seasonal business (approximately nine months versus a 12-month lease), rental rates were lower than in the marketplace, and the ability to collect money from students who failed to pay their rent was restricted by the University. According to Mr. Dunn, CHF had no profit motive and any surplus revenue in a fiscal year would be donated to the University. Mr. Dunn believed the project was designed to benefit University students by providing them with housing.

On cross-examination, Mr. Dunn admitted that none of the students living at Sacony Commons were provided with free or low-cost rent due to financial need or hardship and that the University did not retain the right to direct CHF to accept a student aid or hardship case as a tenant. He also admitted that the majority of leases were endorsed or co-signed by the student's parent or guardian. Therefore, if a student failed to pay his or her rent, HES could attempt to collect payment from the co-signer. However, HES needed permission from the University to do so and Mr. Dunn knew of no instances where HES sought permission; rather, it simply took losses on these cases. Mr. Dunn also testified that HES was entitled to five percent of all rents, receipts and revenue as compensation for its property management services, and that this was a good,

competitive rate. During the time period that Mr. Dunn served as property manager the average occupancy rate at Sacony Commons was approximately 75%. However, the occupancy rate for 2009 jumped to almost 100%.⁴

The Board did not call any rebuttal witnesses or put on any testimony. The majority of the record before the trial court consisted of documents admitted into evidence, including CHF's Articles of Organization, the Affiliation Agreement between CHF and the University, and CHF's "financial report" for the fiscal year ending June 30, 2008.

The trial court granted CHF's request for an exemption finding that it met all of the requirements of the constitutional test as well as the statutory criteria under the Charity Act. The Board then appealed to this Court.⁵

On appeal, the Board alleges the trial court abused its discretion and reached a conclusion not supported by substantial evidence when it determined that CHF satisfied all of the elements necessary to qualify as a "purely public charity" under the Constitution and the Charity Act. Specifically, the Board argues that CHF failed to meet its burden of establishing that it donates or renders gratuitously

⁴ CHF also presented the testimony of Lisa Kowalski (Ms. Kowalski), executive director of Kutztown University Student Services which took over as property manager of Sacony Commons in 2009. She testified that the current rental conditions imposed upon Sacony Commons and her company by the Affiliation Agreement with the University remained the same as those described by Mr. Dunn.

⁵ Our scope of review in a tax assessment appeal is limited to whether the trial court committed an error of law, abused its discretion, or whether its decision was supported by substantial evidence. *Grace Center Community Living Corp. v. County of Indiana*, 796 A.2d 1008 (Pa. Cmwlth. 2002).

any of its services, let alone a substantial portion of its services. CHF's testifying witnesses admitted that all of the students who leased apartments in Sacony Commons were required to pay the full rent due and that no students were ever provided with free or low-cost rent due to financial need or hardship. Every student was bound by a signed lease, many of which were co-signed and guaranteed by a parent or guardian; therefore CHF had the capability to collect unpaid rent from other sources. The Board argues that because CHF charges University students rent and does not offer any free or low-cost leases to students with financial need or hardship, it does not satisfy this element of the constitutional test.

The Board's argument that CHF does not qualify as a purely public charity solely because it charges students rent is without merit. Our Supreme Court has provided guidance on the issue of whether an entity donates a substantial portion of its services in its decision in *Hospital Utilization Project v. Commonwealth*. HUP was organized to collect statistical data on hospital utilization in western Pennsylvania and prepared statistical abstracts for patients upon discharge. It collated this information and distributed it to area hospitals through a fee-for-services arrangement. HUP admittedly charged everyone for its services and did not provide financial aid to customers who were unable to pay. Our Supreme Court held HUP did not qualify as a purely public charity within the meaning of the Constitution because it did not offer any of its services free of charge and "[a]n organization which provides all its services for actual cost is engaged in a commercial enterprise." *HUP*, 507 Pa. at 17, 487 A.2d at 1314. The Court went on to state that although an entity does not cease to be a "purely public charity" just because it receives payment for its services, "this reasoning cannot be used to support [the] argument that an organization which provides no free services

qualifies as a ‘purely public charity’ merely because it has good intentions.” *Id.* at 19, 487 A.2d at 1315.

Just like HUP, CHF charges everyone for its services and does not offer any free or even reduced-rate services for those in financial need. While CHF may not be able to charge the prevailing “market” rent in the area and may be somewhat limited in its ability to pursue collections due to University restrictions, it fully anticipates that each tenant at Sacony Commons will pay his or her rent. The unrebutted testimony demonstrates that the rent charged at Sacony Commons is within \$50 to \$100 of that charged at similar student housing complexes in the Kutztown area and that the occupancy rate for the current school year is basically 100%. CHF holds a lease, a binding contract, with each tenant that requires payment in full, and oftentimes these leases are co-signed and guaranteed by a parent or guardian. While CHF’s purpose is to provide student housing to those seeking higher education in the Commonwealth, it provides this housing at actual cost and has never knowingly rented to a student who could not afford to pay the standard rent or offered reduced rates for student aid or hardship cases. Therefore, it does not satisfy the constitutional requirement of donating or rendering gratuitously a substantial portion of its services.

CHF argues that the trial court correctly found that it donates a substantial portion of its services because it has never operated at a profit and in fact the rental income it receives only covers approximately 86% of its operational costs. According to CHF, this translates into a donation of approximately 14% of

its services and satisfies the statutory requirement under Section 5(d) of the Charity Act regarding uncompensated goods and services.⁶ We disagree.

Whether the portion of an entity's services that it donates gratuitously is "substantial" is to be determined based upon the totality of the circumstances and our courts have not set a specific cutoff or "magical percentage" that will satisfy this element. *HUP*, 507 Pa. at 20, 487 A.2d at 1316. However, our Supreme Court has also stated that in order to meet this part of the test, "[i]t must appear from the facts that the organization makes a bona fide effort to service primarily those who cannot afford the usual fee." *Id.* Once again, CHF admits to charging every tenant full rent, it has never knowingly accepted a tenant who could not pay, and it does not provide reduced rates for students who cannot afford to pay. Clearly it does not "service primarily those who cannot afford the usual fee," and it does not meet this element of the constitutional test. *See Metropolitan Pittsburgh Nonprofit Housing Corporation v. Board of Property Assessment, Appeals and Review*, 480 Pa. 622, 391 A.2d 1059 (1978).

In addition, CHF's claim that its rental income only covers approximately 86% of its operational costs is fuzzy math and is not supported by the evidence. First, these numbers are based upon the previous school year when the rental rate was approximately 75%. (CHF admits that Sacony Commons is currently at almost 100% capacity.) Second, several of the charges listed in CHF's

⁶ Section 5(d) of the Charity Act states that an entity can satisfy the community service portion of the test and demonstrate that it donates or renders gratuitously a substantial portion of its services by, *inter alia*, providing "[u]ncompensated goods or services which in the aggregate are equal to at least 5% of the institution's costs of providing goods or services." 10 P.S. §375(d)(1)(v).

“financial report” were one-time fees, including \$71,645.02 for “letter of credit fees” and \$219,382.00 for an “interest swap payment.” CHF also took the \$119,786.22 in property taxes into consideration when calculating its profit margin. After you take away these fees and account for the substantial increase in income due to the higher occupancy rates, it appears CHF is actually making a significant profit from the Sacony Commons rental property. The fact that any surplus revenue goes to the University and that CHF will donate the property to the school upon retirement of the debt is simply not enough to satisfy the requirement that it donate gratuitously a substantial portion of its services.

Finally, the Board argues that the trial court erred in determining that CHF meets the statutory element of charity to persons, which requires that an “institution must benefit a substantial and indefinite class of persons who are legitimate subjects of charity.” 10 P.S. §375(e)(1). However, courts throughout the Commonwealth “have historically upheld the grant of tax exemption to educational institutions as purely public charities whose beneficiaries were the youth of this Commonwealth.” *City of Washington v. Board of Assessment Appeals of Washington County*, 666 A.2d 352, 362 (Pa. Cmwlth. 1995). All youth seeking an education can qualify as “legitimate subjects of charity,” not just those who are financially destitute. Because CHF provides housing exclusively to students seeking an education in the Commonwealth, the trial court correctly determined that it satisfied this element of the *HUP* and statutory tests. However, the objects of the charity must receive a substantial benefit before other taxpayers will be required to subsidize the foregone taxes if an exemption is granted. An entity must meet all of the constitutional and statutory requirements in order to qualify as a purely public charity, and CHF clearly fails to meet the standard of donating a substantial portion of its services.

Accordingly, for the foregoing reasons, the order of the trial court is reversed.

DAN PELLEGRINI, Judge

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	:
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ORDER

AND NOW, this 13th day of April, 2010, the decision of the Court of Common Pleas of Berks County, dated July 27, 2009, is reversed and CHF-Kutztown LLC's request for an exemption of real estate is denied.

DAN PELLEGRINI, Judge