
Measuring the Efficiency, Equity, and Success of Philadelphia's Residential Property Tax Abatement

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Philadelphia's 10-year property tax abatement program is a tax expenditure meant to stimulate economic development through residential construction and renovation. In an era when many cities appear to be experiencing renewed growth after the urban decline of the late 20th century, it may be time to reevaluate these sorts of economic development policies. This article explores three possible ways to evaluate Philadelphia's tax abatement as a case study for other cities with similar programs and asks whether it is the appropriate time to either restrict or end the program. The article assesses the abatement for its efficiency and equity, but most importantly, for whether and how well it achieved its goals. Based on this evaluation, Philadelphia's policy does not hold up well against the efficiency and equity criteria and its goals are either too broad to measure, or impossible to evaluate without a similar city to compare against. As a part of the analysis, the author considers the key questions of how much of the city's real estate comeback is directly due to the abatement and how to best reshape the policy to target Philadelphia's goals in 2018. The article also presents examples of abatement policies from other cities as models of how to shape such programs to fit a local context. The author finds that Philadelphia and cities with similar policies should look to other cities' targeted abatement programs and evaluate local priorities for growth when considering restrictions or terminations of their programs.

INTRODUCTION

In the latter half of the 20th century, many cities invested in economic development policies to stop the outward migration of residents and jobs to the suburbs. These policies also sought to encourage the redevelopment of dilapidated or abandoned structures in downtown areas. Today, many cities are experiencing renewed growth and attracting new residents, but these economic development policies of the past remain in place. One example of such a policy that many cities still employ is the residential property tax abatement, which encourages the development or renovation of housing stock by reducing property taxes on new or renovated housing.

Philadelphia currently offers virtually unrestricted, 100-percent property tax breaks for 10 years to those who build or renovate homes in the city. The city has changed dramatically over the lifetime of the abatement policy, particularly in and around Center City (Philadelphia's central business district). During this time, some of the objectives the policy set out to achieve have measurably improved: most notably, the real estate market appears to be healthier. In an era when cities continue to offer dramatic tax breaks to attract new businesses and residents, even during periods of apparent growth, it is important to question how much revenue cities should be forfeiting to foster activities that might happen regardless of these incentives.

Philadelphia's tax abatement has been hailed as a success by some real estate developers and building industry organizations who give the policy credit, at least in part, for the perceived recovery of the city's housing market (Gillen 2017). Supporters lobby for the abatement to continue or be expanded because it helps bridge the gap between the high cost of construction in the city and the relatively low sales and rent prices. By reducing the annual cost of homeownership to buyers, the policy allows developers to sell property within a more profitable range (Gillen 2013). The higher potential for profit encourages developers to invest in the city in an otherwise challenging market.

For some Philadelphians, however, the abatement remains highly controversial. Locals opposed to the policy perceive an increase in high-end construction, whose wealthy owners benefit from the abatement at the expense of a poor school district undergoing a fiscal crisis. They see a widening income gap in the city and increases in other local taxes as direct results of the abatement. The views of abatement critics are supported by local media reports that highlight projects, such as a recently completed ultra-luxury condominium building, whose new owners will be exempt from approximately \$2.2 million in property taxes annually for 10 years. That building, within a block of Independence Hall (a fashionable address in Philadelphia), has only 36 units, which are being sold for between \$3 million and \$18 million each (Saffron 2017). A project such as this underscores the critique that the abatement is subsidizing the wealthiest Philadelphians to build homes in neighborhoods that are already the best performing in the city.

Philadelphia's newly elected controller recently released the first assessment of the policy since its expansion nearly 20 years ago. The report analyzes the increase in revenues the city would collect if the policy were eliminated or restricted. Developers who benefit from the policy and some politicians would like to see this policy remain in place or even be expanded. Others argue that now is the time to restrict or eliminate the tax break altogether.

GOALS FOR THE PHILADELPHIA ABATEMENT

The Philadelphia property tax abatement policy has been expanded several times since it was first introduced. In the 1970s, Philadelphia adopted a policy exempting building improvements—any newly built structure or renovations to an existing structure—from property taxation for 30 months (Gillen 2017). In the 1990s, the city extended the property tax break to 10 years for projects that added residential units to commercial buildings. By 2000, the city government expanded that same tax holiday to all new construction and renovations for a full decade (Gillen 2017). This is the policy that remains in place today.

A review of local news coverage during the periods when City Council changed the policy reveals that as it was adapted over time, the city's goals for the abatement evolved as well. When the policy was first established, much of the discussion centered on blight and residential abandonment. A 1972 *Philadelphia Inquirer* article announced one of the first iterations of the property tax abatement for residential improvements—intended to help property owners rehabilitate their properties in neighborhoods where the housing stock was declining (Dunphy 1972). Eight years later, a letter to the editor decried the continuing trend of disinvestment as a “spreading, cancerous blight” and called for a tax abatement or similar policy to help the city address the problem (Smarkola 1980). Though the policy may have specifically targeted blight and abandoned homes, city officials may have intended it to address other problems Philadelphia was experiencing at the time, such as population loss, languishing homeownership rates, and high poverty (Philadelphia Controller 2018).

The city was still experiencing building abandonment and decay in 1997 when the abatement was first expanded to a full decade. This revision encouraged Center City property owners to convert empty office space into residential units after a study by the Center City District recommended such a change. Through this expansion, the city hoped to repopulate the urban center, where historic commercial buildings had become mostly vacant above the ground floor. City leaders thought that repurposing this vacant space would help save the building stock from decay and revitalize the neighborhood by attracting more people to live there (Center City District 1996). Once the neighborhood became more vibrant and populated after business hours, the city could expect an improvement to public safety as well. In addition to these targeted goals, news coverage regarding this policy change indicates that the abatement extension was generally meant to address a glut of vacant office space, spur development, and increase tax revenue in the long run (Gorenstein, Marder, & McCoy 1997).

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The city's objectives for the abatement evolved once again in 2000, when it was expanded to include all new construction and rehabilitation in all areas of the city for a full 10 years—the version that remains in place today. At the time, City Councilmember Frank DiCicco, a well-known champion of the policy, outlined its general goals. By broadening the abatement and removing the aspects specifically targeting vacant Center City buildings, the councilmember hoped to achieve several economic development objectives. Those objectives included encouraging residential construction, boosting the local construction industry, and making the city housing market more competitive with those in the suburbs by offering potential buyers more amenities with their purchase. News coverage also cites evidence that the new policy would help encourage current residents to remain in the city, thus stemming outmigration. The policy would also boost city revenues from resulting increases in income and sales taxes caused by the expected influx of new residents in the short run (Gorenstein 2000), and from expansion of the property tax base in the long run.

BACKGROUND ON RESIDENTIAL PROPERTY TAXES AND ABATEMENT POLICY

Property taxes are one of the oldest means of taxation in the United States, dating back to the British colonies. Today, they are a primary source of revenue for local governments and school districts. Public finance experts generally hold the property tax in high esteem because the tax base is stable, immobile, and usually grows over time with a community's revenue needs. Experts also view the tax favorably because there is a direct connection between the taxes being paid and the benefits received, which in this case are local services. Property owners however, tend to view the property tax with disdain, perhaps because it is highly visible (Brunori et al. 2006). In addition to funding local services, the property tax has other impacts, such as influencing who lives in which neighborhoods and what sort of housing is constructed in a given place. It can encourage or discourage rehabilitation, preservation, and economic development. The tax can also affect blight and abandonment (Farr 1977).

As one of the only revenue streams under the direct control of local governments, the property tax is frequently used to create incentives for economic development. Property tax abatements can be granted for residential properties, as discussed in this paper, but are also frequently employed by municipalities to attract industrial and commercial entities. These incentives generally serve several economic purposes including making the jurisdiction more competitive with neighboring communities and growing the property tax base in the long run. Property tax abatement policies are targeted at the improvements made to land, not at the land itself, which has the effect of making investments on the land more financially attractive. There is some disagreement among scholars as to whether property tax abatements are effective at spurring economic development. Studies have shown conflicting results, primarily for commercial and industrial abatements (Dalehite, Mikesell, & Zorn 2005).

Property tax abatements are tax expenditures: government spending by way of foregone revenues through the tax code. Like other tax expenditures, abatement programs have unintended consequences that can adversely affect both the market and other forms of taxes. In the case of the Philadelphia abatement, the policy reduces economic efficiency by subsidizing homebuying for the group most likely to have undertaken that activity anyway (Marr and Highsmith 2011). It also influences consumers' choices, possibly encouraging more homebuying, and hence, more building and renovating activity than would occur in the absence of the policy. This could lead to an inefficient allocation of resources (Shakin 2017). Tax expenditures can also cause subsequent increases in other types of taxes to compensate for lost revenue.

Some general criticisms of the property tax help explain why a city or town might grant economic development incentives through property tax breaks and illustrate some of the unintended consequences of such policies. Property tax critics hold that it discourages residential rehabilitation because as the value of a property rises, so too do the taxes levied on that property. By this logic, property taxes encourage owners to allow their property to deteriorate, causing a reduction in the overall tax base for the city and forcing the burden of financing local services onto other homeowners (Curran 1964). Some experts note that this inclination to avoid property rehabilitation may be particularly exaggerated for rental properties since the cost of improvements may not be able to be recouped through increases in rent (Farr 1977). Following this reasoning, a break from property taxes should remove such a disincentive to rehabilitate. However, many other public finance scholars disagree, noting that the decision to improve a property is made based on a combination of factors such as family size, return on investment, and prestige. The property tax is only one such factor (Curran 1964).

Some scholars believe that granting economic development incentives through the property tax is an admission that the tax itself discourages development and see the preponderance of property tax incentives as a threat to the tax in general. Scholars also wonder whether governments should manipulate the property tax in order to achieve a goal not directly related to revenue collection. As long ago as 1959, property tax scholars were aware of the potential pitfalls of these types of economic development incentives. At a housing policy conference that year, Mabel Walker, Executive Director of the Tax Institute, provided a warning: "We should be wary of expanding the nonrevenue functions that taxation is supposed to perform [...]. We should be particularly hesitant in utilizing the taxing power to correct sundry and diverse defects in the economic and social structure [...] for [...] we may unwittingly distort our tax structure and bring to pass new hardships and injustices" (Curran 1964).

There is a large body of research on property tax abatement policy in general, though the majority of this research focuses on abatements granted by states and localities for specific commercial and industrial projects. Such policies are similar in nature to residential property tax abatements in that they provide temporary tax reductions or exemptions and because they generally seek to foster economic development. However, the specific goals for these policies are not the same and their success or failure is measured differently.

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A 2010 study by Mark Rosentraub, Brian Mikelbank, and Charlie Post offers an excellent framework through which to evaluate residential property tax abatements. The study attempts to evaluate the effectiveness of such a policy in Cleveland, Ohio, which began in the 1980s to combat blight, attract new residents, and capitalize on some other major public investments the city had made downtown. The researchers found that the policy generated more in revenue growth than it cost in property tax reductions overall, but noted that despite the abatement policy, Cleveland still experienced an overall trend of economic decline (Rosentraub, Mikelbank, & Post 2010).

The Cleveland study looked at several indicators to determine the effectiveness of the abatement policy, including properties that would not have sold without the program, home value appreciation for houses near abated properties, increases in other revenue sources, and long-term gains in the property tax base. The study did not include a comparison group, acknowledging the difficulties of drawing conclusions across cities with unique contextual factors. Through a survey of homeowners who benefitted from the abatement, the researchers found that 60 percent would not have purchased their property without the tax incentive. The team found that Cleveland attracted wealthier homeowners during the abatement policy, effectively growing its tax base, and noted that the city real estate market became more competitive with that of the suburbs (Rosentraub, Mikelbank, & Post 2010).

As the Cleveland study notes, residential property tax abatement policies must strike a balance between their own objectives and those of the property tax as a revenue-generating source. These policies must positively influence a buyer's choice to locate within the city through a superior home inventory at more competitive prices. At the same time, a property tax abatement must allow a city to maintain strong public services, which are financed through the property tax and are required to effectively attract home buyers (Rosentraub, Mikelbank, & Post 2010). Without competitive schools, open spaces, and well-maintained infrastructure in the city, a property tax abatement policy could fail to provide sufficient incentives on its own.

STRUCTURE OF THE PHILADELPHIA POLICY

The Philadelphia property tax abatement effectively reduces the cost of owning a home in the city by taxing new or renovated properties at their pre-improvement value. For example, if a vacant lot is worth \$25,000 and a home worth \$275,000 is built on that lot, the whole property will continue to be taxed at only \$25,000 for the first decade after construction. For renovated properties, the abatement functions similarly. If a property originally worth \$100,000 is renovated, raising the value of the building to \$300,000, that property would continue to be taxed for 10 years at its pre-renovation value of \$100,000. The property tax abatement is granted to the first owner of the new or renovated property, incentivizing the buyer to purchase within the city. With the expectation of very low property taxes for 10 years, buyers can spend more than they otherwise would. The abatement is applied to the property for the full 10-year period and can be passed to subsequent owners within that eligible timespan. The following chart illustrates the hypothetical examples above.

Table 1. Examples of Assessed Property Taxes Before and After Abatement

| | Beginning Value | Post-Improvement Value | Assessed Value Years 1-10 | Property Taxes Years 1-10 | Assessed Value Year 11 | Property Taxes Year 11 | Cumulative Tax Reduction due to Abatement |
|-------------------------|-----------------|------------------------|---------------------------|---------------------------|------------------------|------------------------|---|
| New Construction | \$25,000 | \$300,000 | \$25,000 | \$350 | \$300,000 | \$4,200 | \$38,500 |
| Renovation | \$100,000 | \$300,000 | \$100,000 | \$1,400 | \$300,000 | \$4,200 | \$28,000 |

Source: Author's calculations based on applying property tax abatement policy to hypothetical examples.

The amount of savings for new homeowners can be quite significant. With a property tax rate of approximately 1.4 percent of the assessed value (City of Philadelphia 2018), every \$100,000 worth of improvements receives a tax break of \$1,400 per year (or \$14,000 over the lifespan of the abatement). The reduction in taxes increases with the value added to the property, without any cap on the benefit. For example, property improvements worth \$1 million receive a tax break of \$14,000 per year, or \$140,000 over the 10-year abatement period.

The School District of Philadelphia receives 55 percent of property tax collections as revenue (City of Philadelphia Department of Revenue 2017), so it is particularly impacted by the tax abatement. It is common for property taxes to serve as a primary source of revenue for local school districts (Harris & Moore 2013), so other cities' abatements would similarly affect their schools. By enacting the abatement, Philadelphia effectively narrowed its tax base and reduced the amount of revenue that the city's already highly indebted school district could take in.

Philadelphia's abatement, like those of other cities, may also shift the burden of financing local services onto less-wealthy, long-time homeowners and renters. Since the amount of taxes abated is directly proportional to the amount of dollars spent on improving a property, the wealthy—whose homes tend to be larger and more expensive—receive more of a tax break than those who spend less on more affordable properties. If the abatement shifts the city's revenue reliance to taxes on cigarettes and sugary beverages, or increased sales taxes, it may heavily impact those on the lower end of the income distribution who tend to spend a greater portion of their income on such items.

ANALYZING THE POLICY FOR EFFICIENCY AND EQUITY

There are a number of ways to evaluate the abatement policy including how efficient it is, how equitable it is, and whether or not it achieved its original goals. These analyses, however, all depend on one key question: what portion of the property improvements that occurred since the abatement took effect would have happened regardless of the policy? The following discussion centers on how the policy could be evaluated using different criteria if key information relating to the policy outcomes could be properly measured.

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The first general criterion upon which the abatement policy should be evaluated is efficiency. First, does the policy positively impact economic development while maintaining the city's ability to provide sufficient local services (Vaughan 1979)? Second, do the policy's benefits outweigh its costs? For the first criterion, a good measure of whether the abatement has been successful could be whether the city has been forced to increase taxes elsewhere to cover its losses from the property tax abatement.

A key indicator of efficiency is whether Philadelphia is able to fully finance its public services despite the loss of revenue from the policy. Over the lifespan of Philadelphia's abatement, the tax rate for real estate has increased several times, and another rate hike is proposed for 2019 (Philadelphia Controller 2018). Since the policy's last expansion, Philadelphia has also enacted a sugary beverage tax and increased both the cigarette tax and local sales tax in an effort to increase funds for school and education purposes (Philadelphia Controller 2018). These tax increases point to a city that is struggling to collect enough revenue to maintain a sufficient level of local services, highlighted by the poor financial state of the school district. If the property tax abatement is the cause of the increases in other taxes or the insufficient funding for the school district, it could mean that even if it is fostering economic development, it is doing so at the expense of the city's services. If Philadelphia's local services are viewed as inadequate and other taxes seen as too high, that could effectively dissuade people from moving to or remaining in the city, making the policy counterproductive and inefficient.

Another efficiency metric for the policy is whether its benefits outweigh its costs. The net benefit the abatement has had on economic development in the city is complex and discussed in the goals section of the paper. The cost is defined as the amount of revenue the city has foregone as a result of reduced property taxes. Since the policy's inception, the cumulative loss of property tax revenue due to the program is \$1.05 billion. Approximately 15,000 properties currently have active property tax abatements and are exempt from paying around \$93 million in taxes each year (Philadelphia Controller 2018). Since 55 percent of property tax collections are reserved for funding the Philadelphia School District, that means a cumulative \$577.5 million in school revenues have been lost so far, with a continued forfeiture of about \$51 million per year. In 2017, the school district collected \$720.5 million in revenues via the property tax, so the amount of forfeited revenue is approximately 7 percent of the total collections (Philadelphia Department of Revenue 2017). While the city will not recover the \$1.05 billion in lost revenue, as abatements expire the increased value of those improved properties will flow into the tax rolls. An additional discussion of how the abatement policy benefitted the city through short-run increases in sales and wage taxes and long-term increases in property tax revenue is found under the policy goals evaluation section.

It is worth noting that it is problematic to assume that no properties in Philadelphia would have been renovated or built were it not for the abatement. It is difficult, if not impossible, to determine precisely what percentage of building improvements are due to the abatement versus how much would have occurred in the free market, but

measuring the true economic benefit of the policy hinges on this question. The 2010 Cleveland study measured this impact through a survey of new residents who had purchased abated properties (Rosentraub, Mikelbank, & Post 2010), and while this may be the best way of measuring the factors that play into a person's real estate decisions, it is not a perfectly valid or reliable measurement.

The second criterion by which to evaluate the abatement policy is equity. In order for a tax policy to be considered equitable, those with more wealth should pay a higher tax rate (a concept known as vertical equity), and those with similar wealth should pay the same tax rate (horizontal equity) (Vaughan 1979). Horizontal equity is more applicable to the Philadelphia tax abatement and the key question is whether those with similar wealth (similar home values) pay the same taxes under the policy. Simply said, the answer to that question is no. Since the abatement excuses some tax payers from paying any tax on the buildings they own while forcing other homeowners to pick up the tab, it cannot be considered an equitable policy.

Beyond the question of whether the abatement is horizontally equitable, some criticisms of the policy point out that it gives a larger discount in taxes to wealthier people. If wealthier individuals pay lower tax rates under the policy than less-wealthy people, then the abatement contributes to making Philadelphia's property tax system regressive. In the tax abatement debate, there is evidence suggesting the policy is benefitting Philadelphians of a wide range of income levels, but other evidence that contends that the policy is regressive and inequitable.

A first step in identifying whether the policy disproportionately benefits wealthy individuals is to determine how the value of homes built under the policy compares to that of all other homes in the city. In 2017, the Building Industry Association (BIA) of Philadelphia released a study with the agenda of promoting the policy. The study touted the positive impact the abatement has had on the Philadelphia economy, including some details attempting to dispel the belief that the policy is only benefitting the wealthiest Philadelphians. The study finds that the highest concentration of abated properties is valued between \$200,000 and \$300,000. In fact, approximately 67 percent of all abated properties are valued at or under \$400,000, and only 2.8 percent of properties are assessed at over \$1 million (Gillen 2017). These statistics may be misleading, however. The city's median home value was last estimated at \$151,500 in 2017 (U.S. Census Bureau), and only a minority of abated properties are worth less than \$200,000.

Looking at the value of abated properties per square foot and at the abated properties near the top of the value distribution provides further evidence that the policy is enjoyed predominantly by wealthier Philadelphians. The Philadelphia Controller found in 2018 that the median value per square foot of a home in Philadelphia is \$105. The median value per square foot of properties with tax abatements is \$202, 93 percent higher than the average Philadelphia home (Philadelphia Controller 2018). The 12 most expensive properties with tax abatements are worth a combined total of approximately \$1 billion, which costs the city around \$13 million annually in lost

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property tax revenue (Adelman 2018). These numbers make a strong argument that the policy primarily benefits the wealthy.

The 2018 Philadelphia Controller report appears to confirm that the policy benefits higher-end properties. More than half of the total tax breaks are associated with the top 7 percent of currently abated properties. These properties have abatements of more than \$700,000 (Philadelphia Controller 2018). The abatement does not include the value of the land or any pre-renovated buildings on the site, which means that these properties are each worth in excess of \$700,000. The Controller also found that property tax abatements were highly concentrated, with 59 percent of all the tax benefit going to just six percent of the city's neighborhoods, all in greater Center City (Philadelphia Controller 2018). Since 2000, this area has experienced a 21-percent population increase, and residents there tend to be younger, more educated, and wealthier than the average Philadelphian (Center City District 2018).

HAS THE POLICY ACHIEVED ITS GOALS?

Examining how well the abatement achieved its original goals is another way to evaluate the policy. From its inception to its first and second alterations in 1997 and 2000, the policy was meant to generally promote economic growth. Since its latest expansion in 2000, it has had four primary goals, which were identified previously in the paper:

- Increase construction and renovation of residential properties, thereby boosting the local construction industry.
- Make Philadelphia's housing market more competitive with that of the suburban counties.
- Encourage existing residents to remain in the city and encourage new residents to move in.
- Increase revenue through wage and sales tax gains in the short run and expand the property tax base in the long run.

All of these economic development goals hinge on the "but-for" question regarding this policy. That is: How much of the building improvement that occurred since 2000 would not have happened *but* for the abatement policy? Absent a valid comparison city without a similar policy, it is not possible to estimate how many new homes and new residents would have come to Philadelphia without the incentive of the property tax abatement.

The following discussion considers how to evaluate the abatement policy on each of the four goals established earlier. It is crucial to note that even if the evidence points to Philadelphia's overall improvement based on the metrics of all four goals, this does not mean the abatement policy was necessarily the cause of all, or even part of that improvement.

GOAL 1: INCREASE CONSTRUCTION AND RENOVATION OF RESIDENTIAL PROPERTIES, THEREBY BOOSTING THE LOCAL CONSTRUCTION INDUSTRY

The abatement policy will have boosted the local construction industry if it effectively turns residential development in Philadelphia from unprofitable to profitable. Developers argue that the abatement is necessary because of the city's combination of high construction costs and the comparatively low sales and rental prices the local market can support. This claim is supported by data. When analyzing the cost to construct a single-family row house per square foot, Philadelphia is the fifth most expensive city in the country (Philadelphia Controller 2018). In terms of median home value per square foot, Philadelphia ranks 15th in the nation, and for rental value, the city ranks 14th (Philadelphia Controller 2018). Evaluating these statistics alone may suggest that the abatement is still necessary to stimulate the construction industry. In fact, a 2014 study by the city's Finance Department projected that phasing out the abatement over time could result in a 30-percent slowdown in construction activity (Adelman 2018).

The Controller's 2018 report analyzes the profitability of building homes in every zip code of the city using home sales data. The analysis confirms that building in Philadelphia is generally not profitable and that developers have a chance to turn a profit in only 13 of the 44 zip codes in the city under the current economic environment. The report notes that the zip codes where profit is currently possible are where the majority of abated properties are concentrated. However, the analysis goes a step further and evaluates zip code profitability *without* the benefits provided by the abatement. In this scenario, profitability generally falls to some degree everywhere, though all but four of the neighborhoods that were profitable with the abatement remain profitable without it (Philadelphia Controller 2018). This analysis suggests that while the abatement policy is, to some degree, achieving the goal of stimulating home building, it is not effectively changing unprofitable neighborhoods into profitable ones. The abatement is therefore not meeting the goal of stimulating increased construction activity. Instead, if this analysis is accurate, the policy is only boosting developer profits over what they otherwise would have been without the tax incentive.

The raw numbers of home construction in Philadelphia tell a more optimistic tale as the city's housing market shows signs of improvement between the period before the abatement expansion and the period after. In the 1990s, only around 5,000 housing units were granted building permits in the city during the entire decade. The decade following the policy expansion saw more than 16,500 new housing permits issued. The growth continued between 2010 and 2017, as more than 21,700 new residential units were granted permits (Center City District 2018). This growth in home construction is remarkable, but the boom could have been caused by other factors besides the abatement, such as an overall trend of migration back to city centers. The Controller's market analysis is more illustrative of how the abatement enables developers to build more housing rather than simply analyzing construction statistics.

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GOAL 2: MAKE PHILADELPHIA'S HOUSING MARKET MORE COMPETITIVE WITH THAT OF THE SUBURBS

The city reversed a trend from prior decades by beginning to outperform the suburban markets in housing starts and growth in median home value. The Building Industry Association (BIA) of Philadelphia, which advocates for keeping the abatement policy, released a report in 2017 detailing strong performance statistics attributed to the abatement. The report shows that prior to 2000, construction of new housing units was slower than in the suburban counties, but faster after the abatement was enacted (Gillen 2017). Since the policy's expansion in 2000, home-building activity in Philadelphia increased 376 percent while it fell 11.25 percent on average in the suburbs over the same period (Gillen 2017). Home values, though still less than those of the four suburban counties, increased 148.4 percent in the city between the 2000 U.S. Census and 2013-17 American Community Survey. The suburban counties saw value appreciation of 85 to 95 percent over the same period (U.S. Census Bureau).

Even if the property tax abatement achieved its goal of reviving the Philadelphia real estate market and making it competitive with the suburban markets, this outcome may be a reason to scale back or end the program. If the real estate market is healthy on its own now, then the abatement has done its job successfully and can be discontinued. As Phil Goldsmith, a former city manager and executive for the school district of Philadelphia, suggested: "At some point in time you have to say, we don't need the incentive because the market is carrying itself." He went on to add, "I don't think the school district should be subsidizing development" (Adelman 2018). Goldsmith's concerns echo those of many local critics of the policy.

If the market is healthy on its own and is competitive with the suburbs, the most economically efficient solution is to phase out the policy. However, the status of the market's recovery is also a major source of disagreement. Though signs of growth and revival are evident in the city's real estate market, developers argue that the activity is supported by the abatement policy, and without it, the performance of the city real estate market could fall.

GOAL 3: ENCOURAGE EXISTING RESIDENTS TO REMAIN IN THE CITY AND ENCOURAGE NEW RESIDENTS TO MOVE IN

It is difficult to measure how many people remained in the city or decided to move there because of the policy—a challenge illustrated by the Cleveland study discussed previously. In Philadelphia and other cities with similar programs, it is important to not only look at population trends overall, but particularly in areas where abated properties are concentrated. As discussed earlier, it is quite possible that the abatement policy attracted some people to stay in the city and enticed others to move in who otherwise would not have done so. It is also possible, however, that increases in other taxes or a perceived lower quality of public services indirectly caused by the abatement policy pushed other Philadelphians and potential newcomers away.

Measuring the city's overall population before and after the policy expansion tells a limited story as to how much the abatement encouraged either outside residents to move to Philadelphia or current residents to remain living there. From 2000, when the policy was last expanded, to 2017, the city's population increased by around 4.2 percent (U.S. Census Bureau). The United States as a whole grew 15.7 percent during that same period, and the state of Pennsylvania rose by 4.3 percent (U.S. Census Bureau). Looking at Philadelphia's population increase through this lens shows that the city grew at a rate approximately on par with the state, but far slower than the rest of the country.

Population changes in neighborhoods where most abated properties are located tell a much different story, however. Center City and its surrounding neighborhoods, where most abated properties are located, are indeed enjoying a population boom. Greater Center City grew by 21 percent between 2000 and 2017 (Center City District 2018), while the overall population of the city expanded by only around 4.2 percent (U.S. Census Bureau). However, many cities experienced population growth in their downtown areas over the same period, with or without abatement policies. Evaluating the policy on these observations without knowing exactly how much growth is directly attributable to the abatement does little to solve the question of whether the policy was successful. On the surface, it seems like Philadelphia grew considerably in areas where the abatement was most heavily used, but the city's slow growth overall, coupled with the much faster growth of Greater Center City, suggests that other neighborhoods did not fare so well. A good strategy for estimating how many people's decisions to move into or out of Philadelphia were impacted by the policy could be a survey of those two groups, but that measurement would still only tell a portion of the story.

GOAL 4: INCREASE REVENUE THROUGH WAGE AND SALES TAX GAINS IN THE SHORT RUN AND INCREASES IN THE PROPERTY TAX BASE IN THE LONG RUN

Philadelphia's wage and sales tax receipts over time reveal that the city experienced overall growth in both areas, which may indicate that the policy played some role in boosting revenues outside the property tax. However, it is still not possible to tell how much of this change is directly tied to the abatement. Higher tax rates could have caused these changes in revenue, which would have the effect of pushing some residents out of the city. Although one of the policy's goals was to increase wage and sales tax revenues, the actual growth that occurred could be due to rate hikes the city instituted precisely to cover its losses from the property tax abatement. In that sense, simply showing revenue growth is not necessarily a good thing. Nevertheless, Philadelphia's wage and sales taxes did generally increase over time when adjusted for inflation:

Table 2. Changes in Philadelphia Wage and Sales Tax Rates, 2000-17

| | Wage Taxes | Sales Taxes* | |
|--------------------|-------------------|---------------------|---|
| 2000 — 2010 | - 8.3% | +57.8% | <i>Source:</i> City of Philadelphia Pennsylvania Comprehensive Annual Financial Reports, FY 2001, FY 2010, and FY 2017. *2017 sales tax revenue numbers include sales taxes and sugary beverage taxes, which were implemented between 2010 and 2017. |
| 2010 — 2017 | +16.3% | - 2.1% | |
| 2000 — 2017 | + 6.6% | +54.4% | |

Note: All revenue calculations performed using inflation adjusted 2017 dollars (American Institute for Economic Research Cost of Living Calculator; <https://www.aier.org/cost-living-calculator> accessed 11/25/2018)

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It is worth noting that in both wage and sales tax cases, revenue growth has not been constant over the 17-year period analyzed. This suggests that a change in policy relating to the wage and sales taxes may be responsible for these changes, rather than the property tax abatement policy. Such a change could include an expansion of the taxable base, or an adjustment in the overall rate. If the abatement policy were truly responsible for the growth shown above, one would expect the revenue amounts to increase gradually over time, as population grew. The extreme rise in sales taxes suggests that the city could be relying more on sales tax receipts now than in 2000, a potential indicator of negative side effects that could be caused by tax breaks elsewhere in the code, such as the property tax abatement. It is not currently possible to separate out the increases in sales and wage tax revenue that were directly caused by the abatement policy in order to accurately estimate how well the policy achieved this goal.

The question of how much future property tax revenues will grow due to the abatement again encounters the but-for problem. To accurately estimate this revenue increase would require knowing exactly how the value of abated properties would have risen in the absence of the program. This is difficult to estimate without a valid comparison city to study. Nevertheless, the BIA of Philadelphia touts a future annual property tax revenue increase of \$122.6 million once all currently active abatements expire (Gillen 2017). This projection may be accurate, but it does not answer the full question of how the abatement policy itself helps the property tax base grow in the long run.

RECOMMENDATIONS

Recommendations for the property tax abatement should be based on how the city wishes to evaluate the policy's effectiveness and should be designed to improve that measure. The following set of recommendations is based on evaluating the abatement policy for its efficiency, equity, and how well it achieved its goals.

To improve the efficiency of the policy the city should consider changing the structure of the benefit to interfere less with the choices of buyers in the free market. Aside from eliminating the program altogether, another option might include transforming it from a tax exemption to a flat-rate rebate program with a definite cap on spending. This would enable the city to control the amount of spending on the program, and caps on individual projects would prevent very expensive developments from receiving enormous tax breaks. It would also make the program's expenditures much more transparent.

Other recommendations to improve the efficiency of the abatement policy should be designed to lessen its financial burden on the city. This sort of change should allow Philadelphia to provide high-quality public services without overburdening the city's residents through rate increases elsewhere in the tax code. The City Controller's recent report suggests several possible steps that might reduce the financial burden of the policy on the city and school district. The Controller suggests discontinuing the abatement for zip codes where construction is profitable without it or placing a cap on the total abated amount for each property based either on overall value or price per

square foot (Philadelphia Controller 2018). The Controller also considers removing the school district portion of property taxes from eligibility for the program or gradually shrinking tax breaks from a 100-percent abatement in year one to a 10-percent abatement in year nine before the abatement expires (Philadelphia Controller 2018). These options would both save the city money and make the benefits structure of the abatement less regressive, preventing ultra-luxury homes from not contributing a fair share toward local services. In that regard, several of the controller's recommendations would increase the equity of the policy. However, these recommendations could also have the unintended effect of slowing real estate development in the city. Just as the presence of the abatement encourages additional building improvements, the market without the policy would offer fewer incentives to build or renovate (Shakin 2017). This would effectively result in reduced growth of the tax base in the long run.

Other cities have taken a more targeted approach when setting goals for their abatement policies relative to Philadelphia's very broad set of objectives. This targeting ultimately makes these cities' policies less challenging to evaluate. Philadelphia should consider targeting its own program more strongly which would allow it to better estimate the actual impact of granting property tax abatements and allow the policy to be assessed on specific goal-achievement success measures.

Philadelphia's abatement program is remarkable for its length and lack of restrictions. Cleveland, Pittsburgh, and New York, among other cities, all have abatement programs, and their policies provide examples for potential ways to frame property tax abatement. Even though Cleveland offers full abatements on all property improvements for up to 15 years (five years longer than Philadelphia), it does so with the caveat that to qualify for the abatement, the construction or renovations must meet "green" building requirements for environmental sustainability (City of Cleveland 2018). In Pittsburgh, the abatement structure is organized geographically, with building improvements in some neighborhoods eligible for longer or larger abatements if the neighborhood is designated as needing investment. In some areas of the city, the amount of building improvements eligible for exemption is capped at \$250,000 (Pittsburgh City Controller 2017).

New York City has two abatement programs with different requirements. The 421-A program, which has been in place since the 1980s, excludes most of Manhattan where the real estate market is not in need of stimulus. The program also requires that affordable units be included in the project and any rental building with an active abatement must be rent stabilized for the life of the tax break (Tuman 2015). New York's other program, the J-51 abatement, is specifically designed for rehabilitation projects in order to increase the quality of housing and standards of living (City of New York 2003). These programs offer examples of ways that other cities have targeted their abatement programs to achieve measurable results and advance city priorities beyond simply economic development in general.

The city should work to determine any future priorities that the abatement policy could help to advance if it chooses to keep the policy in place. Does Philadelphia wish to increase affordable housing for low- and moderate-income earners? Is historic preservation too

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difficult and costly to undertake and in need of a stimulus? Are there neighborhoods that would benefit greatly from an influx of investment? If any of these questions can be answered affirmatively, a change to the property tax abatement may hold the answer to the problem. With a specific quantifiable target in mind, the effectiveness of the policy would also be much easier to evaluate.

Finally, the city could continue the abatement policy as it currently stands but change its overall property tax valuation structure to a split-rate system or reassess city properties and increase the assessed value of land relative to structures. A split-rate property tax system is one that taxes land at a higher rate than improvements. Such systems serve as a development incentive to landowners and encourage the most efficient and highest use of land that the market will bear (Brunori 2003). Such a system would fundamentally change the property tax abatement since the land upon which new buildings are built would accrue more taxes than under the current system. Implementing a split-rate system or simply reassessing land at a higher value relative to buildings would allow Philadelphia to retain its economic development incentive while lessening the fiscal impact of the policy and making the whole property tax system more equitable. It would also allow Philadelphia to collect more revenue to deliver higher quality public services. A split-rate tax system could also have other positive effects for land use in the city by discouraging vacant or underutilized property (Brunori 2003).

Split-rate tax systems are not a new concept and have already been used in cities such as Pittsburgh. In that city, the policy was credited with positively impacting economic development (though Pittsburgh has since done away with the practice). Other countries including Australia, South Africa, New Zealand, and Canada have also implemented split-rate systems (Brunori 2003).

Philadelphia itself even authorized a study in 2002 to reevaluate how it taxes land relative to buildings (Brunori 2003). While the fate of that study is unclear, it is certainly worth revisiting the concept today, amid a very different economic environment. As recently as 2015, current Mayor Jim Kenney's election platform detailed plans to accomplish this. He thought such a change would encourage improvements while discouraging vacancy and less-efficient land uses such as surface parking lots (Geeting 2015). Split-rate tax systems are not illegal in the state of Pennsylvania for home rule cities including Philadelphia and would likely not require any state-authorizing legislation (Geeting 2015). These systems may not be legal everywhere, however, so applying a split-rate system will not work in every jurisdiction.

CONCLUSION

The Philadelphia property tax abatement is facing renewed scrutiny in an era of rising taxes, a faltering school district, and a housing market that seems to have at least partially recovered from its slump in the second half of the 20th century. Now is an appropriate time for Philadelphia to reconsider its abatement policy, and cities with similar policies may want to do the same. The best strategies to alter an abatement policy are those that would improve its efficiency and equity, or that would restrict it to better achieve some

measurable goal. The most crucial first step for any city is to identify its priorities for property taxation, housing, and revenues, and determine how an abatement policy can be adjusted to advance these goals. Cities with the ability to alter their tax structure should also consider strategies such as a split-rate tax system to recoup more revenue from abated properties while still encouraging development (but at less of an expense to other city residents).

Based on the analysis in this paper, the Philadelphia property tax abatement is not functioning well in its current state, and so it should be altered, scaled back, or ended altogether. Other cities may come to similar conclusions about their own policies. In Philadelphia, the abatement policy could be considered inefficient if the loss of revenues associated with the program is causing rate increases elsewhere in the tax code. The policy is not equitable by nature as it taxes similarly valued homes in different ways by design. The measures the policy set out to improve may have changed for the better, but it is impossible to tell how much of that change is directly attributable to the tax abatement. In general, the broad nature of this program makes it extremely difficult to analyze in terms of how it achieved its goals.

When deciding whether or how to change a property tax abatement, or to eliminate it entirely, a city must first evaluate its priorities for efficiency, equity, and real estate development goals. As it currently stands, the benefits of these policies are difficult to quantify because of the lack of measurable criteria and the unresolvable question of how much of the increase in development a city experiences is caused directly by the abatement.

Certainly, Philadelphia is a much different place now than it was in 2000 when the policy was expanded, which can be said of many U.S. cities. For Philadelphia, moving forward to improve the policy requires the city to evaluate its 2018 needs and priorities. After identifying these goals, the city can craft a more efficient, equitable, and effective incentive for future development. Unfortunately, for Philadelphia and other cities with property tax abatements, it is difficult to determine the benefits of these types of programs in order to know when might be the right time to end or restrict them. Eliminating or phasing out an economic development program such as a property tax abatement even on a trial basis is a gamble but may be the only way to determine if the policy is no longer necessary.

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