

PHILADELPHIA'S TEN-YEAR TAX ABATEMENT

Updated statistics on the size and distribution of abated properties in Philadelphia.

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In an effort to encourage real estate development, the City of Philadelphia offers extensive property tax abatements for almost all new construction and significant improvements to existing buildings. The City's property tax abatement program, begun in the late 1970s (3 years) and expanded in 1997 (conversions to residential only — 10 years) and again in 2000 (all new construction or substantial rehab — 10 years) has been credited with spurring considerable investment in the City's commercial and residential infrastructure, in the latter case after decades of disinvestment.

In 2009, the first abated properties that received a ten-year abatement will begin returning to the city's tax rolls. This will be happening at approximately the same time the city's property assessor, the BRT, will be implementing its move to "Actual Value" property valuation. As most homeowners in the city will see their property taxes increase as a consequence, there is a growing public concern that the abatement program exacerbates inequity in the city's distribution of the property tax burden. Although the abatement has been credited with promoting significant new construction in Philadelphia, the common perception is that this has been disproportionately confined to the higher-priced and higher-income segment of the housing market, particularly in Center City. As the abatement program comes under increasing political scrutiny, there is also the issue of how new tax revenues from properties with expired abatements may be deployed to lessen this inequity.

This paper hopes to contribute to the public debate over this issue by providing updated analysis to the original report done by Econsult Corporation for the BIA in 2006, Philadelphia Tax Abatement Analysis

Defining Abated Properties: Because Philadelphia's tax code offers a number of both exemptions and abatements for owners of real property, it is first necessary to identify which properties are specifically designated by the ten-year abatement program. Table 1 lists the six City ordinances that define the extent and eligibility of property tax abatement:

Table 1
Philadelphia Property Tax Abatement Ordinances

| Ordinance Number | BRT Exemption Code | Description |
|-------------------------|---------------------------|---|
| 961 ¹ | M | 10-year abatement for existing residential rehabilitation, capped at \$50,000 of total value. |
| | 1 | 10-year abatement for existing residential rehabilitation, uncapped. |
| 1456 | N | 10-year abatement for new residential construction, uncapped. |
| 970274 | 6 | 10-year abatement for conversion of existing buildings to commercial residential use. |
| 1130 | 8 | 10-year abatement for either improvements or new construction of commercial, industrial or other business properties. |
| 175 | 2 | 30-month abatement granted to developer of residential property until properties are sold or otherwise transferred. |

For the purposes of this analysis, only properties for which the BRT has assigned an exemption code of “M”, “1”, “N” or “8” are analyzed.

Data: The BRT’s property file contains detailed property-level information of the city’s property tax roll. The file used in this analysis is as of August 2008. All properties with the aforementioned exemption codes were extracted from the file and classified as follows:

- Exemption code “M” or “1”: Residential Improvements or Conversion
- Exemption code “N”: Residential New Construction
- Exemption code “8”: Commercial, Industrial and all other Non-Residential, both Improvements and New Construction.

¹ Note: Ordinance number 961 covers both exemption codes “M” and “1”. This is because this ordinance was more recently amended to remove the cap on the abatement.

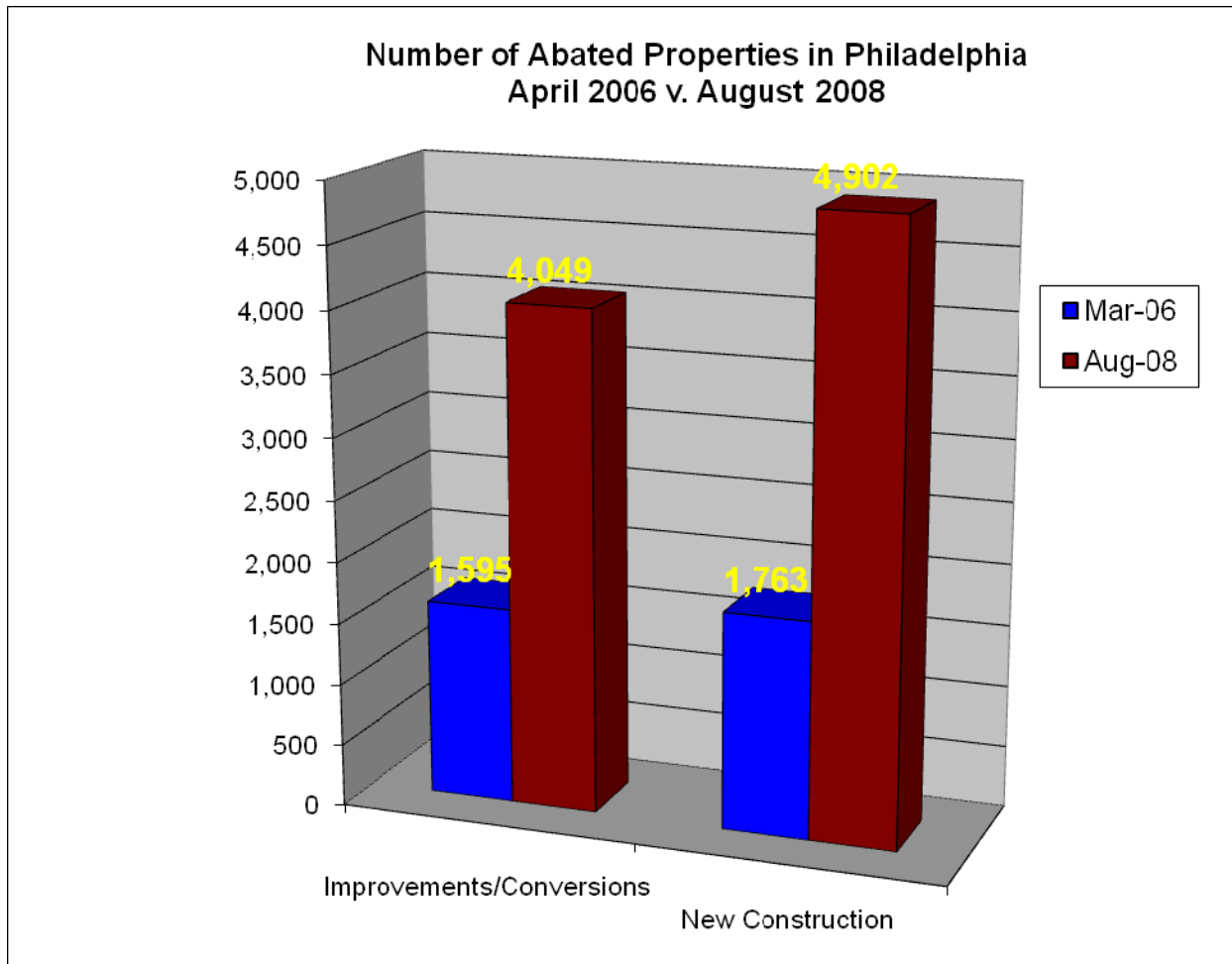
Some notes on the terminology used in this report:

- 1) "Property" is defined to be a taxable parcel of real estate in Philadelphia. If a parcel has a unique tax ID, as defined by BRT, is referred to in this analysis as a "property". Note that this can often be different than a "home" or "dwelling". For example, a 100-unit rental apartment building has one tax ID, so it is referred to as one property. If that same building is condo-ized so that each unit has a separate owner, then that structure is now referred to as 100 properties.
- 2) "Market Value" is defined as BRT's estimate of what a given property would transact for in the market; e.g. an appraised value. This is the value used to determine a property's tax bill, and hence, the dollar amount that is abated for a property with an abatement designation. Note that this is different from the recorded transaction price of a property.
- 3) "Improved/Converted" is defined as a property with an existing structure located on it that was either, upgraded, added to, converted to another use, or some combination of the aforementioned. For the purposes of the abatement program, the value of the new additions or upgrades, and/or the value created by converting the structure to another use, are not taxed.
- 4) "New Construction" is defined as a property for which the structure occupying the site is 100% new. Since this represents a 100% improvement to the site, then for the purposes of the abatement program, only the land is taxed.

From the BRT's August 2008 property file, all properties with the aforementioned exemption codes were extracted with the assistance of SAS software, and classified as either "Improved/Converted" or "New Construction", according to the aforementioned definitions. The results are as follows:

- As of August 2008, there are 8,951 such abated properties in Philadelphia.
- In the April 2006 Econsult report, there were 3,358 such abated properties in Philadelphia.
- That is an increase of 5,593 abated properties since the report was released two years ago; an expansion of 167%.

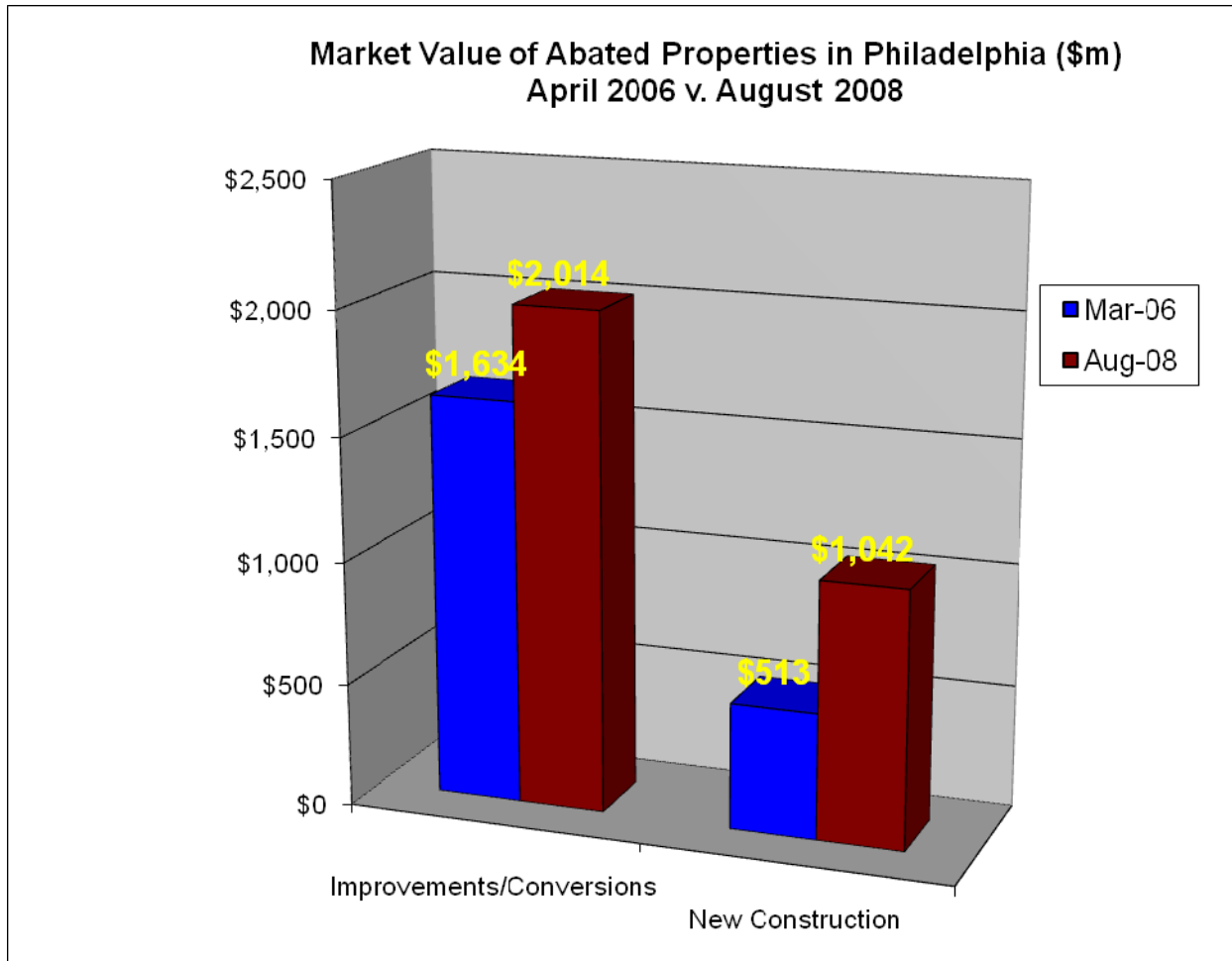
The following Figure shows how this increase in abated properties breaks down by “Improved/Converted” v. “New Construction”.



- As the chart indicates, the number of properties with “Improved/Converted” abatements grew from 1,595 in 2006 to 4,049 in 2008; a 154% increase.
- Similarly, the number of properties with “New Construction” abatements grew from 1,763 properties in 2006 to 4,902 in 2008; a 178% increase.

- Thus, the number of abated properties in Philadelphia has more than doubled since the release of the Econsult report in April 2006².

The next chart shows the change in the total market value of abated properties from 2006 to 2008, in \$m.



- The market value of “Improved/Converted” properties increased from \$1,634m to \$2,014m; a 23% increase.
- The market value of “New Construction” properties increased from \$513m to \$1,042m; a 103% increase.

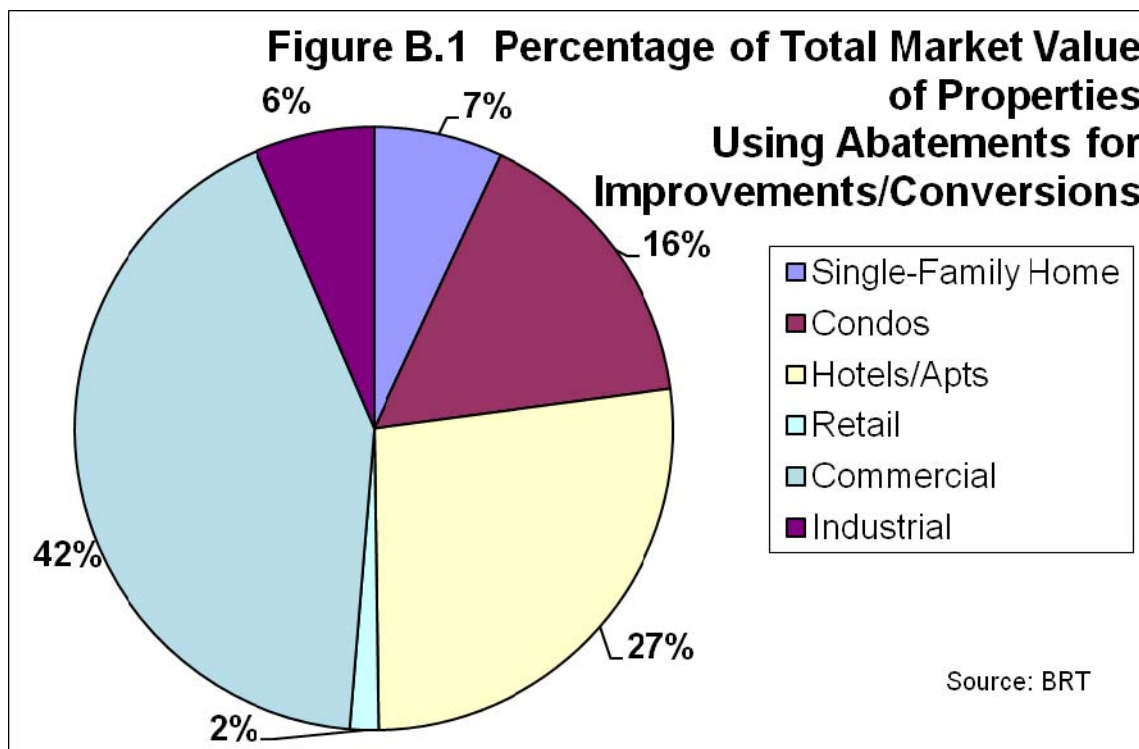
² Note: Although the chart title may refer to April 2006, the axes label indicates March 2006. This is because although the Econsult report was released in April 2006, the data used in its analysis is as of March 2006.

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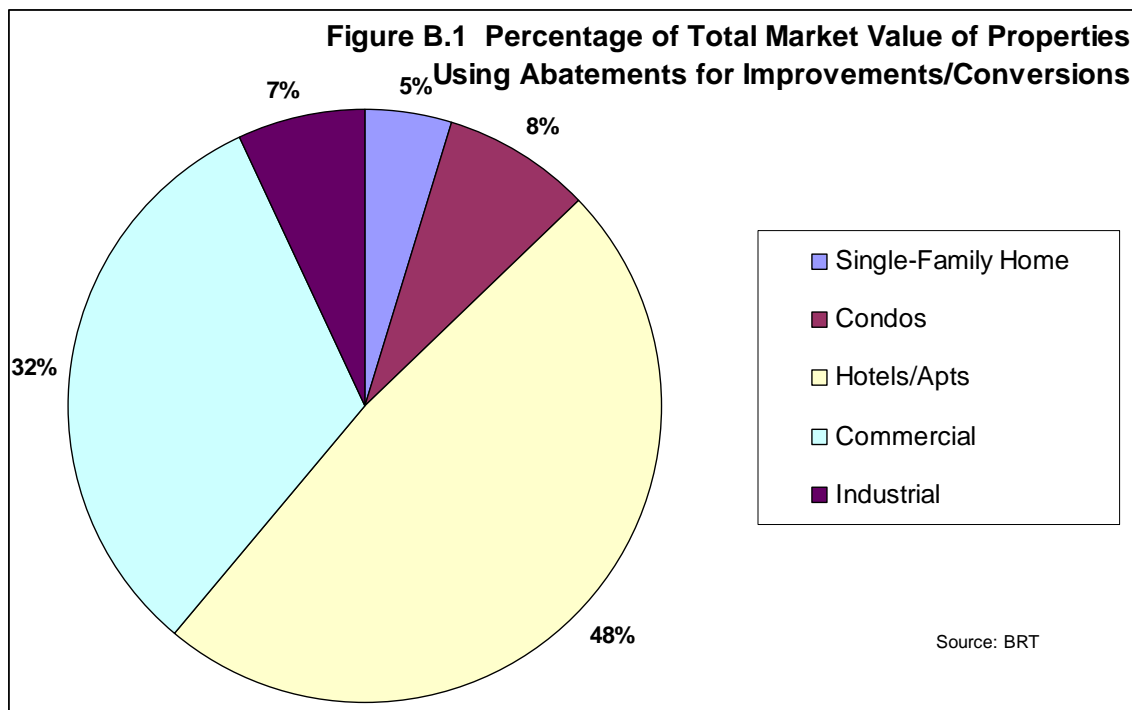
- The total market value of abated properties has grown from \$2,146m to \$3,057m; a 43% increase.

We now break down abatements by property type. The following figure shows the composition of all properties with “Improved/Converted” abatements, as of August 2006.

August 2008



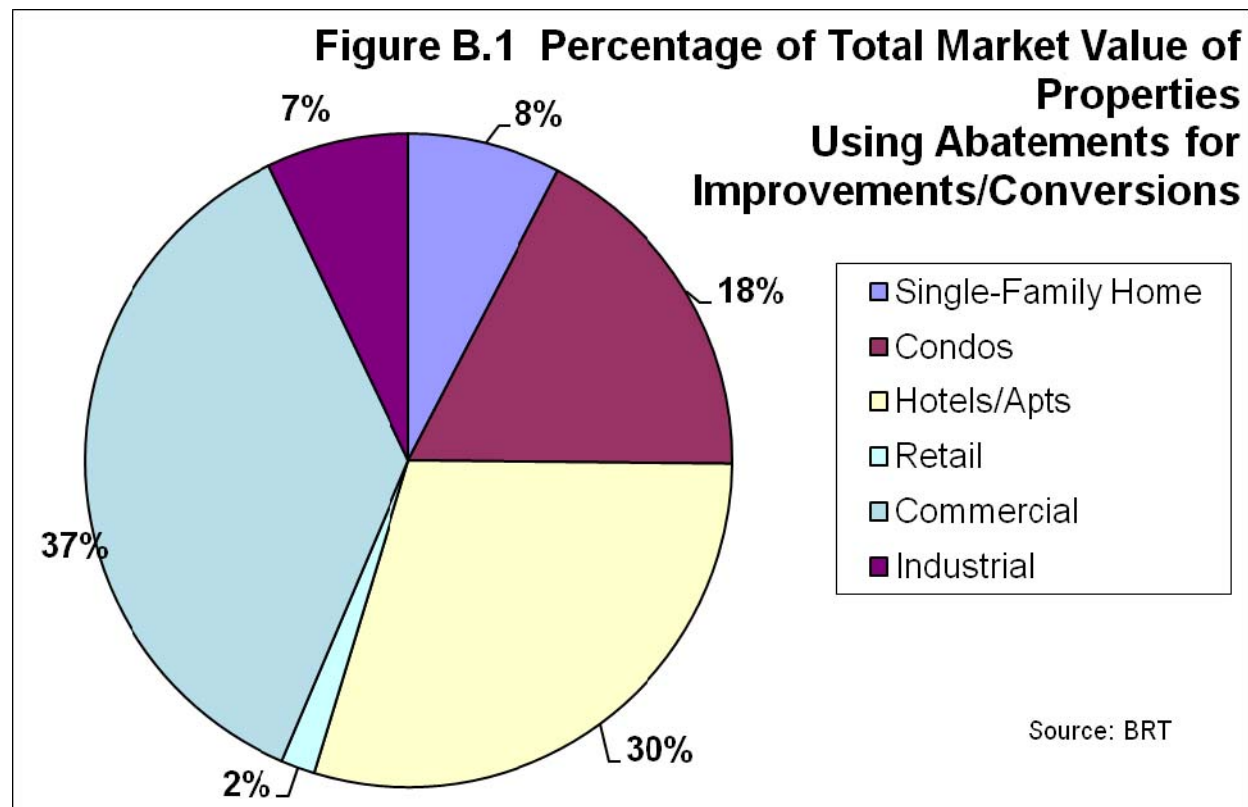
Here is the same chart, as of April 2006:



- The source of growth in the market value of abated properties with “Improved/Converted” status appears to be due to commercial properties (from 32% to 42%) and condo properties (from 18% to 16%).
- The growth in these two property types appears to have been at the expense of Hotel/Apartment properties, which fell from 48% to 27% of total market value of “Improved/Converted” properties.

However, further examination of this data revealed that one single property accounted for a significant percentage of the growth in the market value of commercial properties with abatements: Comcast’s headquarters at 17th and JFK. Completed only a few months ago, this property is listed on the city’s tax rolls as having a market value of \$181,500,000 (although, why it is listed with an “improved/converted” exemption instead of a “new construction” exemption is puzzling.) To see how the presence of such a large abated property may have skewed the results, we dropped it from the sample and re-created the previous pie chart. It is shown below:

August 2008. Minus the Comcast tower

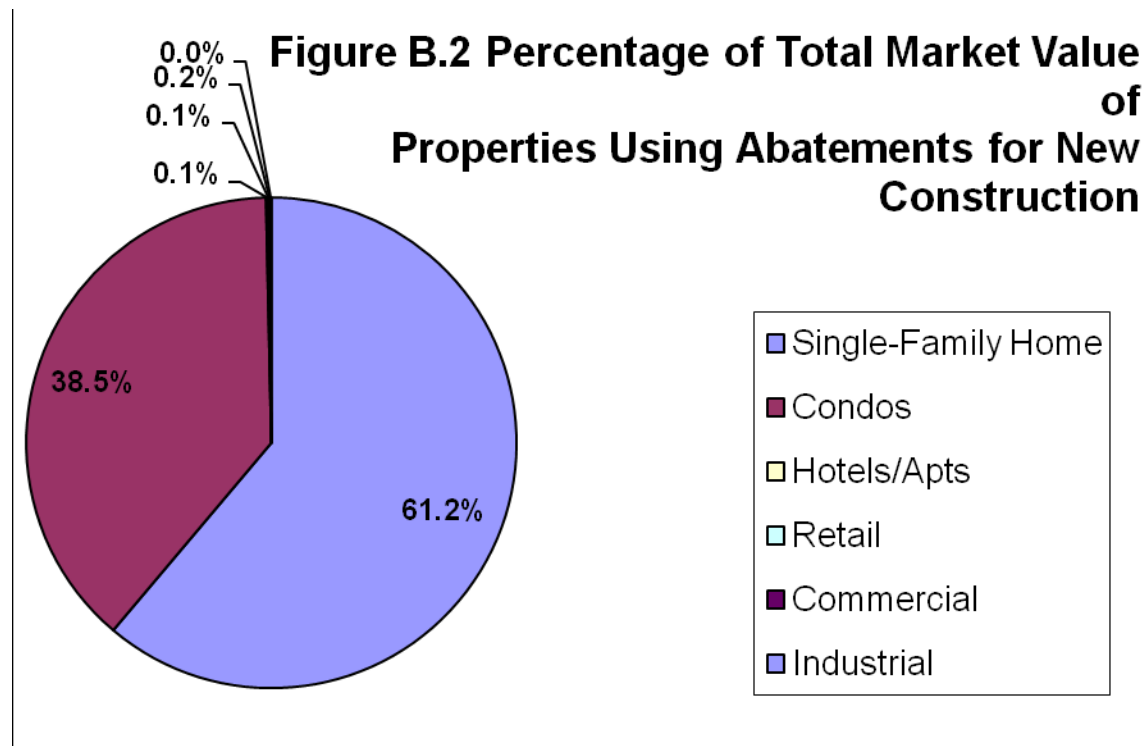


- After dropping the Comcast tower, commercial properties account for 37% of the market values of “improved/converted” abated properties.
- This is higher than the 32% reported in 2006, but less than the 42% if it is included.
- While this is a significant change, it is not enough to explain the change in the composition of the market value of abated properties from 2006 to 2008. Commercial properties with abatements have grown since then, while the percent attributable to hotels and apartments has shrunk.

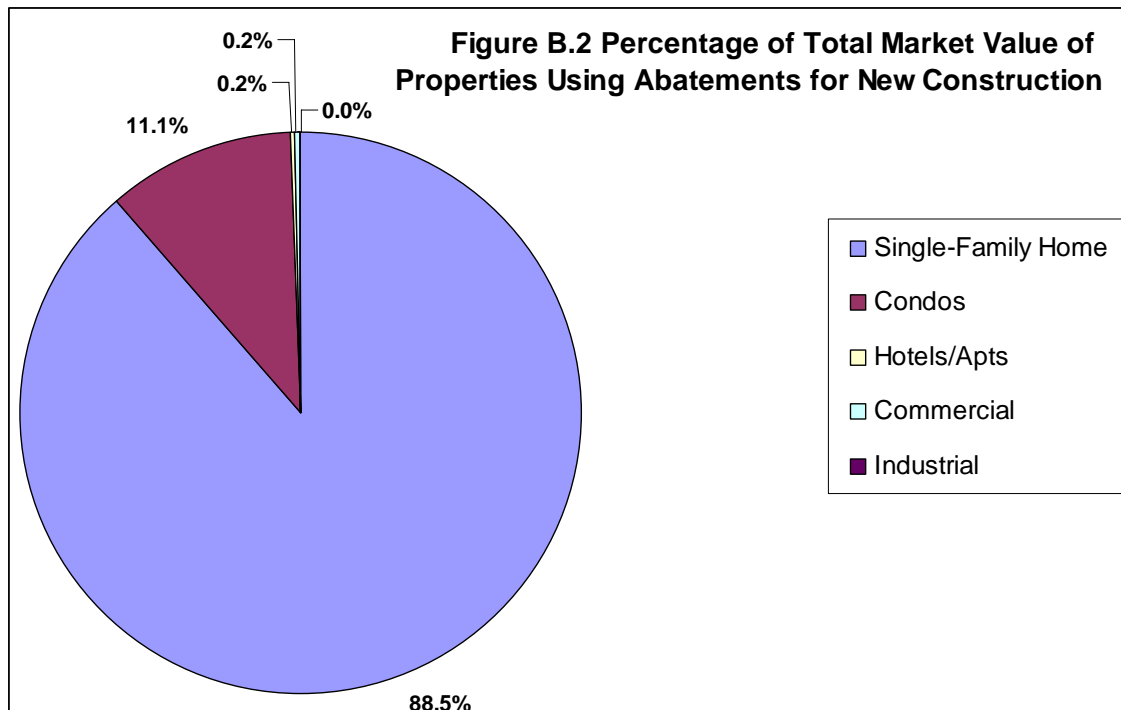
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We now repeat the same analysis for “New Construction”. The following chart shows the composition of the market value of properties with “New Construction” abatements, as of August 2008:

August 2008



Here is the same chart as of April 2006:

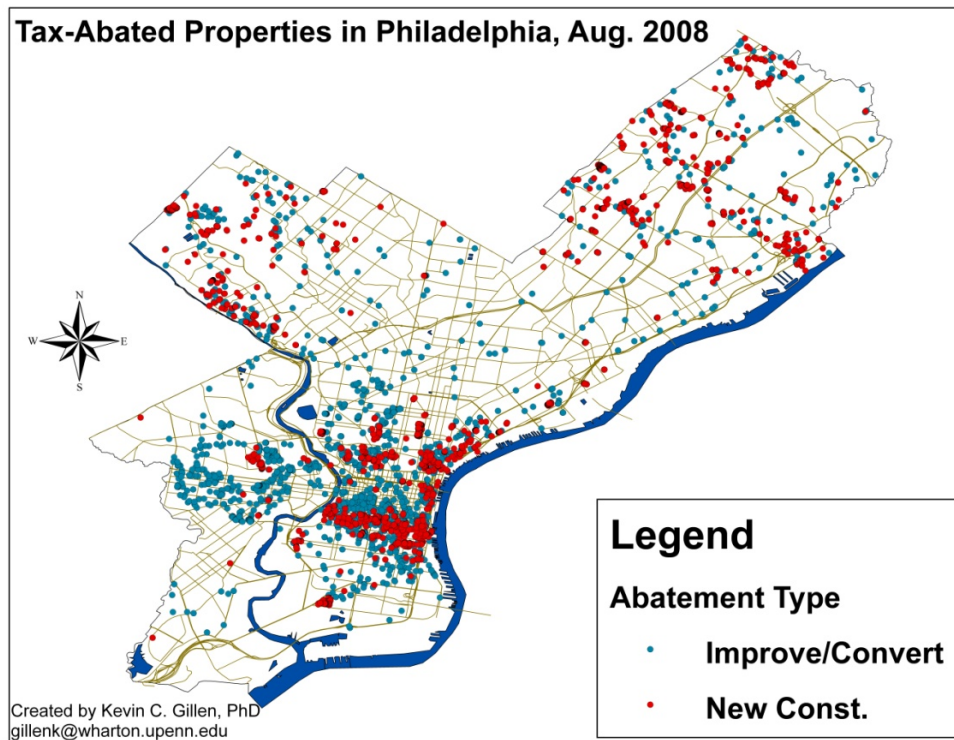


- The growth in the total market value of abated properties with “New Construction” status is overwhelmingly due to condo properties, which grew from 11.1% in 2006 to 38.5% in 2008.
- This growth appears to have been at the expense of single family homes, which fell from 88.5% of total market value to 61.2%.
- However, even with this change in composition, residential properties account for an overwhelming percentage of abated properties with “New Construction” status.

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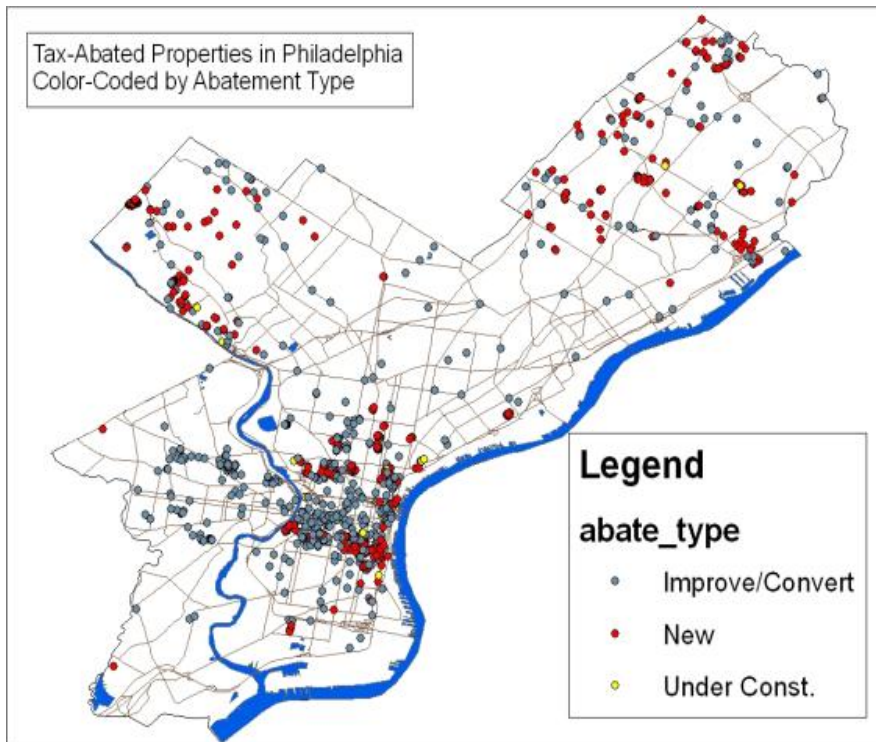
We now examine the spatial distribution of abated properties in Philadelphia. The following map shows the location of abated properties in Philadelphia in August 2008, with each dot representing a property³. Blue dots represent “Improved/Converted” properties, while red dots represent “New Construction.”

August 2008



³ Note: for condo properties, one dot may represent multiple units since condo units in the same building share the same geographic location.

Here is the same map as of April 2006:

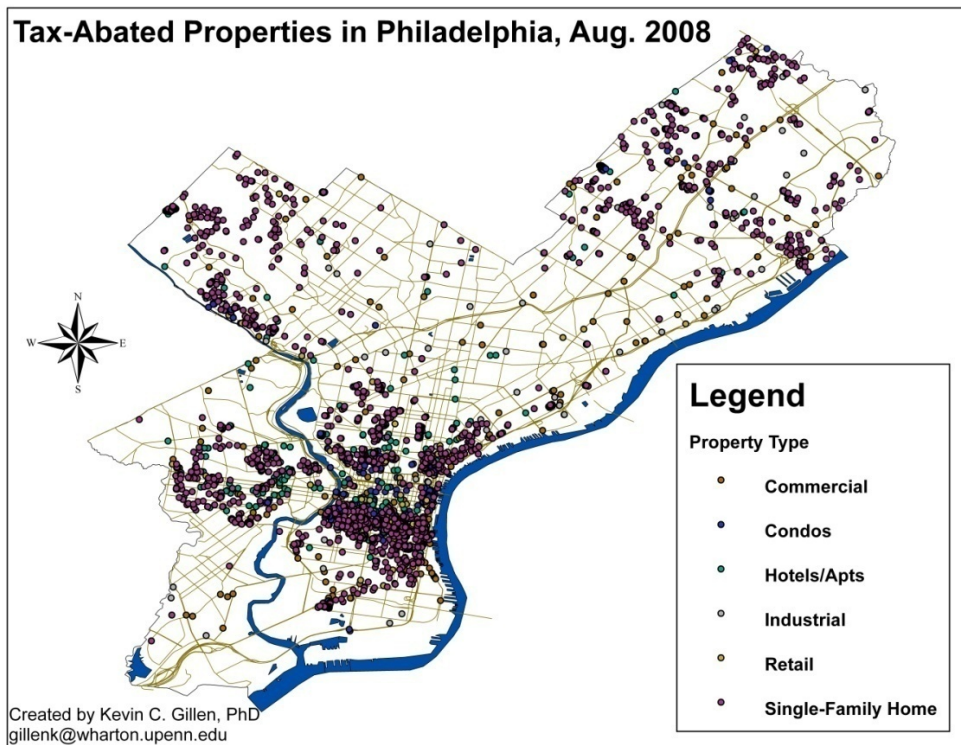


- The growth in the number of abated properties is visually evident. Perhaps surprisingly, the growth may exhibit more spatial variation across the city than might be expected, considering the abatement's perception as being disproportionately confined to Center City condos.
- Although Center City does appear to have the greatest concentration of abatements, it should be remembered that it also has the greatest concentration of housing units (i.e. housing density) than any other neighborhood in the city. Hence, it is not necessarily apparent that the growth in abated properties Center City is disproportionately accounted for by condo construction in Center City. The percent growth in abated properties since 2006 appears more geographically balanced than what popular perception may otherwise be.

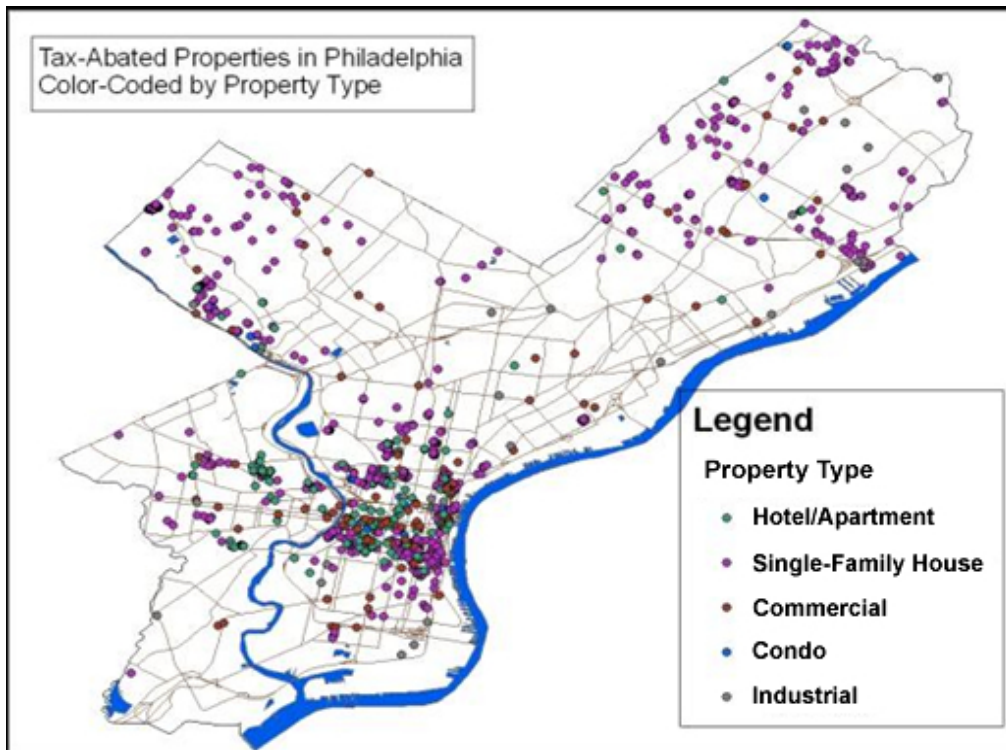
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We now examine the composition of abatements by type of property. The following map color-codes all abated properties in 2008 by their property type:

August 2008



Here is the same map as of April 2006:



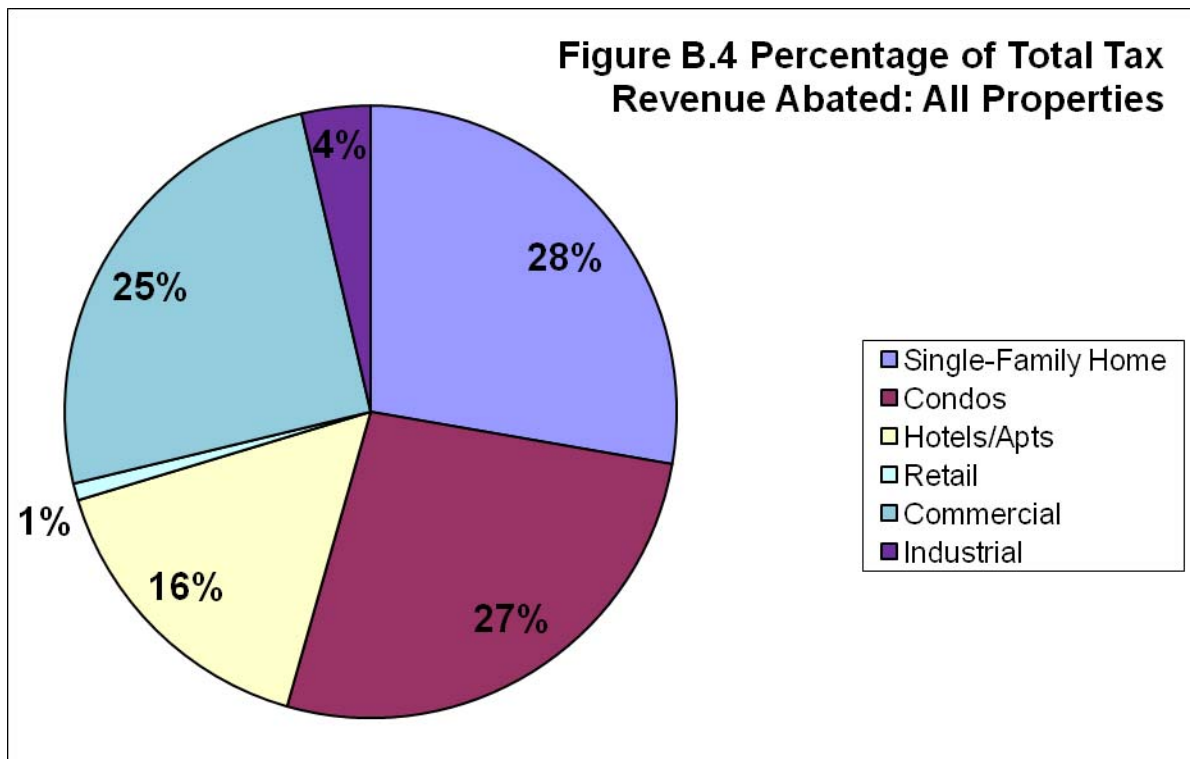
- As indicated by the map, the growth in the number (as opposed to total market value) of abated properties appears to be due to growth in the number of single-family homes. However, this may be a bit misleading for the reasons previously mentioned. 100 individual houses are typically represented by 100 dots. However, 100 units in one condo tower are represented by just one dot.
- With this caveat aside, however, the map would certainly seem to dispel the notion that it is only condo owners in Center City that account for the growth in abated properties. Not only has there also been growth in the number of single-family homeowners receiving abatements, but also growth in these homeowners throughout the city.

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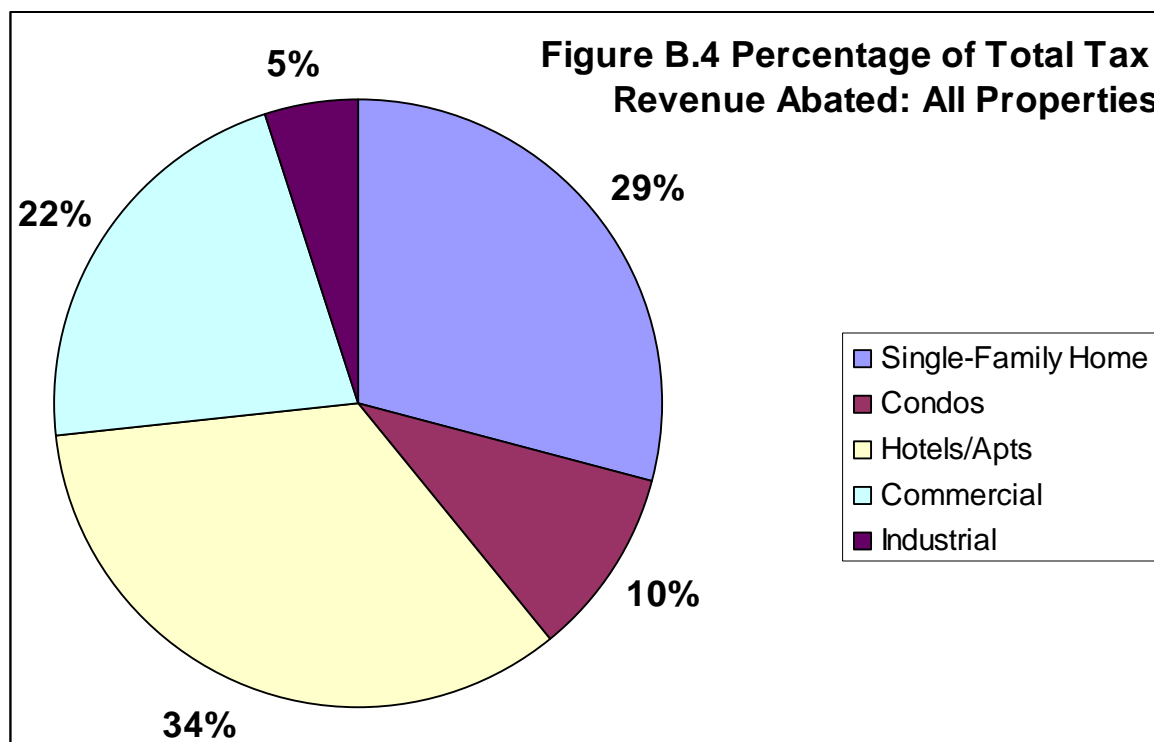
Next, we examine how the total amount of property tax revenues that are abated breaks down by property type. As abatements begin to expire after their ten years, this indicates where these new property tax revenues will be coming from.

The following chart breaks out the total amount of abated tax revenue by property type, as of August 2008:

August 2008



Here is the same chart as of April 2006:



- The growth in abated tax revenue since 2006 is due to growth in the number of abated condo properties in Philadelphia. These properties accounted for only 10% of abated property tax revenue in 2006, but currently account for 27%.
- The growth in abated condos appears to have come at the expense of abated hotels/apartments, which shrunk from 34% of all abated revenues in 2006 to 16% in 2008.
- Other property categories have held relatively constant since then.

We now examine the fiscal implications of the abatement program to the City of Philadelphia. Based on our estimate of the incremental impact on housing production during the tax abatement period, we can use standard input-output models to estimate the economic impacts – spending, earnings and employment – attributable to the abatement policy. These impacts are the result of the construction spending that would not have otherwise occurred in the City. This additional economic activity has generated incremental tax revenues to the City (and to the state) that also would not have been generated in the absence of the abatement program.

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This is done by computing the total direct and indirect expenditures made by the owners and developers of abated properties, and then inputting these numbers into the federal government's RIMS multiplier model to impute the tertiary effects of this spending, and then applying the appropriate city and state tax rates to measure how much tax revenue has been generated by abatement-related investment in real estate. To be consistent with our 2006 analysis, we assume that the percent of investment that is abatement-related is still 66%; i.e. one-third of the real estate investment in Philadelphia during the past ten years would still have occurred if the abatement program did not exist. The results are given in the following table:

Table I.3 Fiscal Impact of New Construction Spending Attributable to Abatement

| Local Taxes (Philadelphia County) | |
|--|---------------|
| Wage and Earnings | \$42.3 |
| Sales | \$4.6 |
| Business Privilege | \$21.3 |
| Total Local Taxes | \$68.2 |

| State of Pennsylvania | |
|------------------------------|---------------|
| Personal Income | \$40.4 |
| Sales and Use | \$32.2 |
| Corporate Net Income | \$7.9 |
| Capital Stock and Franchise | \$5.2 |
| Total State Taxes | \$85.7 |

The results indicate that construction spending that would not have otherwise occurred without the abatement program has generated a total of \$68.2m to the city of Philadelphia and \$85.7m to the Commonwealth of Pennsylvania.

Here is the same table from our 2006 report:

Table I.3 Fiscal Impact of New Construction Spending Attributable to Abatement

| Local Taxes (Philadelphia County) | |
|-----------------------------------|-----------------|
| Wage and Earnings | \$ 74.4 |
| Sales | \$ 7.8 |
| Business Privilege | \$ 36.4 |
| Total Local Taxes | \$ 118.6 |

| State of Pennsylvania | |
|-----------------------------|-----------------|
| Personal Income | \$ 67.8 |
| Sales and Use | \$ 54.3 |
| Corporate Net Income | \$ 13.3 |
| Capital Stock and Franchise | \$ 8.8 |
| Total State Taxes | \$ 144.2 |

As can be seen, the more recent numbers are significantly less than the previous numbers:

- Projected city tax revenues due to the abatement were \$118.6m in 2006, whereas the city has only received \$68.2m to date.
- For the Commonwealth, projected tax revenues due to the abatement were \$144.2m in 2006, whereas the Commonwealth has received only \$85.7m to date.

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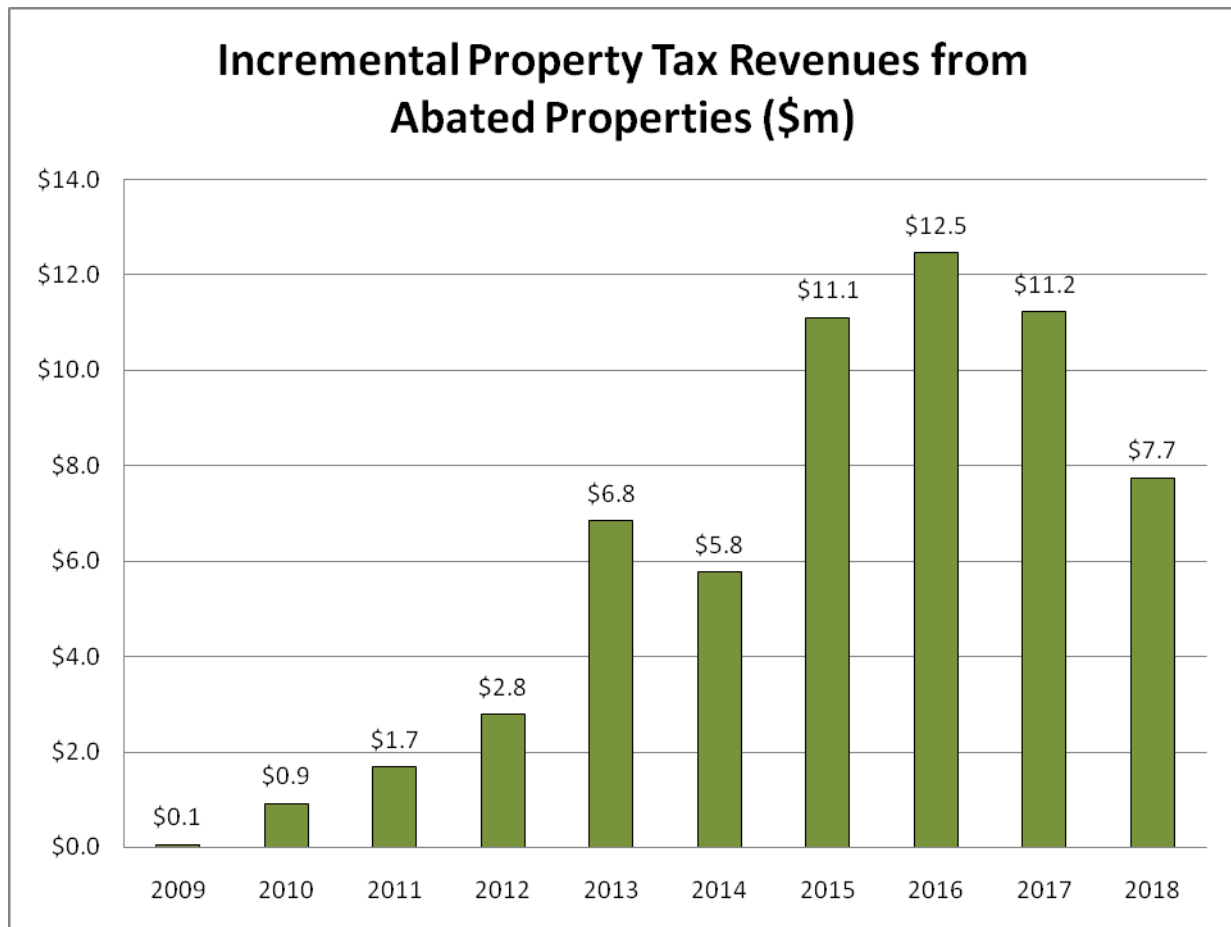
The reason for this discrepancy is because the 2006 forecast included all existing abated properties plus all proposed projects, whereas the 2008 numbers only counts finished projects that are now on the City's tax roll.

- Some of these projects are still under construction, and hence not on the city's tax roll; e.g. Waterfront Square Phase II, 10 Rittenhouse, The residences at the Ritz-Carlton.
- Since the report's publication, the real estate market has since cooled, resulting in a number of projects being scaled back (e.g. Waterfront Square), delayed (e.g. Western Union) or indefinitely deferred or cancelled (e.g. Mandeville Place, Marina View).

However, the results do confirm that the existence of the abatement program has still generated an additional \$154m in tax revenues that would not have been generated otherwise.

(Patrick: be aware that this additional revenue is solely from the improvements to and construction of abated properties. It does not include any additional revenue from attracting new residents to the city to occupy these properties. They generate additional revenue by working in Philadelphia and paying the wage tax, and by spending money in Philadelphia and paying the sales tax, etc. In addition, they also generate additional economic activity, and hence even more tax revenues, via a multiplier effect. --Kevin)

Lastly, we examine what the city and taxpayers of Philadelphia can expect as abatements expire and these properties return to the tax rolls. This is computed by adding ten years to the year that each property was abated in order to identify the year it will return to the tax roll, and then summing the total amount of tax dollars that were abated across all properties in the same year. The incremental tax revenue that the city can expect as abatements expire is shown in the following chart:

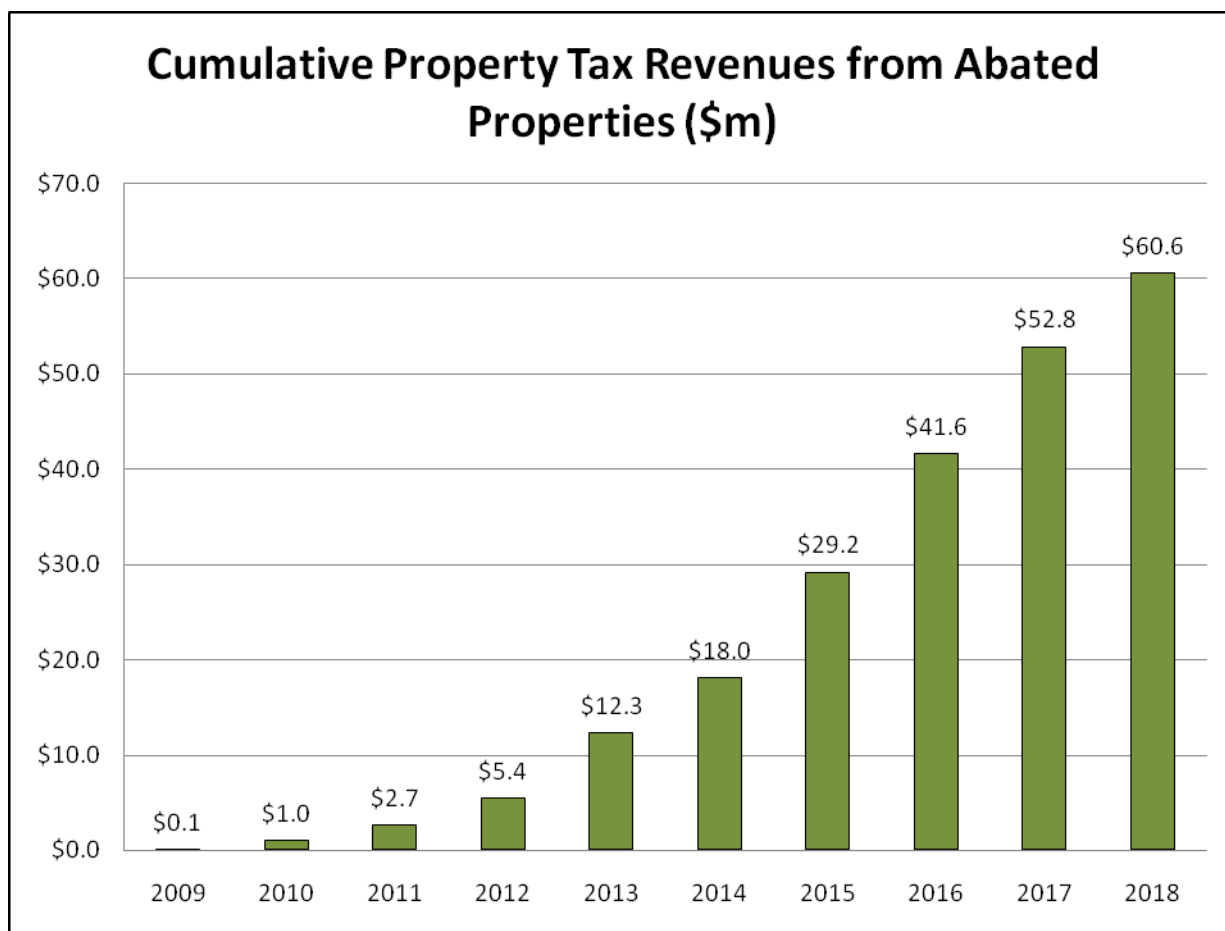


- As the chart indicates, the very first abated properties from 1999 have their abatements expire in 2009, and (at current assessments) this will add \$0.1m in property tax revenues to the city's coffers.
- As properties which were abated in 2000 see their abatements expire, this will add another \$0.9m in property tax revenues to the city's coffers.
- As the chart indicates, the biggest bulge in additional tax revenues will occur in the 2015-2017 period, because the peak of the recent house price and construction boom was ten years earlier, in 2005-2007. Additional revenues will peak in 2016, and then begin declining thereafter.

Unlike additional revenues from construction, which are a one-time event, the increases in property tax revenues are in perpetuity for the life of the property. Once an abatement expires, that property will pay its full property taxes every year thereafter. Hence, the actual

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additional revenue that the city will receive as abatements expire is better characterized by measuring cumulative rather than incremental property tax revenues. This is done by adding the incremental tax revenue in any given year to the sum of incremental property tax revenues from previous years. The results are shown in the following chart:



- As the chart indicates, the additional property tax revenues from the first abatements will still be \$0.1m in 2009. But, by 2010, it will be \$1m in additional revenues: \$0.1 from 2009 plus another \$0.9m in 2010.
- Revenues will continue to rise until hitting a peak of \$60.6m in 2018.
- There will likely be some additional further increases from properties that are currently under construction as of the time of writing this report (e.g. Residences at Ritz-Carlton, 10 Rittenhouse, etc.). However, these further increases will likely be fairly modest compared to previous increases.

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- Hence, once all current abatements expire, the abatement program will generate an additional \$60.6m+ in property tax revenues in perpetuity.

Summary:

- Both the number of and value of properties in Philadelphia with ten-year tax abatements has grown significantly since Econsult's 2006 report.
- For "Improvements/Conversions", the growth in the number of abated properties is accounted for by the growth in residential properties, while the growth in the value of abated properties is accounted for by growth in commercial properties. This is likely due to fact that abated commercial properties have a much higher value than residential properties.
 - The completion of the Comcast tower accounts for a significant percentage of this change.
- For "New Construction", growth in both the number of and value of abated properties is overwhelmingly accounted for by growth in residential properties.
- This growth in abated properties appears to have come disproportionately at the expense of Hotels and Apartments, whose relative share of abated properties has shrunk since 2006.
- Although growth in the value of abated residential properties is disproportionately accounted for by Center City condos, growth in abated single-family homes both in and outside of Center City has also been significant. This result is likely due to the fact that the typical value of a Center City condo significantly exceeds the typical value of a single-family home outside of Center City.
- The spatial distribution of abatements across city neighborhoods appears to be more uniform than what public perception suggests. And the growth in the number—if not necessarily the value—of abated properties across Philadelphia's neighborhoods since 2006 especially appears to be more equitable than what public perception suggests.
- The abatement program has generated an additional \$154m in tax revenues to the City and Commonwealth from conversions, improvements and new construction of real estate. This is a one-time revenue payment (although it occurred over several years).
- As abatements expire, this will eventually generate an additional \$60.6m+ in property tax revenue to the city. This payment will continue in perpetuity.