

Policy Analysis: 10-Year Tax Abatement

OFFICE OF THE CITY CONTROLLER

Philadelphia's Ten-Year Tax Abatement is one of the most all-encompassing property tax incentives in the nation, providing a 100% tax benefit for new construction and the value of improvements or conversions to existing properties. The abatement was created to spur development city-wide after decades of disinvestment, population loss and stagnant home-ownership rates - and it's been successful, credited with incentivizing much of Philadelphia's development over the last two decades. However, the Office of the City Controller believes that tax stimulus programs should be re-evaluated regularly to determine if the benefits of the incentive outweigh the opportunity cost represented in its associated tax revenue. Our analysis looks at the abatement by geographical concentration, the distribution of benefit and developer profitability.

ABATEMENT QUICK FACTS

Currently abated properties as of 2017: **14,345**

Abated assessed value: **\$6.67 billion**

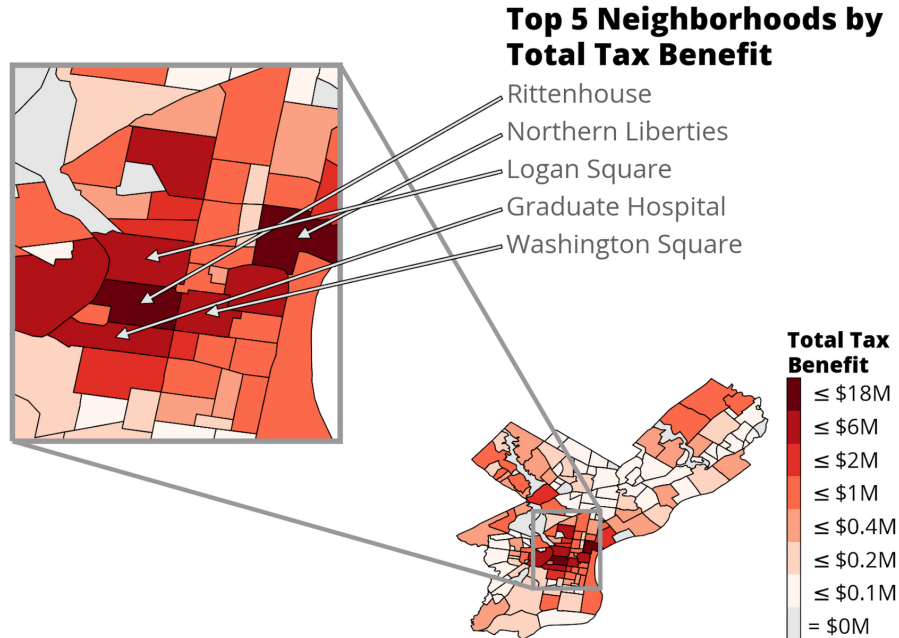
Tax contribution from previously abated properties in 2017: **\$83 million**

Over the life of the policy, the number of abated properties has risen to more than 14,000 and remained there since 2012. Annually, around 1,400 abatements are added each year.

Of the new abated properties, approximately 60% are new construction and 40% are converted or improved properties.

Abatement by Value and Neighborhood

Abatements, and the associated tax benefit with them, are concentrated in the greater Center City area, as shown right. Just 6% of neighborhoods, or about 10 neighborhoods, receive 59% of the tax benefit. Rittenhouse alone accounts for 9% of the total properties but benefits from 19% of total tax benefits. Abated value is concentrated in high-value properties and those properties receive the majority share of tax benefits.



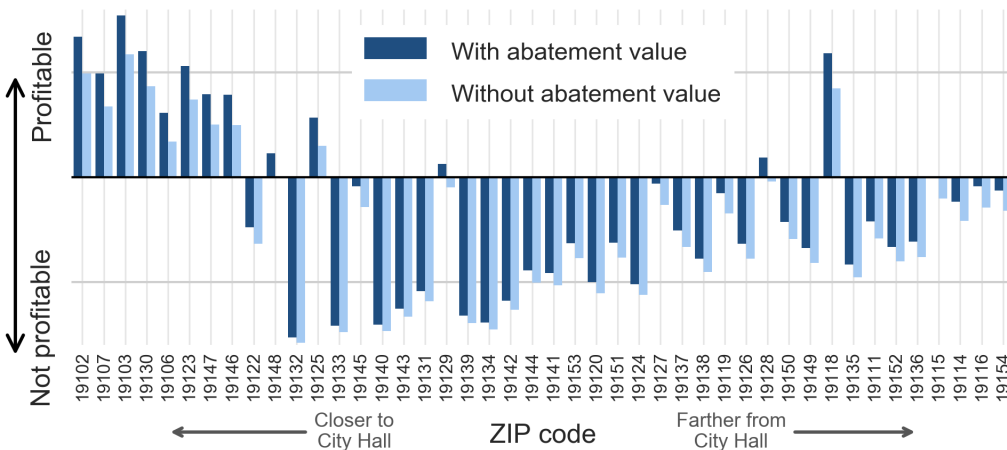
At the owner level for abated properties, properties with abated values greater than \$700K make up 7% of all abated properties, but receive 51% of the tax benefit.



The Office of the City Controller used data from the City's Office of Property Assessment, Zillow and cost figures for residential and commercial properties generated by RSMeans to identify abated properties, to understand development profitability and to run scenarios for possible changes to the abatement policy.

Development Profitability

Development profitability is an important component of the abatement - it is one of the reasons why the abatement was enacted in the first place. Development profitability is based on three prongs: cost of construction, market value and market rent.



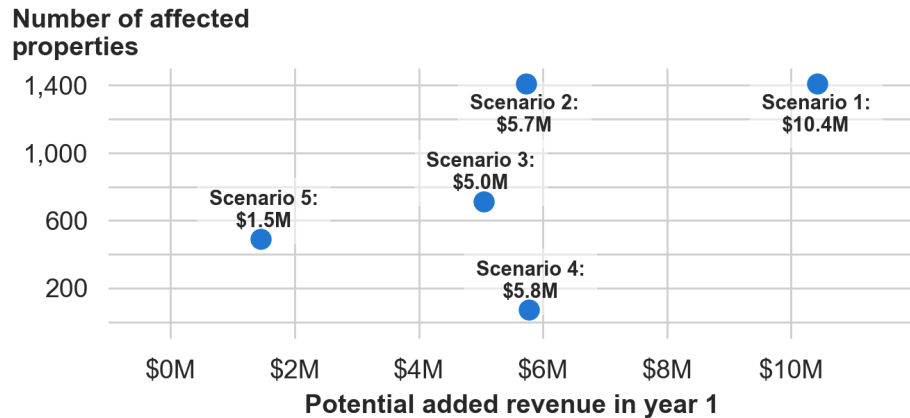
Source: home values from Zillow Home Value Index; construction costs from RSMMeans; land acquisition costs from OPA data

Our analysis shows that the vast majority of Philadelphia is not profitable for development with or without the abatement. Our high labor costs, coupled with lower market values and lower rents, contribute to the unprofitability. As the chart to the left shows, only about 10 ZIP codes have positive development economics with or without the abatement.

Changes to the Abatement Policy: Scenarios Considered

In the years since its inception, the abatement has become a contentious issue. Many Philadelphians feel the abatement is an unfair tax boon for developers, investors and the wealthy while they have continued to pay higher and higher taxes. Still, the abatement has accomplished its original intent - spurring development in the city, development that may not have happened without it. Its added real estate tax revenue, along with jobs and other tax revenue, may not have been generated without the abatement. However, that development hasn't been uniform throughout the city - many neighborhoods haven't benefited from the abatement. It is clear that a change is needed, but what change is best? Our office evaluated six potential policy changes to the abatement, shown below.

- Scenario 1: Rescind the Abatement
- Scenario 2: Rescind the School District Portion
- Scenario 3: Remove the Abatement in the Eight Most Profitable ZIP Codes
- Scenario 4: Cap Abated Value in Excess of \$700,000
- Scenario 5: Cap Abated Value at \$150 Per Square Foot
- Scenario 6: Amortize the Abatement (not shown)



When considering how to change the abatement, potential revenue gained must be weighed against the possible negative impact on development, given that so much of the city has negative development economics. Any change should be made cautiously - eliminating the abatement completely could depress development, thereby lowering city revenues, whereas capping the abatement would generate revenue and address the fairness issue. Ultimately, the decision to end, continue or alter the tax abatement lies with City Council and the Mayor. But one thing is clear, any change to the abatement must consider the negative impact that might happen to development overall as a result. Growth and development should continue to be incentivized, but in a fair and inclusive way.

