

The High Cost of Affordable Housing

How do you spur low-income housing when developers can't break even?

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SINCE ITS INCEPTION IN 1997, THE CITY'S TAX-ABATEMENT PROGRAM — WHICH ALLOWS NEW OR renovated properties to be taxed at pre-improvement values for 10 years — has spurred a glut of new construction in Center City and spawned \$4 billion in economic activity throughout Philadelphia, making it more than worth the \$27 million the program cost the city in lost property taxes between 1997 and 2006, according to reports by Econsult Corp.

From the outset, Frank DiCicco has been among the program's most ardent proponents on City Council, and in February, he introduced a bill to extend the abatement period to 15 years in low-income neighborhoods. His bill aims to assuage critics who have long complained that the abatement program benefited high-end developers, investors and buyers far more than low-income folks.

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"I think [the bill] sends a clear message that we're not ignoring low-income neighborhoods," says DiCicco. "If we were able to get developers in those fringe neighborhoods ... we'd hopefully meet the increased demand for rental units."

It's an important goal in a city where almost 130,000 households earn less than \$20,000 a year and pay more than they can afford on housing. The Office of Housing and Community Development states that "demand for affordable housing exceeds the supply by at least 60,000 homes." But given the depressed housing market, will the lengthier tax abatement get developers to bite?

"Construction costs in Philadelphia, all in, start at about \$180 or \$200 a [square] foot," says Philadelphia economist Kevin Gillen, vice president of Econsult. "The median house price in Philadelphia is about \$110 a foot. So you lose 60 to 80 bucks a foot on the average Philadelphia home."

Indeed, Philadelphia has the fourth-highest construction costs of any major city in the nation — largely driven by the high cost of union labor. According to a joint report by FixItPhilly and the Building Industry Association of Philadelphia, labor makes up 45 percent to 60 percent of a project's cost — 39 percent more than the national average. Combined with the city's low home prices — \$142,000 for a new home versus the national average of \$179,600 — it is next to impossible to make a profit in many of the city's neighborhoods.

This is why, according to Gillen, that while the 10-year tax abatement helped bring about "the biggest home-building boom in Philadelphia since the immediate postwar years after World War II," only a little more than 11,000 new units were added to a housing stock of about 560,000 units. "Specifically, the people who it hurts are actually lower-income and working-class households," says Gillen. "Because construction costs are so high, when development does happen, it's overwhelmingly at the other end of the market."

And herein lies the rub: How do you stimulate development of low and moderately priced housing when it so hard for developers to break even, let alone make a profit?

"I think that the 15-year tax abatement could revolutionize the housing market in some neighborhoods by making the numbers work for the very first time," says Karen Black, a policy analyst for May 8 Consulting, who teaches urban studies at the University of Pennsylvania. "Consumers overvalue the benefit of not having to pay taxes for 15 years and are willing to pay even more for their new homes than the tax abatement is truly worth."

Others aren't so sure. "Whether [the abatement is] enough to encourage development in a low-income neighborhood, I don't know," says Rick Sauer, head of the Philadelphia Association of Community Development Corporations.

There are political problems, too: City Council recently passed a two-year, 9.99 percent property tax increase. If long-term residents were already upset about new homeowners getting a break, how would they feel about an even longer abatement?

DiCicco's bill has a long way to go before becoming reality. It has stalled in Council.

"Coming up [to] an election year, where there are so many Philadelphians who don't understand the full benefit of the 10-year tax abatement, my colleagues might be concerned about talking about a 15-year abatement," DiCicco says. "It's probably not the best time politically, although I think it's the right thing to do."

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