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The Politics of Housing and Urban Development Group
School of Arts and Sciences
Urban Studies Department
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High and Low

Realigning Housing Incentives to Promote Equitable Development

Managing Editors

Gabriella Alexis Nelson
ganelson@upenn.edu

Joanna Maria Joye
jojoye@upenn.edu

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Managing Editors

Gabriella Nelson and Joanna Joye | PennDesign | City and Regional Planning

Contributors

Zidu Cao and Anbei Zhao
PennDesign | Urban Spatial Analytics

Alexis W. Lee and Steve Zheng
Wharton Undergraduate Program

Sonya M. Lopez
Social Policy and Practice

Jesse Earl Luke and Kevin Todd
Fels Institute of Government

Ellisyn C. Lupo
Urban Studies

Narrative and Commentary by John Kromer

Memorandum

"Impact of Real Estate Tax Abatement on Home Purchase"

by James E. Hartling

Contents

Introduction

This report describes some of the most significant costs and benefits associated with two categories of Philadelphia housing programs: the ten-year tax abatement, which provides an incentive for housing development and improvement; and low-cost housing interventions that prevent homelessness and enable owner-occupants to remain in healthy and safe homes.[1]

Part One is a summary and analysis of data obtained from the City of Philadelphia's Office of Property Assessment (OPA), documenting the use of the tax abatement from tax years 2007 through 2018.

Part Two is a description of affordable housing needs in Philadelphia's current real estate market.

Part Three is a summary of affordable housing interventions and an explanation of how the infusion of additional funding resources, at a relatively low cost per unit of assistance, could substantially improve housing conditions for many Philadelphians.

Part Four is an explanation of possible opportunities to support continued wealth-building in Philadelphia's housing markets while simultaneously generating new resources for affordable housing development and preservation.

Part Five is a commentary on the extent to which the competitive disadvantages that Philadelphia was experiencing in the mid-1990s, when dialogue about the introduction of the ten-year tax abatement began in earnest, have or have not been overcome two decades later.

A memorandum by James E. Hartling of Urban Partners on the impact of the tax abatement on home purchases at three price levels is provided in the Appendix.

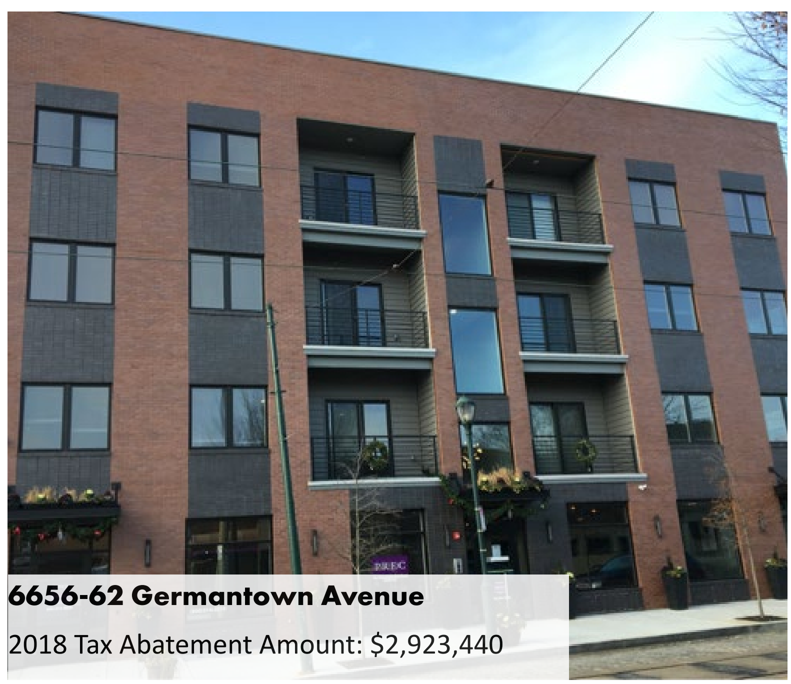
The purpose of this project is to provide a foundation for new policy initiatives that will stimulate additional investment and development in Philadelphia's downtown and neighborhoods while stabilizing and expanding the city's affordable housing base.

Philadelphia is unlike the overheated housing markets of the East and West coasts, where the prospects for improving housing affordability are rapidly shrinking. Despite being the nation's poorest big city, Philadelphia is unlike many disinvested postindustrial cities across America, in which downtown and neighborhood real estate markets are too weak to attract a game-changing level of private investment. Can we take advantage of Philadelphia's special characteristics to achieve the best of both worlds: continued growth in real estate market value accompanied by the preservation of existing affordable housing and the development of new housing affordable to citizens with incomes at or below the citywide median?

1 The use of the ten-year tax abatements to support non-residential development is not addressed in this report.

640 North Broad Street

2016 Tax Abatement Amount: $45,921,935 (final abatement year)



6656-62 Germantown Avenue

2018 Tax Abatement Amount: $2,923,440

1 The Ten-Year Tax Abatement From 2007 to 2018

Initially launched in 1997 as an incentive to promote the conversion of older Center City office and industrial buildings to residential use, the ten-year tax abatement was expanded citywide in 2000, to include new construction as well as housing rehabilitation and improvement projects. The abatements provide a ten-year, 100 percent exemption from real estate taxes on the increased market value associated with the completed development. During the abatement term, property taxes are imposed only on the pre-existing condition of the real estate—on the value of the unimproved building or vacant lot that existed prior to development.

The ten-year tax abatement is a highly efficient way of delivering housing assistance. The tax abatement takes effect only upon the City's issuance of a certificate of occupancy following completion of development activity and does not require any significant degree of additional administrative oversight or regulation.

The availability of the tax abatement is unlimited. The underlying authorization for the abatement is an agreement on the part of the City and School District of Philadelphia to forgo tax revenue associated with real estate development ventures for a decade following completion. There is no restriction on the amount of tax revenue to be foregone or on the location of development ventures eligible for the tax abatement.

The tax abatement has been highly effective as a vehicle for wealth-building, for the attraction of capital to a city challenged by past disinvestment, and for the creation and restoration of valued assets. The term "wealth-building" should be considered in a broad sense. The greatest *individual* beneficiaries of the tax abatement are wealthy homeowners and investors that can afford to buy or develop expensive residential properties in Philadelphia's most attractive downtown and neighborhood real estate markets. However, the *development projects* that have received the most benefit from the tax abatement are projects with abatement amounts of less than $500,000, and projects of this kind can be found in every area of the city.

Information included in this section of the report was extracted from a data file obtained from the City of Philadelphia Office of Property Assessment in September 2017. The file contains information about tax abatements associated with the development or upgrading of residential properties over twelve tax years, from 2007 to 2018, with a total of 151,972 address-specific records.[2] The data file includes information for each year in which an abatement was made available, meaning that an individual record appears for each year in which a particular property received a tax abatement. For example, for a property which began the ten-year abatement term in 2016, three individual records would appear, for tax years 2016, 2017, and 2018.

1414 South Penn Square, Unit 22B

2018 Tax Abatement Amount: $1,030,032

2 The analysis of this file was limited to addresses with Exemption Codes 1, 8, and N, the codes for the abatements that are currently in effect. In addition, the analysis is limited to properties in Category Codes 1 and 2, the designations for "Residential" and "Hotels and Apartments," respectively (the addresses of hotels were deleted from the file).

In light of the above any presentation of aggregated data covering multiple years, such as that in the two tables that follow, is imprecise. For example, **Figure 1** includes some properties that began the ten-year abatement period in 2007 and are therefore counted ten times--once for every year between 2007 and 2016. At the same time, the table also includes other properties that began the ten-year abatement period in 2017 and are therefore counted only twice—once for 2017 and once for 2018.

With this caveat in mind**, Figure 1** provides an indication of how development activity grew substantially in the aftermath of the Great Recession, with the number of projects receiving abatements in 2011 roughly tripling the 2007 total, with abatement totals rising steeply over the twelve-year period.

Projects in ten zip codes received $26.6 billion in tax abatements between 2007 and 2018. This amount represents nearly 80 percent of the total tax abatements in effect citywide during this twelve-year period.

Most abatements in effect as of the date of this report (i.e., in tax year 2018) were associated with projects involving development costs of less than $500,000. Many of these projects are located in Greater Center City and in areas undergoing gentrification. Some addresses are associated with large-scale residential development plans, such as Toll Brothers' Naval Square in Southwest Center City, while many others are individual infill and rehabilitation projects in row house neighborhoods.

Figure 1. Total Abatements by Tax Year, 2007-2018

	Active Abatements	
Tax Year	No.	
2007	4,765	$352,931,048
2008	6,685	$485,156,525
2009	9,023	$657,159,206
2010	11,832	$762,068,403
2011	13,491	$848,040,961
2012	15,314	$921,911,900
2013	15,788	$952,639,348
2014	15,355	$5,375,548,449
2015	15,969	$5,638,815,084
2016	15,551	$5,849,114,990
2017	14,450	$5,642,249,623
2018	13,749	$6,262,698,831
Totals	**151,972**	**$33,748,334,368**

Figure 2. Top Ten Zip Codes with Abatements in Tax Year 2018

Zip Code	No. Properties Receiving Abatements	Total Abatement Amount	Median Abatement Amount
19103	13,410	$5,788,022,529	$118,389
19146	21,187	$4,232,462,257	$121,792
19123	13,395	$3,083,391,740	$127,168
19147	14,193	$2,816,076,844	$102,200
19102	6,445	$2,122,323,899	$75,712
19106	10,891	$2,049,129,524	$79,744
19130	7,245	$1,934,373,385	$139,732
19121	6,078	$1,673,728,452	$95,446
19104	3,941	$1,593,052,235	$28,840
19107	6,735	$1,304,910,065	$56,768
Totals	**103,520**	**$26,597,470,930**	

Figure 3. Top Ten ZIP Codes with Abatements in Tax Year 2018

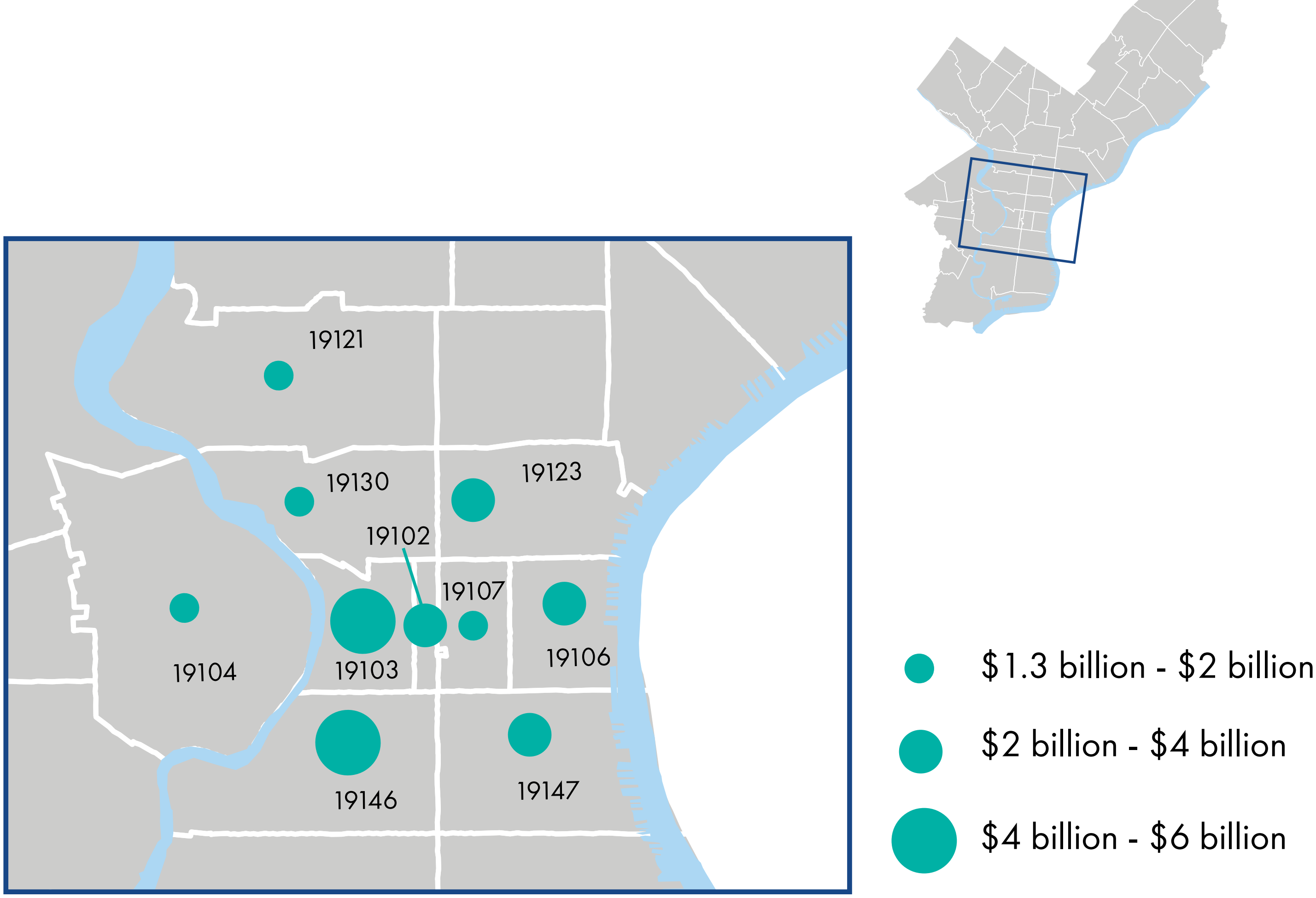


Figure 4. Greatest Number of Abatements and Abatement Amounts by Tax Year, 2007-2018

	No.	Amount
Up to $100,000	1,817	$99,592,734
$100,101 to 500,000	10,396	$2,754,120,676
$500,001 to $1,000,000	944	$624,028,425
$1,000,001 to $5,000,000	518	$954,795,897
$5,000,001 to $10,000,000	27	$186,070,877
$10,000,001 to $50,000,000	36	$739,716,701
$50,000,001 to $100,000,000	6	$364,771,501
Greater than $100,000,000	5	$539,602,020
Totals	**13,749**	**$6,262,698,831**

Eight of the ten addresses in the Residential category code that received the highest tax abatements in 2018 are condominium units located in two new Center City buildings. The other two addresses are two rehabilitated brownstones marketed as The Annex at The Touraine.

Figure 5. Top Ten 2018 Abatements: Residential Category Code

Address	Unit	Taxable Building (Rehabilitation Project)	Exempt Building	Owner Location, if Investor
1706 Rittenhouse Square	3100		$10,877,160	
130 South 18th Street	3202		$9,573,200	Bryn Mawr,PA
130 South 18th Street	3102		$5,658,289	Newtown, PA
1706 Rittenhouse Square	2601		$5,137,280	Bala Cynwyd, PA
1706 Rittenhouse Square	2701		$5,137,280	Philadelphia 19127
1706 Rittenhouse Square	2801		$5,137,280	Philadelphia 19102
1706 Rittenhouse Square	2901		$5,137,280	Vorhees, NJ
130 South 18th Street	3301		$5,062,330	Philadelphia 19103
1516 Spruce Street		$2,139,521	$5,051,479	Philadelphia 19103
1518 Spruce Street		$2,029,766	$4,792,334	Philadelphia 19103
Totals		**$4,169,287**	**$61,563,912**	

The Annex, 1516 and 1518 Spruce Street
2018 Abatement Amount, 1516 Spruce Street: $277,782

1706 Rittenhouse Square

2018 Abatement Amount, Unit 3100:
$10,877,160

130 South 18th Street

2018 Abatement Amount, Unit 3202:
$9,573,200

The addresses in the Apartments category code that were receiving the highest abatement amounts in tax year 2018 include older projects nearing the end of the ten-year abatement term, as well as recently-completed development. Three of them—Edge Village, Domus Apartments, and 3200L Chestnut Street—are associated with university-related rental housing demand. Most of the others illustrate the expansion of the Center City rental market beyond the central business district core.

The total abatement amounts for these ten projects represent about 8.5% percent of total housing-related abatement amounts in tax year 2018.

There is no question that the tax abatement has strengthened both downtown and neighborhood real estate markets and has enhanced the financial feasibility of both market-rate and affordable housing ventures. However, before any changes in tax abatement policy are considered, the question of whether the wealth that the abatement is generating can be leveraged to help address Philadelphia's growing housing affordability crisis should be explored.

Figure 6. Top Ten 2018 Abatements: Apartments Category Code

Address	Name	Zip Code	Taxable Building	Exempt Building
2116 Chestnut Street		19103		$71,148,747
2323 Race Street	Edgewater Apartments	19103		$69,538,604
1601 North 15th Street	The Edge Village	19121		$63,709,205
3401 Chestnut Street	Domus Apartments	19104		$61,220,639
777 South Broad Street		19147		$51,855,773
630-40 North Broad Street		19130	$6,261,973	$45,921,135
2026-58 Market Street		19103	$18,998,760	$44,330,440
1901-39 Callowhill Street	The Granary Rentals	19130		$42,849,268
3200L Chestnut Street		19104		$40,060,000
4055 Ridge Avenue	Dobson Mills Apartments	19129	$9,810,621	$38,643,277
Totals			**$35,071,354**	**$529,277,088**

2116 Chestnut Street

2018 Abatement Amount:
$71,148,747

1601 North 15th Street

2018 Abatement Amount:
$63,709,205

4055 Ridge Avenue

2018 Abatement Amount:
$38,643,277

3200 Chestnut Street

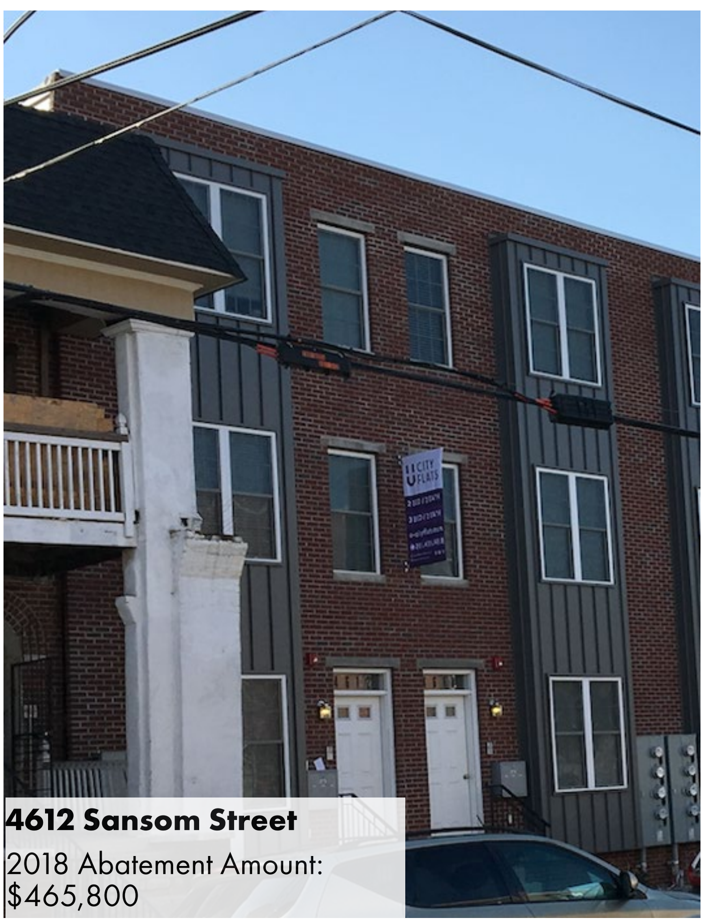
2018 Abatement Amount:
$40,060,000

3205 Pietro Way

2018 Abatement Amount:
$358,747

214 East Durham Street

2018 Abatement Amount:
$181,181



4612 Sansom Street

2018 Abatement Amount:
$465,800

725 North 20th Street

2018 Abatement Amount, Unit A:
$268,515

In contrast to the unlimited availability of the ten-year tax abatement, the availability of funding for housing interventions to make housing affordable to people with incomes at and below median is severely limited. Support from the U.S. Department of Housing and Urban Development (HUD), the source of most funding for these interventions, has declined significantly during recent decades. Cuts to affordable housing programs have been made under both Republican and Democratic administrations and the prospect of further funding reductions during the coming months seems inevitable.

The increase in rental housing construction that occurred in the years after the end of the Great Recession did not include the production of a significant number of additional homes for lower-income households, many of whom are being priced out of existing rental housing.

> ***"...With overall rental demand strong, particularly in centrally located communities, rents for an increasing number of once-affordable units have become out of reach for lower-income households. At the same time, the rents charged for units in neighborhoods with weak demand may not support adequate maintenance, leaving those rentals at risk of deterioration and loss. Given the lack of new construction of lower-cost rentals, preserving the existing stock of privately owned affordable units is increasingly urgent."***
>
> -Joint Center for Housing Studies of Harvard University, America's Rental Housing 2017

Although sales prices and rent levels are significantly lower in Philadelphia than in other cities of comparable size, Philadelphia's poverty level is significantly higher than in comparable cities.

Many Philadelphia households are unable to afford to buy, rent, or maintain decent homes, notwithstanding the fact that Philadelphia's housing costs are lower than in many other large cities.

A number of federal subsidy programs have supported affordable housing development and preservation in Philadelphia neighborhoods, including those in the 19104 and 19139 zip codes, shown in **Figures 10 - 11**.

However, as described later in this section, the prospect of continued federal support to sustain these housing programs is highly uncertain.

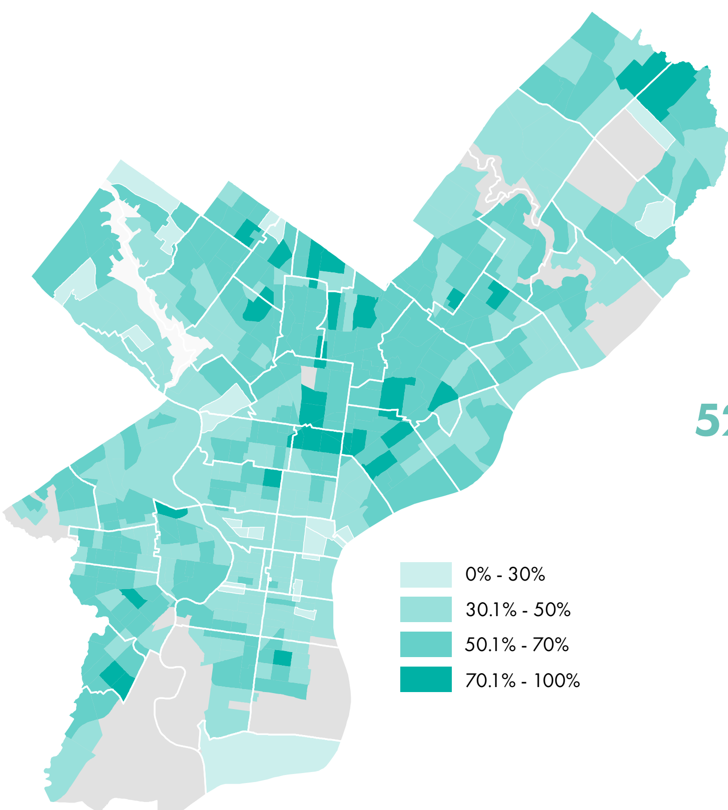
Evidence of Philadelphia's housing affordability problem: the consistently high level of applications for subsidized housing.

Figure 7. Evidence on Twitter of Philadelphia's housing affordability problem

Figure 8. Poverty Rates in Major U.S. Cities

Source: US Census Bureau, 2016 American Community Survey 1-year Estimates

Figure 9. Rent Burden in Philadelphia



52% of Philadelphia renters are cost burdened

30% are severly cost burdened

Source: 2011-2015 American Community Survey 5-year Estimates

Figure 10. Location of Subsidized Housing in 19104 and 19139 ZIP Codes

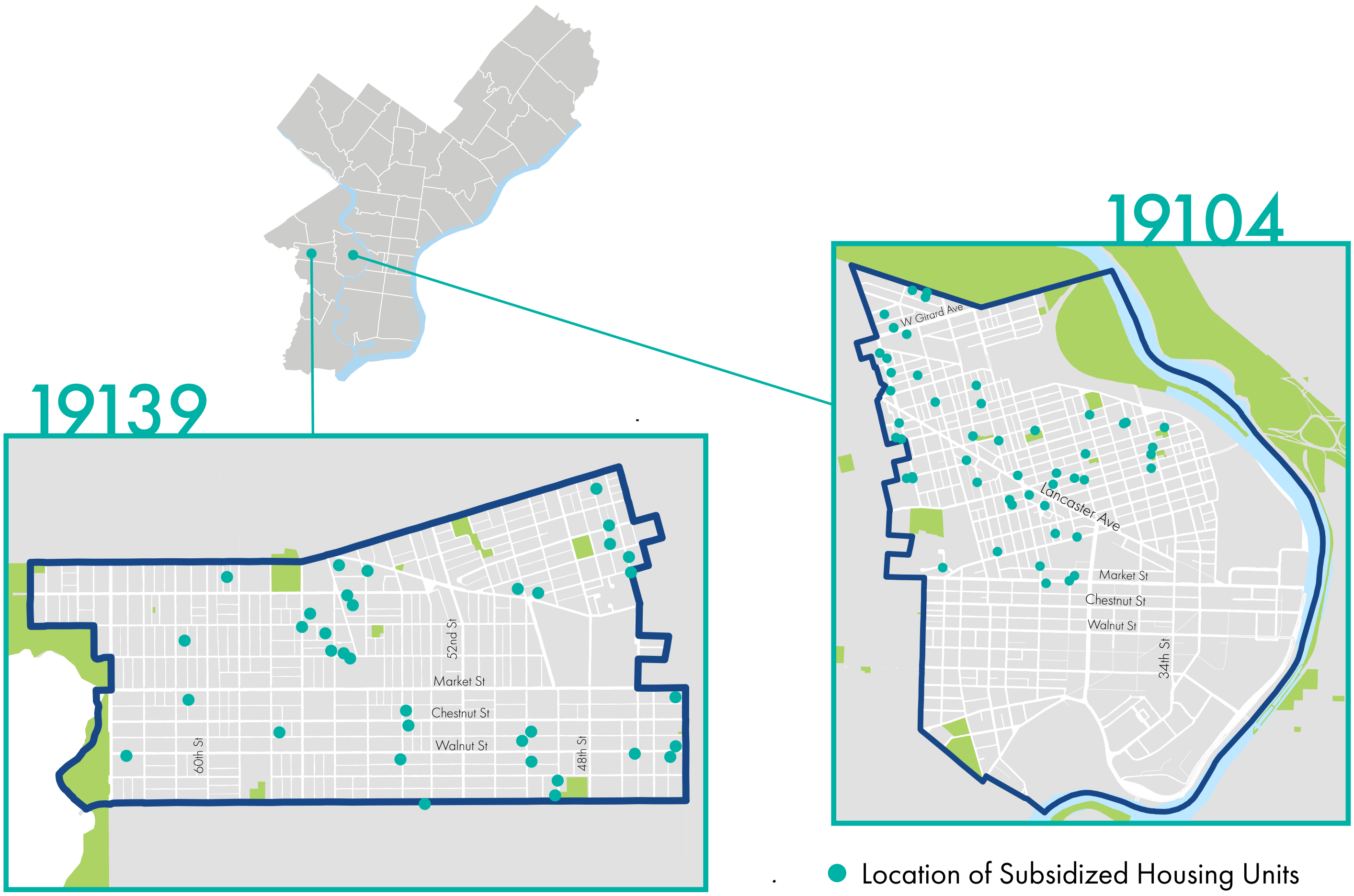
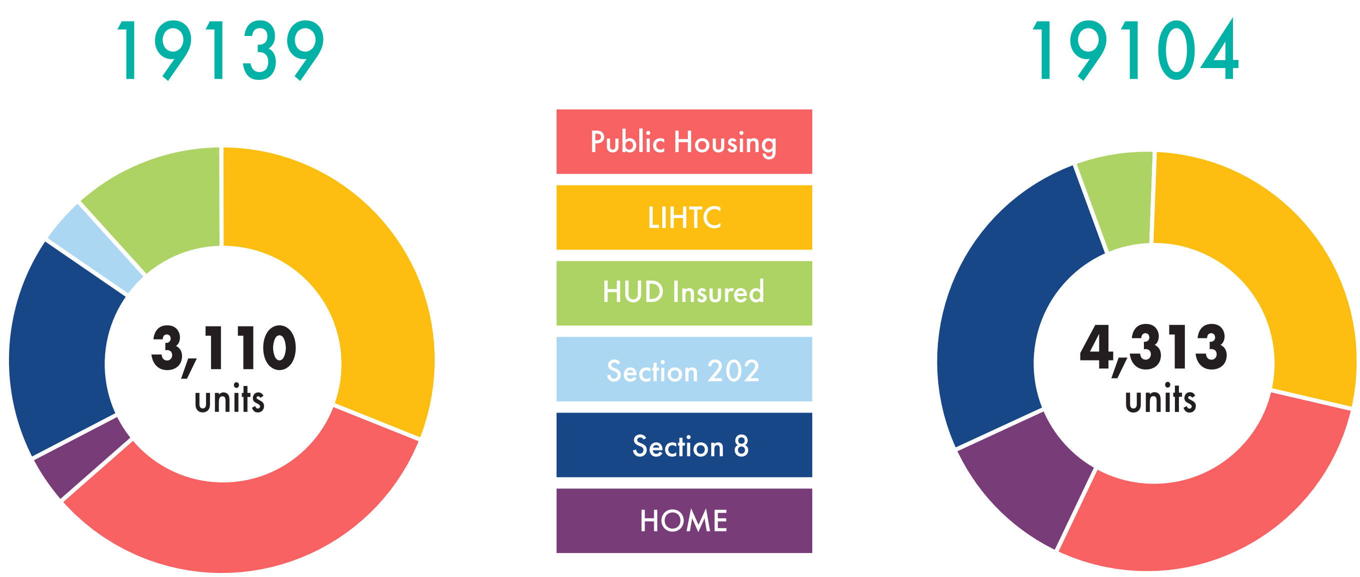


Figure 11. Type of Subsidized Housing in 19104 and 19139 ZIP Codes



Source: National Housing Preservation Database

Housing Affordability Challenges

An "affordable" housing expense is generally defined as one that does not exceed 30 percent of income. The annual income categories used by the City of Philadelphia to establish eligibility for certain housing assistance programs, along with 30 percent of income in each category, are shown in **Figure 12.**

Figure 12. City of Philadelphia Annual Income Eligibility for Housing Assistance

	Very Low (30% AMI)		Low (50% AMI)		Moderate (80% AMI)		Middle (120% AMI)	
Household Size	**Income Level**	**Housing Affordability (30% of Income)**	**Income Level**	**Housing Affordability (30% of Income)**	**Income Level**	**Housing Affordability (30% of Income)**	**Income Level**	**Housing Affordability (30% of Income)**
1	$14,575	$4,373	$29,150	$8,745	$46,600	$13,980	$69,960	$20,988
2	$16,650	$4,995	$33,300	$9,990	$53,250	$15,975	$79,920	$23,976
3	$18,725	$5,618	$37,450	$11,235	$59,900	$17,970	$89,880	$26,964
4	$20,800	$6,240	$41,600	$12,480	$66,550	$19,965	$99,840	$29,952
5	$22,475	$6,743	$44,950	$13,485	$71,900	$21,570	$107,880	$32,364
6	$24,150	$7,245	$48,300	$14,490	$77,200	$23,160	$115,920	$34,776

Source: Zillow

The cost of most rental housing currently being advertised in the South, West, and Northwest Philadelphia ZIP codes shown in **Figure 13** is substantially higher than the affordability levels shown in the **Figure 12.**

Figure 13. Rental Housing Available in October 2017

Address	ZIP Code	Square Feet	Rent (Monthly)	Rent (Annually)	Annual Income at which Rent is Affordable
3102 Tasker St	19145	1,220	$1,000	$12,000	$40,000
332 W Manheim Street	19144	1,000	$1,000	$12,000	$40,000
6421 Vine Street	19139	1,100	$1,050	$12,600	$42,000
615 E Upsal Street	19119	1,000	$1,095	$13,140	$43,800
1532 Rodman Street	19146	1,140	$1,180	$14,160	$47,200
353 W Mount Airy Ave	19119	1,000	$1,195	$14,340	$47,800
4130 Parkside Ave	19104	1,218	$1,200	$14,400	$48,000
4510 Walnut Street	19139	1,200	$1,200	$14,400	$48,000
1835 Moore Street	19145	1,000	$1,245	$14,940	$49,800
6108 Chancellor Street	19139	1,150	$1,250	$15,000	$50,000
228 E Montana Street	19119	1,064	$1,300	$15,600	$52,000
542 W King Street	19144	1,275	$1,300	$15,600	$52,000
4419 Baltimore Ave	19104	1,000	$1,400	$16,800	$56,000
3636 Reed Street	19146	1,400	$1,400	$16,800	$56,000
3825 Hamilton Street	19104	1,000	$1,500	$18,000	$60,000
2024 Annin Street	19146	1,086	$1,500	$18,000	$60,000
6656 Germantown Ave	19119	1,013	$1,550	$18,600	$62,000
1831 Schley Street	19130	1,152	$1,900	$22,800	$76,000
3131 Walnut Street	19104	1,100	$1,980	$23,760	$79,200

1532 Rodman Street
Monthly Rent: $1,180

4510 Walnut Street
Monthly Rent: $1,200

Some of the lowest-priced sales housing that received tax abatements over the past twelve years was also unaffordable to most households at the income levels shown on the affordability table, **Figure 14.**

Figure 14. Affordability of Selected Tax-Abated Sales Housing

Address	Zip Code	Sales Price	Mortgage (Monthly)	Mortgage (Annually)	Annual Income at which Annual Mortgage Payment is Affordable
218 East Johnson Street	19144	$279,900	$1,497	$17,959	$59,863
132 East Walnut Lane	19144	$172,500	$1,036	$12,428	$41,427
5032 Knox Street	19144	$90,000	$584	$7,014	$23,380
5852 Morton Street	19144	$33,000	$469	$5,630	$18,767
424 West Queen Lane	19144	$140,000	$741	$8,889	$29,630
12 South 51st Street	19139	$87,000	$476	$5,713	$19,043
4527 Sansom Street	19139	$320,000	$1,758	$21,097	$70,323
4501 Fairmount Ave.	19139	$110,000	$608	$7,294	$24,313

*30-year mortgage at 4% with 5% down payment

4527 Sansom Street
Monthly Mortgage: $1,758

4501 Fairmount Avenue
Monthly Mortgage: $608

Housing Preservation Needs

Housing preservation, the stabilization and upgrading of existing homeowner-occupied and rental housing units, is the single best way to address Philadelphia's housing affordability challenges. Because occupied housing in need of improvement can be found in every area of the city, the implementation of a citywide housing preservation strategy is the best way to counteract the adverse impact of gentrification on longtime residents and to promote mixed-income housing over a broad area rather than on a project-by-project basis. Repairing and improving existing housing is far less costly than developing new housing, and preservation activities can be completed far more quickly than housing production projects.

Participants on both sides of the debate over inclusionary zoning (IZ) in Philadelphia may not have given sufficient consideration to the possibility that people in need of affordable housing might prefer to remain in the residential neighborhoods where they live now or might choose to move to other residential neighborhoods rather than to relocate into the central business district or to waterfront locations where many IZ-mandated units would be most likely to emerge.

The Proposed Consolidated Plan, 2018-2022, published by the City's Division of Housing and Community Development, identifies 2,350 homeowner households and 3,980 renter households as living in substandard housing lacking complete plumbing or kitchen facilities. Although these 6,330 households represent a relatively small proportion of the total number of Philadelphia households faced with housing affordability challenges, this category of housing need can be addressed quickly and cost effectively if more funding could be made available for this purpose.

5032 Knox Street

2015 Tax Abatement Amount:
$43,743 (final abatement year)

Shrinking Federal Support

Federal support for affordable housing is proposed to be reduced substantially. The City of Philadelphia received nearly $39 million in federal Community Development Block Grant (CDBG) funding and more than $8 million in HOME Investment Partnerships (HOME) funding for Fiscal 2018. The Trump Administration's budget proposal calls for both these programs to be eliminated.

Although some of this funding is likely to be restored in the version of the budget that is approved by Congress, it is unlikely that federal support for affordable housing will be continued at its present level, and the prospect of further funding reductions seems increasingly likely. In this environment, Philadelphia will have to find new ways to make use of available resources, to focus on opportunities to leverage private financing, and to support housing interventions that can be implemented at relatively low cost, as described in the next section.

Activities Supported with Federal CDBG and HOME Funds, FY 2018

- Development of Affordable Rental Housing
- Development of Housing for Formerly Homeless People
- Repair of Existing Rental Housing
- Housing Counseling and Foreclosure Prevention Services
- Matching Funds for Employer-Assisted Housing Program
- Repair and Replacement of Basic Systems in Owner-Occupied Homes
- Weatherization of Owner-Occupied Homes
- Rental Assistance Funding for Formerly Homeless People

Total FY2018 CDBG and HOME funding for Philadelphia:	Funding for CDBG and HOME Based on Federal Budget Proposal:
$47,000,000	$0

3 Low-Cost Housing Interventions

Many of the housing interventions that are most effective in making housing affordable can be made available at a relatively low cost. The best known of these interventions can be grouped into three categories:

1. Rental assistance payments that make up the difference between a "fair market" rent for an apartment or house and the amount that a household can afford to pay (usually defined as not more than 30 percent of gross income);
2. Rental assistance for chronically homeless individuals in support of the housing first model;
3. Basic systems repair/replacement and adaptive modifications to make existing occupied homes suitable for continued occupancy; and
4. Short-term rental assistance payments, security deposit payments, or utility bill payments that enable a household to respond to a housing crisis and avoid eviction and homelessness.

Housing interventions are highly efficient ways of delivering assistance. The cost per unit of providing a rent subsidy, completing a home repair, or paying a housing expense in order to avoid a crisis is far lower than the per-unit cost of developing a new apartment building. The administration of these interventions is much simpler than the financial underwriting, construction-period financial management, and other tasks associated with the completion of an affordable housing development venture.

Housing interventions are effective vehicles for supporting human capital development and improving an individual's potential for achieving self-sufficiency in the mainstream economy. Providing more households with safe and stable living environments increases the likelihood that young people and adults enrolled in schools, colleges, and workforce development programs will complete the education and training that will qualify them for jobs with higher earning potential.

4017 Lancaster Avenue

2018 Tax Abatement Amount: $234,240

1. Rental Assistance for Low Income Housing Tax Credit Ventures

Rental assistance payments make up the difference between a "fair market" rent for an apartment or house and the amount that a household can afford to pay (usually defined as not more than 30 percent of gross income.)

Best use of this funding: Providing revenue to extend the life of existing affordable rental housing ventures supported with federal Low Income Housing Tax Credit (LIHTC) financing.

Illustration of estimated cost per unit: To provide the level of rental assistance needed to extend the life of an existing LIHTC affordable rental housing venture in Point Breeze for fifteen years: $3,000 per unit in Year One, plus annual escalation to $4,500 in Year 15.

Total subsidy per unit: $56,000, disbursed over a 15-year period, or an average of $3,733 annually.

The Low-Income Housing Tax Credit (LIHTC) is currently the primary source of financing for most affordable rental housing developed in Philadelphia and other cities. Tax credits that the Internal Revenue Service allocates to Pennsylvania are used to finance rental housing development proposals submitted to the Pennsylvania Housing Finance Agency (PHFA) in response to PHFA Requests for Proposals and a statewide funding allocation plan. The sale of the tax credits to investors provides a for-profit or nonprofit developer with a substantial amount of the total funding needed to complete a development venture. **Figure 15** summarizes funding sources for three Philadelphia rental housing ventures approved by PHFA in recent years.

Figure 15. Funding Sources for Three Rental Housing Venture

Funding Source	Project #1	Project #2	Project #3
LIHTC Equity	$10,800,000	$12,600,000	$9,000,000
City of Philadelphia/HOME	$700,000		
PHFA PennHOMES		$950,000	
Historic Tax Credit Equity			$2,500,000
Other Sources		$2,650,000	$1,000,000
Total Development Budget	**$11,500,000**	**$16,2000,000**	**$12,500,000**

Source: Pennsylvania Housing Finance Agency

The financial structure of LIHTC development projects differs fundamentally from that associated with market-rate rental development. Because most or all tenants are low- or very low-income households, rental income is not sufficient to cover operating expenses. The PHFA-administered tax credit financing provides only the level of support needed to sustain the project during a fifteen-year "compliance period" in which affordability must be maintained. Any positive cash flow must be used to pay off secondary financing. Thus, the developer is unable to create an operating reserve that is greater than the amount shown in the income and expense documentation approved by PHFA. As a result, operating expenses for many LIHTC projects routinely exceed income by the end of the first decade of operation, as shown in the data in **Figure 16,** extracted from a PHFA-approved proposal for a Philadelphia LIHTC venture.

In contrast to market-rate rental development, "return on investment" is not a factor in a LIHTC venture. The investor benefits from the purchase of the tax credits at the start of the project. The developer's goal is to maintain the project at break-even status until Year 15, at which time there may be an opportunity to resyndicate the project after obtaining new tax credits. The developer's fee is included in the project development budget, and property maintenance fees are included in the income and expense pro forma.

Tasker Village,
16th and Tasker Street

Figure 16. Operating Expenses for Philadelphia LIHTC Venture

	Year 1	Year 5	Year 10	Year 15
Gross Residential Income	$350,364	$379,245	$418,717	$462,298
Effective Gross Income	$335,066	$362,686	$400,435	$442,112
Total Operating Expenses	$322,207	$361,666	$431,735	$498,996
Net Operating Income	$12,859	$1,020	($31,300)	($56,884)
Cash Flow After Working Capital	$12,011	$173	($32,147)	($57,731)

Source: Pennsylvania Housing Finance Agency

The most capable for-profit and nonprofit LIHTC developers know how to organize financing proposals that will be competitive in PHFA funding rounds, hold down annual operating expenses, and make use of opportunities to benefit from economies of scale associated with the ownership of multiple properties. However, the following graph, included in a 2006 study, is illustrative of the challenge of operating an LIHTC venture today.

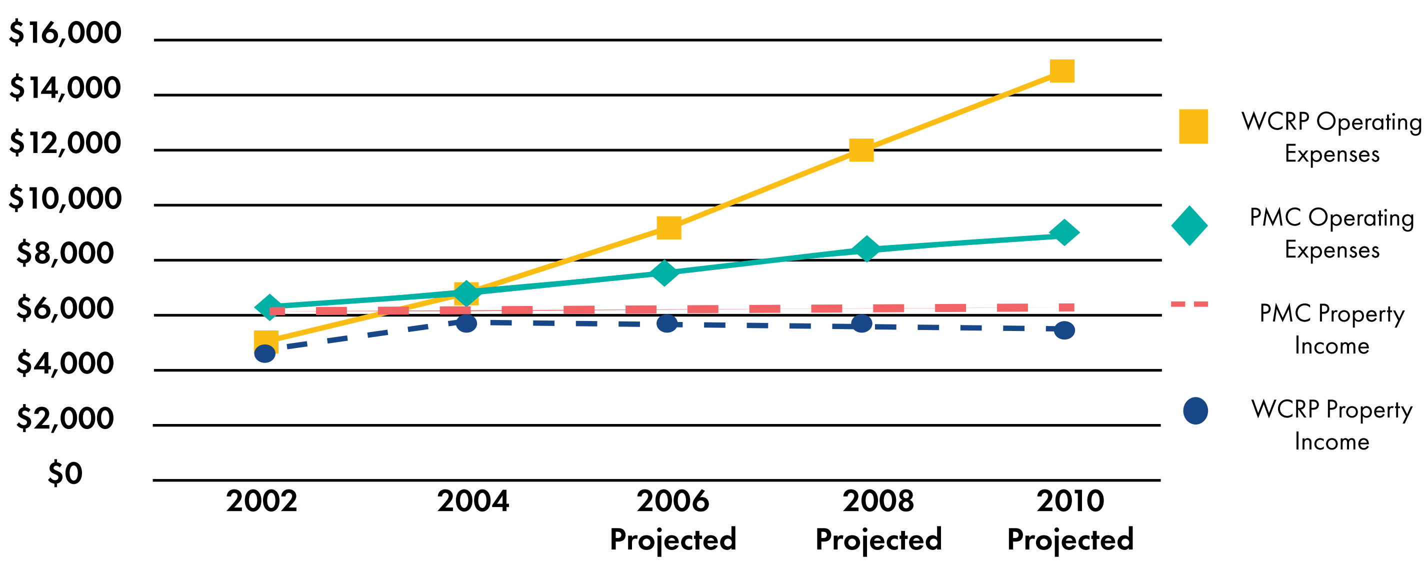
Authors of a 2006 report, *Affordable Housing Management and Preservation Initiative,* which compared tax-credit financed afforable rental housing in Philadelphia, stated that "While regulations hold operating revenue down, housing managers are hard-pressed to counter the relentless market forces that drive operating costs up." This statement has even more relevance today than it did when the report was published, given the surge in market-rate rental development that Philadelphia has experienced in recent years.

"Project-based" Housing Choice Vouchers administered by the Philadelphia Housing Authority (PHA) have been a source of support for affordable rental housing ventures for many years. However, because PHA is also an affordable housing developer and in light of ongoing reductions in federal funding, "project-based assistance" is not available for new development ventures by other developers. PHA makes available Annual Contributions Contract (ACC) funding (operating subsidies associated with inactive public housing units), but ACC funding provides less support than Housing Choice Vouchers. Rental assistance may be available through the City's Office of Homeless Services or through the City's allocation of HOME Investment Partnership funding. However, this funding is designed for short-term assistance to be made available over a relatively few years, a term that would not be satisfactory for a tax credit investor seeking assurances of financial stability over the length of the fifteen-year compliance period.

These characteristics expose LIHTC ventures to more vulnerabilities than comparable market-rate ventures. As one person with expertise in organizing tax credit proposals commented, "Even during the [ten-year tax] abatement period, some projects are operating at negative cash flow, others just breaking even, and some are throwing off cash flow."

A relatively small amount of rental assistance funding can contribute to the financial stability of an affordable rental housing project in a manner similar to the value that project-based Housing Choice Vouchers provided at the time when this resource was more accessible.

Figure 17. Expenses vs. Income 2002-2204, Projected to 2010



Source: Jeffrey Allegretti, Court Daspit, and Mona Williams, *Affordable Housing Management and Preservation Initiative: Final Report,* commissioned by Women's Community Revitalization Project and The William Penn Foundation, April 25, 2006

2. Rental Assistance in Support of Housing First Model

Rental assistance payments support the Pathways to Housing PA Housing First model that provides housing and supportive services for chronically homeless people.

Best use of this funding: Providing revenue to expand the number of Housing First units available to formerly homeless people.

Illustration of estimated cost per unit: Between $8,400 and $12,000 per year, to leverage matching funds for case management, supportive services, and any housing maintenance costs. Combined cost of housing and services for a chronically homeless individual estimated at $28,500 per year.

Total subsidy per unit: Up to $12,000 per year, subject to availability of matching funds.

As with LIHTC-financed ventures, additional funding for rental asistance payments can make up the difference between a "fair market" rent for a rental unit and the amount that a household can afford to pay (usually defined as not more than 30 percent of gross income).

A rental assistance resource could also be beneficial to Pathways to Housing PA (PTHPA), which provides housing and supportive services for chronically homeless people with mental health challenges and/or substance use disorders. As an alternative to the traditional approach to homelessness, which often involves placement in an emergency shelter followed by the possibility of a subsequent move into transitional housing, PTHPA's Housing First model offers the opportunity to move into an apartment immediately. While there is no requirement to achieve clean-and-sober status or enter into psychiatric treatment, the tenant must agree to abide by the terms of the lease agreement, be a responsible tenant, to pay a share of the rent (i.e., thirty percent of income), and participate in a home visit by supportive service staff at least twice a month.

Supporters of the Housing First Model have found that, if the homeless individual or family is able to move from the streets into safe, affordable housing, then the prospects for voluntarily taking advantage of supportive treatment services that may lead to improved health and greater self-sufficiency are substantially improved, as described on PTHPA's web site.

"While the Housing First Model is very simple, the Housing First Program is very complex and requires dedicated staff to coordinate all aspects (outreach, housing, healthcare, treatment and case management) of the program. To be eligible for our Housing First Program, people must be chronically homeless and suffer from severe psychiatric disabilities and/or substance use disorders. Therefore, building a trusting relationship with these individuals living on the street, which may take many months, is the very first step of the program. Once a relationship is established and the person agrees to let us work with them, he or she chooses an apartment, it is furnished and then we celebrate as they move in."

-Pathways to Housing PA[3]

PTHPA currently receives rental assistance through the City's Office of Homeless Services (OHS) and the U.S. Department of Housing and Urban Development (HUD). The organization's annual cost for housing and supporting a single chronically homeless individual with disabilities is about $28,500. This amount includes rent subsidy, case management services, some primary care, psychiatric care, expedited access to substance abuse treatment, and any costs related to housing or maintaining housing. Current PTHPA rentals average about $875, with rents ranging between $700 and $1000; average rents are expected to steadily increase as rental demand continues to rise in Philadelphia.

3 Pathways to Housing PA. https://pathwaystohousingpa.org/housing-first-model

If additional funding for rental assistance were to become available, then PTHPA currently possesses the administrative/management capacity to increase its caseload. However, the rental assistance funding would have to be matched by funding for intensive case management and support services through Community Behavioral Health and the City's Department of Behavioral Health (provided that the affected tenants agreed to these services).

One of the advantages of the Housing First approach is that it provides opportunities for formerly homeless individuals and families to move into mixed-income communities, as shown by the diversity of ZIP codes where the 342 PTHPA-supported units are located.

Figure 18. Selected Zip Code Locations of Housing First Rental Units

ZIP Code	Area	No. Units
19104	University City	10
19111	Fox Chase	16
19119	Mount Airy	5
19121	Fairmount	35
19125	Kensington/Fishtown	2
19132	North Philadelphia/West	10
19139	West Philadelphia	10
19151	Overbrook Hills	5

Source: Pathways to Housing PA

3. Basic Systems Repair/Replacement and Adaptive Modifications

Basic systems repair/replacement and adaptive modifications make owner-occupied homes safe and suitable for continued occupancy over the long term.

Best use of this funding: Grants or recoverable grants, with repayment due upon sale of home.

Estimated cost per unit.

- Average grant for basic systems repair/replacement: $10,000
- Average grant for making a home accessible for people with disabilities: $14,000

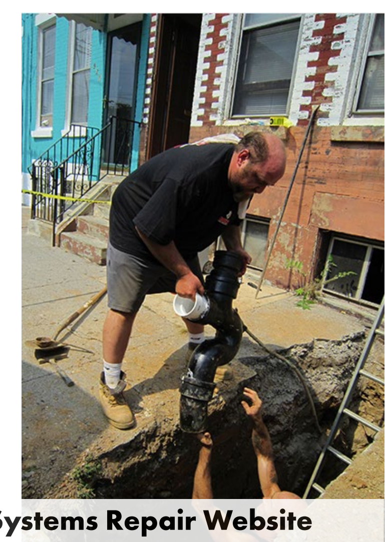
Total subsidy per unit: $10,000 to $24,000 in grant or recoverable grant financing.

Source: City of Philadelphia, Division of Housing and Community Development, Proposed Consolidated Plan, 2018-2022.

Housing preservation, the stabilization and upgrading of existing occupied housing, is the single best way to address Philadelphia's housing affordability challenges. Because occupied housing in need of improvement can be found in every area of the city, the implementation of a citywide housing preservation strategy is the best way to counteract the adverse impact of gentrification on longtime residents and to promote mixed-income housing over a broad area rather than on a project-by-project basis. Repairing and improving existing housing is far less costly than developing new housing, and preservation activities can be completed far more quickly than housing production projects.

The City of Philadelphia provides tax exemptions that are designed to enable longtime residents of changing neighborhoods to remain in their homes, including a Homestead Exemption that reduces a property's assessed value by $30,000, as well as a discount on real estate tax through the Longtime Owner Occupants Program (LOOP). However many homes in these neighborhoods are more than a century old and in need of significant, costly repairs.

With an annual infusion of funding from a source other than the federal government or municipal bond financing, more housing preservation activities could be supported through an ongoing repair/adaptive modification program.



Photos from Division of Housing and Community Development Basic Systems Repair Website

3. Eposodic Homelessness Prevention Through Financial Assistance

Preventing homelessness or providing a "rapid rehousing" solution for a homeless individual or family is much less expensive and much more effective than paying for emergency shelters or responding to crises as they occur.

Homelessness prevention and rapid rehousing services provided by the City of Philadelphia assist individuals and families that are not chronically homeless but that need to find an alternative to an unsustainable housing situation other than unnecessary placement in emergency shelters.

Best use of this funding: Short-term rental assistance payments, payments of security deposits or rental arrearages, payment of utility deposits or utility bill arrearages, payment of moving costs, support for related counseling services.

Estimated cost per unit (two examples).

Rental assistance, utility assistance and related services for 100 households:

Approximately $6,000 per household.

Rental assistance and security deposit payments to "rapidly rehouse" homeless persons:

Approximately $7,000 per household.

Source: City of Philadelphia, Division of Housing and Community Development, Proposed Consolidated Plan, 2018-2022.

In Philadelphia, where over 25% of the population is living in poverty and over 50% of renters are cost burdened, housing instability and risk of eviction is significant for many. Housing instability makes getting to a job or school more challenging. Eviction or foreclosure often results in people moving into substandard or over-crowded housing or, at worse, becoming homeless.[4] Further, losing one's home is traumatic. It can result in depression, poorer health, and higher stress - the side effects of which can last for years.[5]

In an article published in Science, three researchers reported that providing temporary financial aid to families at imminent risk of homelessness reduces by 76 percent the likelihood that they will enter homeless shelters, finding that the benefits of this approach, including lower shelter costs, lower costs of other public services, and better education and health outcomes, outweigh the costs.[6]

4 Dealing With Gentrification. "How Does Gentrification Create Housing Instability". http://dealingwithgentrification.org/housing-instability/

5 Matthew Desmond, Rachel Tolbert Kimbro. "Eviction's Fallout: Housing, Hardship, and Health". *Social Forces*. Volume 94, Issue 1, 1 September 2015, 295-324

6 William Evans, James Sullivan, and Melanie Wallskog, "The Impact of Homelessness Prevention Programs on Homelessness," *Science*, Volume 353, Issue 6300, August 12, 2016, 694-699).

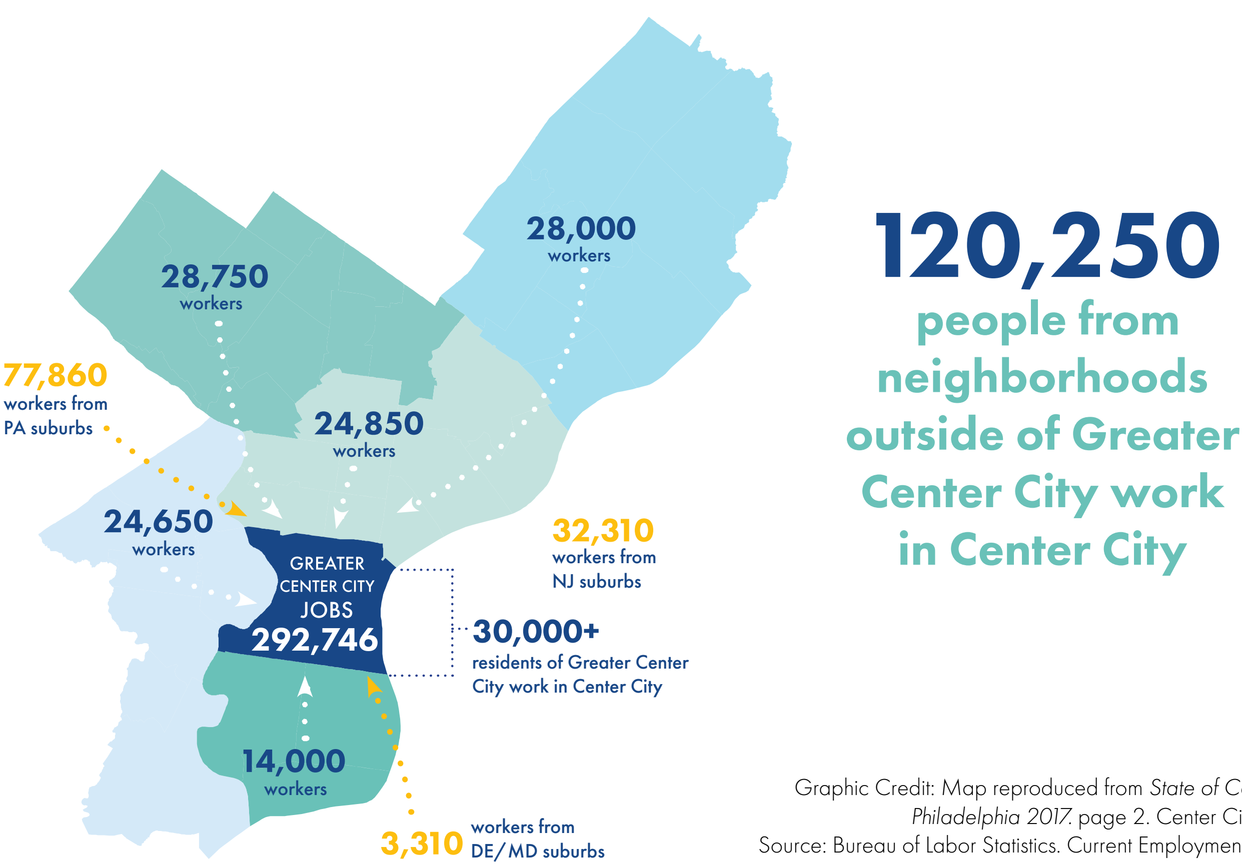
Neither affordable housing advocates nor real estate industry constituencies are likely to have been pleased with the inconclusive results of the debate over inclusionary zoning that took place during 2017. However, one reason why this experience should be viewed in a positive light is the fact that both sides supported their positions with analyses of real estate market data and commentary on operational issues associated with current and proposed development ventures to a much great extent than in past debates of this kind.

Any consideration of changes in the ten-year tax abatement policy should be informed by a similar analytical approach. Because of the large number of properties that have received and are receiving the tax abatement—nearly 14,000 individual addresses in tax year 2018 alone—any change in policy is likely to have a significant impact on Philadelphia's rental and sales housing markets and on the residential portion of the city's tax base.

Such an analysis should take account of the following considerations:

- The best way to address the housing needs referenced in Part Two of this report—and to addressing chronic poverty in Philadelphia—is by leveraging the value generated by the city's strongest real estate markets to help finance affordable housing preservation and human capital development in high-poverty neighborhoods. If a leverage strategy is implemented effectively, then continued wealth-building in Center City and in strong neighborhood real estate markets will deliver more value to communities across the city.
- A successful leverage strategy is not "trickle-down" economics; it's a synergy between downtown and neighborhoods that's comparable to the downtown/neighborhood employment synergy, in which employers in Greater Center City and University City provide many jobs held by residents of neighborhoods across Philadelphia (see **Figure 19**).

Figure 19. Number of City and Region Residents Who Work in Center City



Graphic Credit: Map reproduced from *State of Center City Philadelphia 2017.* page 2. Center City District, Source: Bureau of Labor Statistics. Current Employment Statistics

- Although strong real estate markets will be affected by any reduction in the benefits associated with the ten-year tax abatement, location will still matter. For example, although a reduction or elimination of the tax abatement would be certain to influence change in Toll Brother's proposal for the Jeweler's Row site at 7th and Sansom Streets, it seems highly unlikely that the entire project would be abandoned as a result. A developer currently active in a strong Philadelphia real estate market will continue to have opportunities to do well under a less generous tax abatement policy.
- In the event of a reduction in the benefits associated with the tax abatement, developers are likely to give first consideration to adjusting sales prices and rent levels, reducing amenities or substituting lower-priced amenities for higher-priced ones (i.e. substituting granite countertops with quartz). However, in most of the neighborhoods where projects receiving abatement amounts of less than $500,000 have been completed, it is unlikely that sufficient adjustments can be made to offset a significantly reduced tax abatement benefit (or a loss of the tax abatement altogether) and achieve profitable results.
- Developers in some neighborhoods outside the Center City/University City core may not be able to make changes of this kind sufficiently to the extent needed to make a profit. As a result, some of these neighborhoods will experience a "development loss" as a result of a change in tax abatement policy.
- A reduction in tax abatement benefit will be problematic for current and future affordable rental housing ventures supported with Low Income Housing Tax Credits. Thus, any change in tax abatement policy should be accompanied by action to offset this disadvantage (see "Rental Assistance" section in **Part 3**).

Countertop Choices

A significant change in tax abatement policy is likely to be challenging to many developers currently active in the city. However, the need to improve the quality of public education in Philadelphia and preserve housing affordability in the neighborhoods are priorities as critical to Philadelphia's competitiveness and viability today as the need to reinvigorate Center City was in the mid-1990s when the ten-year tax abatement was initially introduced.

Policy Options

As shown in Part 1(**Figure 1**), the growth in Philadelphia's real estate markets that occurred in the years following the Great Recession has been accompanied by a significant increase in the number of properties receiving tax abatements and in the associated amount of tax revenue that the City has forgone as a result of the tax abatement policy. For the twelve properties that received the highest abatement amounts in tax year 2018, the abated assessed value totaled nearly $1 billion, amounting to more than $13 million in forgone city property taxes (**Figure 20**).

However, the properties shown in this table are not representative of the abated-property universe as a whole. Although many of the more than 14,000 properties subject to the abatement in tax year 2018 received abatements of more than $10 million per property, most of them received abatements of less than $500,000.

2026-58 Market Street

2018 Abatement Amount: $1,154,747

17 East Springfield Avenue

2018 Abatement Amount: $269,169

Figure 20. Forgone 2018 Property Tax Revenue: High-Value Projects

Address	Abatement Assessed Value, 2018	Total	City Share	School District Share
2116 Chestnut Street	$120,365,370	$1,684,874	$760,348	$924,526
1919-43 Market Street	$109,200,600	$1,528,590	$689,820	$838,770
1900-24 Arch Street	$105,399,900	$1,475,388	$665,811	$809,577
1901-39 Callowhill Street	$102,535,470	$1,435,292	$647,717	$787,575
3400L Lancaster Avenue	$102,100,680	$1,429,205	$644,970	$784,235
2026-58 Market Street	$82,493,679	$1,154,747	$521,113	$633,634
3737L Chestnut Street	$63,733,950	$892,148	$402,607	$489,540
1100 West Montgomery Avenue	$57,107,280	$799,388	$360,747	$438,641
3200L Chestnut Street, Unit A	$57,090,150	$799,148	$360,638	$438,509
1112-28 Chestnut Street	$53,864,272	$753,992	$340,261	$413,731
777 South Broad Street	$50,482,170	$706,649	$318,896	$387,754
4700 City Avenue	$45,159,443	$632,142	$285,272	$346,870
Totals	**$949,532,964**	**$13,291,562**	**$5,998,199**	**$7,293,363**

Abatement Modifications

Three possible abatement term reduction approaches:

1. Limit the abatement amount to the first $500,000 of investment;
2. Limit the abatement term to five years;
3. Replicate the sliding-scale tax abatement approach used by many municipalities in Pennsylvania under the Local Economic Revitalization Tax Act (LERTA). In the first tax year following the completion of a development project, a project subject to LERTA may receive an abatement of 100 percent of the assessed development/improvement value, just as in Philadelphia. However, the abatement level decreases in each successive year, with a 90 percent abatement in the second year, and so on, with full taxation in the eleventh year.

With respect to these approaches, the City's share of the collected tax revenue could be allocated to a separate fund that would become the financing resource for the low-cost housing interventions described in Part 3. Under the first policy option, for example, 100 percent of the City's share of taxes on investment value exceeding $500,000 would be allocated to the fund for ten years. Under the second option, 100 percent of the City's share of taxes collected in years six through ten would be allocated to the fund. Under the third policy option, ten percent of the City's share of taxes collected in year two would be allocated to the fund, with a ten-percent increase each year, up to 90 percent in Year Ten.

This fund-allocation method would not be especially difficult to administer; it is similar to the approach used in connection with the financing of economic development projects through Tax Increment Financing (TIF). Certain tax revenues are assigned to a separate fund rather than combined with other revenues in the municipality's general fund. Although, in a typical TIF-supported project, TIF proceeds are used to pay-off bond financing, a bond issue would not be required in this instance.

In a 2014 report prepared for the City of Philadelphia by Jones Lang LaSalle Americas, Inc. (JLL) analyzed the impact of retaining the tax abatement at the 100 percent level for five years and subsequently phasing out the abatement through 20 percent reductions in years six through ten. JLL projected that this policy would result in a 30 percent "development loss" (Jones Lang LaSalle Americas, Inc., *City of Philadelphia Economic Impact Analysis of Proposed 10 Year Tax Abatement Adjustments,* May 2014). Given that the real estate market has grown stronger during the four years since the JLL analysis was completed, an updating of the "development loss" calculation may be appropriate.

Philadelphia skyline from the West

Preservation Approach

Another alternative would be to return to the policy of using the tax abatement exclusively to support rehabilitation projects, with no abatement for new construction ventures. This policy would be consistent with the one that was in effect when the ten-year tax abatement was initially introduced in 1997 as an incentive to encourage the conversion of older office buildings in Center City to residential reuse. The abatement was subsequently made available to new construction projects when this policy was expanded citywide in 2000.

Some of the new construction projects supported by the tax abatement are infill housing ventures that were built to respond to student demand for off-campus housing in neighborhoods in the vicinity of Drexel, Penn, and Temple. Some of these ventures are not well designed and have created an imbalance in the amount of student-oriented rental housing relative to housing occupied by other neighborhood residents.

Student Rental Housing, Temple University Area

Student Rental Housing,

University of Pennsylvania Area

Making the tax abatement available to rehabilitation projects exclusively would probably reduce the number of tear-down projects involving the demolition of older homes and their replacement with lower-quality new construction. In Chestnut Hill, for example, a developer nearly succeeded in demolishing a 130-year old Queen Anne home on Chestnut Hill Avenue and constructing four townhouses on the site.

The Chestnut Hill Conservancy was able to stop the demolition, and a subsequent agreement with the developer provided for the creation of a conservation agreement and the rehabilitation of the house. The agreement also allowed for the development of a portion of the rear yard area for new residential construction, the design of which is not particularly appealing or consistent with the appearance of the property's surroundings.

30 West Chestnut Hill Avenue

New construction in former rear yard area

If the tax abatement had previously been limited to rehabilitation projects only, then the plans for the Philadelphia Housing Authority's Sharswood-Blumberg Transformation project, which called for the acquisition and demolition of many existing occupied and vacant residential properties, might have been drafted with a greater emphasis on preservation. Participants in a 2015 Historic Preservation studio at Penn's School of Design documented such an approach in a detailed proposal.

2109 and 2111 West Master Street
Sharswood Blumberg Transformation Area

October 2015

January 2018

Illustration of Proposed Rehab/Infill Approach, 2400 Block West Thompson Street

Source: PennDesign Historic Preservation Studio, Sharswood-Blumberg: A Preservation Approach to Revitalizing a Neighborhood, December 2015.

IZ Variations

Some of the insights gained during the 2017 debate over inclusionary zoning legislation should be considered with respect to planning for a change in tax abatement policy. In addition to the possibility of using tax proceeds to fund low-cost affordable housing interventions, other incentives should be considered, including site assemblage in support of mixed-income housing ventures.

In a report produced for the Philadelphia Building Industry Association, Kevin C. Gillen, Ph.D. provides detailed documentation from four completed projects to support his argument that the implementation of Philadelphia's proposal would make it impossible for developers to earn a sufficient return on investment for them to consider continued activity in Philadelphia (Kevin C. Gillen, Ph.D., *Inclusionary Zoning in Philadelphia; An Economic Analysis of the City's Proposed "Mixed-Income Housing Program,"* Philadelphia Building Industry Association, October 2017).

Gillen's profiles of these projects show the relationship between sales or rent revenue, total development cost, and return on investment, as shown in **Figure 21**, for the 31 Brewerytown rental housing venture.

In communication with Kevin Todd, one of the contributors to this report, Gillen explained that the relatively high return on investment shown for this project was largely due to the fact that the developer had been able to acquire the construction site in 2005 at a much lower cost than its current value, producing a much lower Total Development Cost line item than would have been possible in today's market.

Gillen's presentation and this exchange suggest a possible opportunity. What would be the effects on project feasibility if the income requirements associated with the affordable units were less restrictive (i.e., by not limiting eligibility for the affordable units in a project such as 31 Brewerytown to households with incomes at or below 30 percent of area median income) and if the City were to offer development sites at nominal cost?

In the case of 31 Brewerytown, renting some of the units to a combination of some households with incomes of up to 50 percent of area median and other households with incomes of up to 80 percent of area median would improve the prospects for project feasibility while increasing the affordable housing supply.

31 Brewerytown rental housing venture

Figure 21. 31 Brewerytown: 100% Market Rate Scenario

NPV Gross Rental Revenue	$4,904,718
+ NPV Sale Value	$6,373,951
= NPV of Total Revenue	$11,278,669
- Total Development Cost	$10,286,445
= NPV of Cash Flows	$992,224
Cash-on-Cash Return	$1.10
ROI	9.6%

Gillen, *Inclusionary Zoning*

Public Land Trust

A policy in which the City reserved certain parcels for future mixed-income development--a kind of public-sector land trust--could be incorporated into current district plans published by the City Planning Commission and reinvestment strategies for target areas that the City has designated as priorities.

For example, the Promise Zone Comprehensive Housing Strategy documents housing development opportunities associated with parcels in the 46th Street Station Area and the Mill Creek Watershed Area that could produce a significant number of mixed-income units.

A large city-owned parcel on Parkside Avenue, across from Fairmount Park and west of a charter school, is currently being used as a Department of Public Works facility, largely devoted to parking for trucks. If another site could be found for this existing use (possibly in the vicinity of the rail line south of Parkside Avenue) then this well-located parcel and a nearby City-owned parcel west of it could be made available for mixed-income residential development.

All of these policy options deserve to be researched in more depth. As the documentation produced by both parties engaged in the inclusionary zoning debate shows, sufficient information about downtown and neighborhood real estate markets and about individual housing ventures completed in these markets is readily available and can be used in an evaluation of these alternatives.

4804-48 Parkside Avenue

25,544 SF (103’ X 248’)

4862-70 Parkside Avenue (corner 49th)

24,000 SF (120’ X 200’)

The ten-year tax abatement was, to a large extent, a response to the concerns of prospective developers about the competitive disadvantages of doing business in Philadelphia as opposed to the suburbs. The developers and their supporters cited four specific competitive disadvantages:

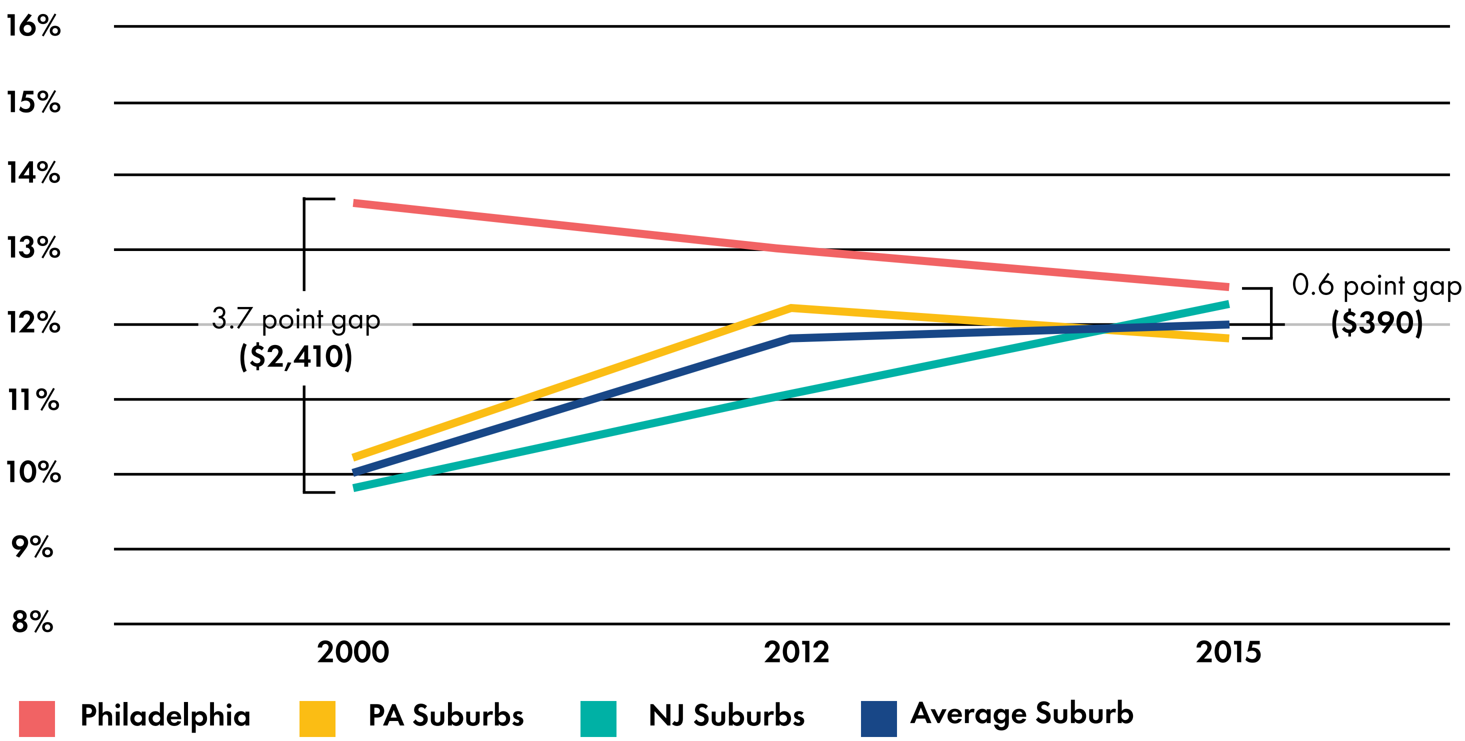
1. The city wage tax;
2. The quality of Philadelphia public schools compared with their counterparts in the suburbs;
3. The burdensome and time-consuming process for obtaining plan approvals, permits, and zoning variances; and
4. The high cost of labor, based on the political influence of the Philadelphia building trades.

To what extent has the environment for real estate investment and development changed in the two decades since the tax abatement was adopted?

Taxes

If other taxation, in addition to the city wage tax, is taken into account, Philadelphia's disadvantage relative to the suburbs as a whole has been minimized, although differences between the city and individual suburban communities may vary greatly.

Figure 22. City-Suburban Tax Gap for a Median Income Family



Source: The Pew Charitable Trusts "Shrinking Tax Gap Between Philadelphia andits Suburbs" November 16, 2016

Schools

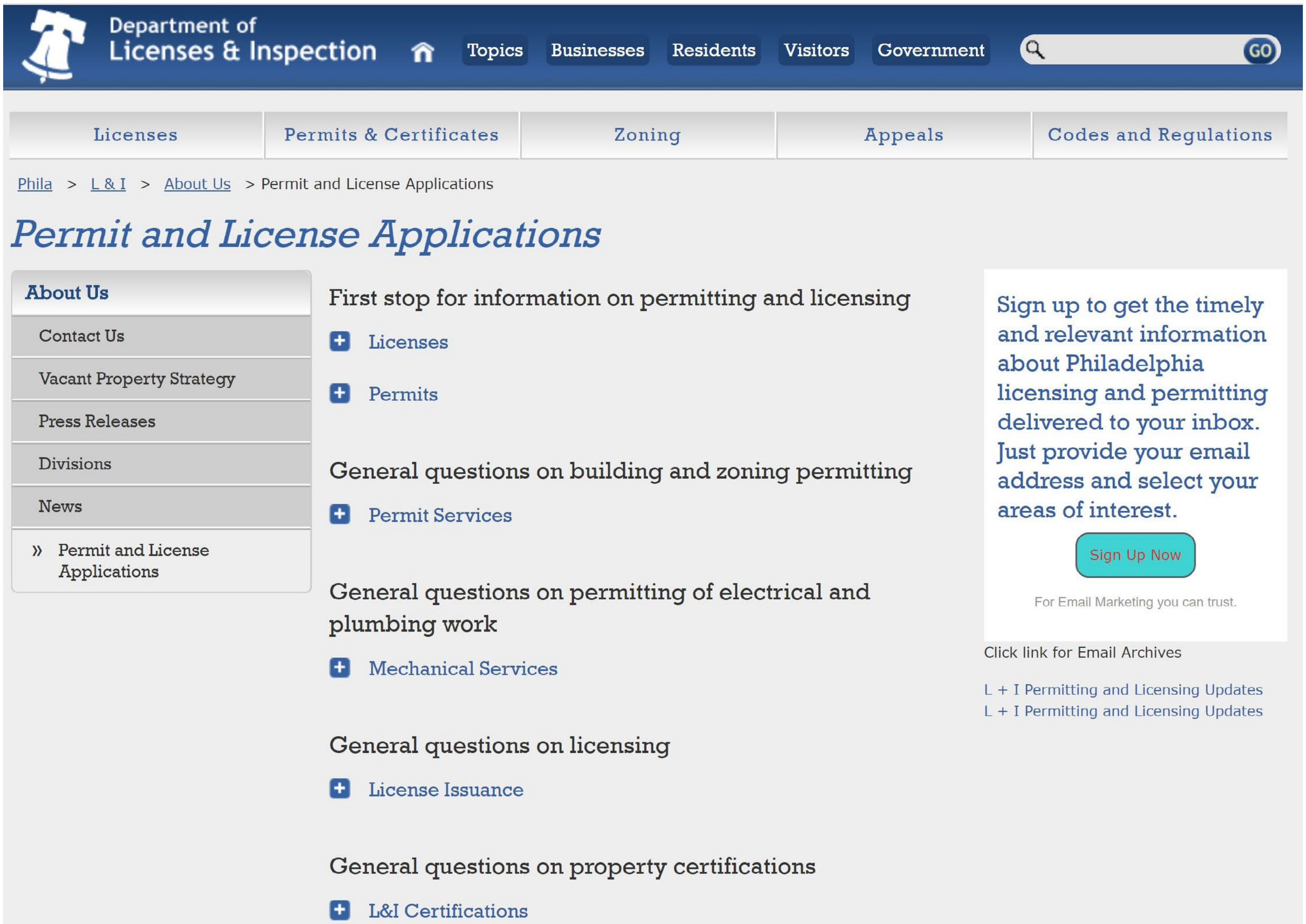
Following legislative approval of Pennsylvania's charter school legislation in 1997, many alternatives to the public education system began to emerge. Although families now have many more school options to consider, including both public and charter schools of high quality, Philadelphia schools as a whole are not competitive with public schools in nearby suburban communities.

Meredith Elementary School

Boys' Latin of Philadelphia Charter School

Plan Review/Permitting

Developers who have been highly critical of the Department of Licenses and Inspections' management of permitting and licensing processes in past years have expressed a high level of satisfaction with the department's performance in recent years. However, systemic issues beyond the control of L&I that can delay the review/approval process, such as requirements associated with the review of zoning applications by registered community organizations (RCOs), have no counterpart in the suburbs.



Source: City of Philadelphia, Department of Licenses and Inspections (http://www.phila.gov/li/aboutus/Pages/Appointments.aspx).

Building Trades

In September 2017, the City's Zoning Board of Adjustment (ZBA) rejected an application that would have enabled Post Brothers, a for-profit developer, to convert the long-vacant Quaker warehouse on 9th Street south of Girard into apartments. Post Brothers had negotiated an agreement with the local community organization that called for half the construction workforce on the proposed $100 million project to consist of African-American, Hispanic, or Asian workers, with ten percent of the labor force to consist of community residents. Although not stated at the hearing on the application, these workforce goals could not be achieved with an all-union labor force. Several months later, the Court of Common Pleas overturned the ZBA's ruling.

Although union participation in construction projects is not an issue to be given consideration in a zoning hearing, the building trades are well represented on the ZBA. Union members had previously interfered with construction activities at the Post Brothers' Goldtex apartments project site at 12th and Wood Streets over a protracted period during 2012, in reaction to the developer's engagement of nonunion contractors.

Other industrial buildings in the area have been approved for conversion to residential use, and no valid reason has been given for the ZBA;s rejection of the Quaker warehouse application.

Conclusion

Despite becoming a stronger city over that past several decades, Philadelphia still has many of the same disadvantages and weaknesses that it did in the 1990s. To the extent that Philadelphia is unable to fully overcome its longstanding competitive disadvantages, the City will need to continue relying on costly subsidies and incentives in order to attract investment and development. However, if Philadelphia can overcome its chronic disadvantages, the City could reduce or eliminate costly financial inducements that weaken the City and School District's funding base, create unnecessary financial burdens for taxpayers, and promote inequitable development.

The ten-year tax abatement has proven to be a source of great value during the past two decades by making Philadelphia more competitive despite its disadvantages. If adjustments are made as suggested in this report, the tax abatement could be used to more effectively bring additional value to the City as a whole and promote more equitable development in the nation's poorest big city.

Quaker Warehouse, 900 North 9th Street

Impact of Real Estate Tax Abatement on Home Purchase

by James E. Hartling, Urban Partners

The following commentary on the relationship between the ten-year tax abatement and the affordability of for-sale housing was prepared by Jim Hartling of Urban Partners, based on a preliminary analysis of the data file. Although a detailed review of these findings with housing developers was not possible due to project time constraints, preliminary responses from Jeffrey Allegretti, President of Innova Services Corporation, are provided in italics following each subsection.

Together, the observations by Hartling and Allegretti illustrate the desirability of further dialogue about the relationship between market value, tax abatement level, and buyer affordability.

For 2018, 13,756 residential properties benefit from tax abatements. As identified in City of Philadelphia data, the Market Value of these properties ranges from $7,300 to more than $133 million (see **Table 1**). Most properties with market values above $10 million tend to be multi-unit apartment complexes.

Table 1: Residential Abatements-2018

Market Value Range	No. of Abated Properties	Market Value Abated (%)	Amount Abated ($millions)	Abatement Value (%)
Under $100,000	649	70.0%	$19.4	0.3%
$100,000-$399,900	7,531	70.6%	$1,460.8	23.3%
$400,000-$699,900	4,019	71.2%	$1,444.7	23.1%
$700,000-$999,000	649	66.8%	$353.8	5.6%
$1,000,000-$1,999,999	569	70.0%	$538.6	8.6%
$2,000,000-$4,999,999	239	73.3%	$529.7	8.5%
$5,000,000-$9,999,999	38	63.3%	$169.0	2.7%
$10,000,000+	62	68.2%	$1,746.6	27.9%
Total	**13,756**		**$6,262.6**	**100%**

About 85% of residential properties receiving abatement have market values in the $100,000 to $700,000 range. The total abatements for 2018 are $6.26 billion, with about half the abatement value being provided to properties with market values in excess of $1 million.

Within all market value ranges, the percentage of market value abated is about 70%, though this percentage appears to drop a bit for owner-occupied properties valued above $5 million.

To examine how these abatements have impacted the affordability of new home purchases at various price points, three cases are examined in detail: a starter home priced in the vicinity of $325,000; a "move-up" home priced at $600,000; and a luxury condo priced at $1.5 million. On **Table 2**, these three examples are analyzed in terms of the likely impact of abatement on purchase price and the ability of homebuyers to complete home purchase.

Table 2: Home Purchase Impact of Abatements

Example 1: Starter Home	No Abatement	Abatement	To Match Abatement	Percent Reduction
Sales Price	$325,000	$325,000	$280,000	13.8%
Mortgage (10% Down pmt)	$295,500	$292,500	$252,000	
Monthly Principal & Interest	$1,396	$1,396	$1,203	
Taxable Market Value	$286,000	$286,000	$246,400	
Tax Base Abatement		$200,000		
Market Value for Taxation with Abatement		$85,800		
Real Estate Taxes	$4,003	$1,201	$3,449	
Monthly Principal, Interest & Taxes	$1,730	$1,497	$1,491	

Example 2: Move-up Home	No Abatement	Abatement	To Match Abatement	Percent Reduction
Sales Price	$600,000	$600,000	$520,000	13.3%
Mortgage (10% Down pmt)	$540,000	$540,000	$468,000	
Monthly Principal & Interest	$2,578	$2,578	$2,234	
Taxable Market Value	$528,000	$528,000	$457,600	
Tax Base Abatement		$369,600		
Market Value for Taxation with Abatement		$158,400		
Real Estate Taxes	$7,391	$2,217		
Monthly Principal, Interest & Taxes	$3,194	$2,763		

Example 3: Luxury Condo	No Abatement	Abatement	To Match Abatement	Percent Reduction
Sales Price	$1,500,000	$1,500,000	$1,300,000	13.3%
Mortgage (10% Down pmt)	$1,350,000	$1,350,000	$1,170,000	
Monthly Principal & Interest	$6,445	$6,445	$5,586	
Taxable Market Value	$1,320,000	$1,320,000	$1,144,000	
Tax Base Abatement		$924,000		
Market Value for Taxation with Abatement		$396,000		
Real Estate Taxes	$18,477	$5,543	$16,014	
Monthly Principal, Interest & Taxes	$7985	$6,907	$6,920	

Example 1--Starter Home: $325,000

More than 40% of residential properties receiving abatements sold in the range of $225,000 to $425,000. For a home priced in the vicinity of $325,000, without abatement monthly principal, interest, and real estate tax payments will be $1,730 at current conditions of home finance and City taxation. An abatement of 70% of market value would lower annual real estate tax payments from about $4,000 to $1,200, lowering monthly cost of mortgage and real estate tax payments to $1,497. ***Assuming purchasers of starter homes "stretch" to achieve homeownership, this abatement significantly increases affordability.*** For developers to deliver an equally affordable home without tax abatement would drop sales prices to $280,000. In many circumstances, developers would find it difficult to achieve this cost reduction and still produce a marketable product.

Allegretti response:

The margins between development cost and sales price are typically $25k-$50k, so there is no possibility of reducing the price to maintain the same affordability.

The impact should be characterized as reducing affordability dollar for dollar, because that is the practical effect

But there is more fundamental importance to the statement that, "More than 40% of residential properties receiving abatements sold in the range of $225,000 to $425,000." This means that the de facto "affordable" or "workforce" product is nearly half of all abatements.

Some neighborhood/civic constituencies argue that the abatements should only be offered for high end properties, which is another way of saying for the Center City market only. The above statement makes plain the reality that the abatement is an important tool for supporting "workforce housing" development, for buyers earning at median and just above median income. That puts the civics' argument on its head: eliminating the abatement for workforce buyers reduces affordable products in the market, whereas retaining abatements for high-end products has the effect of subsidizing the wealthiest buyers. It's unclear how much effect on pricing or demand there would be in the face of much stronger market forces.

Example 2—"Move Up" Home: $600,000

About one-sixth of residential properties receiving abatements sold in the range of $475,000 to $725,000. For a home priced in the vicinity of $600,000, without abatement monthly principal, interest, and real estate tax payments will be $3,194 at current conditions of home finance and City taxation. An abatement of 70% of market value would lower annual real estate tax payments from about $7,400 to $2,200, lowering monthly cost of mortgage and real estate tax payments to $2,763. Purchasers of homes in this price range may have more equity to invest; however, that merely adjusts the monthly cost of their mortgage under all conditions of taxation and does not significantly impact their ability and/or desire to increase their monthly housing costs.

Therefore, again, tax abatement significantly increases affordability. For developers to deliver an equally affordable home without tax abatement would drop sales prices to $520,000. At this price point, there are some options open to developers. As noted by one developer, development cost could be adjusted by reducing "some of the finishes/amenities compared to the $600,000 home" and "in a scenario where the abatement ended, I would also expect land prices to be depressed as the reduction in demand for finished homes affects homebuilder production and eventually demand for land."

Nonetheless, there is ***likely to be some reduction in demand, as less perceived value reduces homebuyer interest, although a partial abatement could overcome some of that resistance.***

Allegretti response:

Again, there is no way to make up an $80k difference by adjusting profits. Finishes might allow for $10k-$15k in adjustments, but that is not going to have much impact on closing the pricing gap.

As to the second part, we are already seeing some impact of the 10-year-old first-in products, with abatements exhausted, entering the market in competition with brand new products with abatement. That puts pressure on the first-in units to be priced low enough to compete without abatements the new abated products, and pressure on the new product to adjust to the increased supply of "like quality" products in the market.

Example 3—Luxury Condominium: $1,500,000

Homes, especially condominiums, selling in the $1 million to $2 million range represent about 5% of residential properties receiving abatements. For a condominium priced in the vicinity of $1,500,000, without abatement, monthly principal, interest, and real estate tax payments will be $8,000 at current conditions of home finance and City taxation, assuming the buyer secures a large (90%) mortgage. Many buyers in this price range, however, are likely to provide significantly higher down payments.

An abatement of 70% of market value would lower annual real estate tax payments from about $18,500 to $5,500, lowering monthly cost of mortgage and real estate tax payments to $6,900. Therefore, again, tax abatement significantly increases the attractiveness of the purchase. For developers to deliver an equally affordable home without tax abatement would drop sales prices to $1,300,000. At this price point, land value generally is a higher percentage of overall cost; ***therefore, we would expect adjustments in acquisition costs to developers to support some significant share of this sale price reduction.***

Purchasers in this price range can afford the higher monthly costs—will they pay them? Are there amenities they are willing to forego to lower development costs? Or will they increase their monthly costs to achieve the quality of product they desire?

Allegretti response:

Maybe, maybe not. Again, this high-end market is not as price sensitive to "affordability." It is the product and the location sought by buyers that could "afford" much higher prices if that is where the market ended up.

Beyond that, the impacts of eliminating or reducing the tax abatement for this market segment revolve more around consumer choices and less around affordability.

Note

Due to time constraints, some student research could not be finalized and integrated into this report. This research includes a preliminary analysis of how the real estate market might be affected by 1) reducing the abatement term to five years and 2) eliminating the abatement altogether, by Alexis W. Lee and Steve Zheng; and a compilation and graphing of data on tax abatements in eight zip codes by Jesse Earl Luke. This material is available for review, with the understanding that it has not been subject to final review/revision and finalized in preparation for publication.

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