Overview of 2018 Abatement Study

It has been four years since the City's last detailed analysis of the impact of the 10-year Real Estate Tax abatement on development, jobs, and revenues. During those four years, economic conditions have changed as the city emerged from the Great Recession, making it particularly important to revisit the impacts of this tax incentive. With the School District of Philadelphia facing a $630 million projected gap in its five-year plan, the Administration wanted to examine the impact of the abatement on City and District revenues in the short- and long-term. The Administration thought it important to update the economic analysis on the impact of abatements, and, after a competitive selection process, chose Jones Lang LaSalle (JLL), which had produced the 2014 analysis, to do a new study.

JLL's new report looks at options for changing the abatement compared to maintaining the current program. These options were developed by JLL with input from the Administration and members of City Council. The analysis looks at the impact of those options on likely new development, construction jobs, and City and School District tax revenue. In addition, the study looks at the impact of the recently proposed construction impact tax on these scenarios.

About the 10-Year Tax Abatement

The 10-year abatement of Real Estate Taxes exempts from tax the added value from new construction or rehabilitation of both residential and commercial properties, allowing the property owner to pay no tax on improvements for the full 10-year period. However, those receiving abatements do pay taxes on the value of the land and prior improvements.

Out of the 580,000 parcels in the city, 15,359 properties (3%) had active abatements in 2017. New construction accounts for about 53% of all abatement volume (8,185 properties). Therefore, nearly half of properties receiving the abatement are for existing housing stock that has been upgraded or stabilized. Properties with an abatement that expired in any year prior to this study paid a combined total of $75 million in Real Estate Tax in 2017. In 10 years, the revenue from currently abated properties is expected to generate $100 million per year, for a total of $180 million in annual value. Both the School District and City include revenue from expiring abatements in their five-year financial forecasts.

What We Learned

Gauging the value of any potential changes is difficult and relies on historical data to estimate what would have happened had the incentive not been in place. The study evaluated the expected development volume, jobs, and tax revenue of the current abatement program and considered modifying the current abatement by:

- Eliminating or significantly limiting the term of individual abatements;
- Gradually phasing out individual abatements;
- Capping individual abatement values on residential properties;
- Basing abatements on geography.

The analysis reached several conclusions, including:

- **Any curtailing of the abatement comes with the risk of losing development and related tax revenue over the long-term.** Changes to the abatement are likely to lead to a reduction in the number of projects developed in the city. Over a 30-year period, the current program is projected to generate more development, jobs, and tax revenue than scenarios that modify or decrease the incentive. The abatement still improves the city's competitiveness and helps offset the high cost of construction and lower relative investment return than can be earned in peer jurisdictions. Historical analysis indicates that having the abatement in place also helped the city recover from the Great Recession at the same pace as other major urban real estate markets, faster than it would have without the incentive.
- **With our current strong market, the benefits of the program are not as strong as they once were.** Improvements in the economy and local real estate market since 2014 mean that the impact of the abatement program has changed:
    - The difference between the impact of various scenarios is less dramatic than it was four years ago. In JLL's prior study, keeping the current abatement program in place generated 50% more in net present value over 30-years than eliminating the abatement completely. Now, those same cases are only 25% apart.
    - The current abatement program generates only $20 million more over 30-years on a net present value basis relative to eliminating the program completely.
    - While the current abatement program is still projected to generate more revenue in the long-term than any potential modification to the program, it takes longer than it did when studied in 2014 for the current abatement to provide more revenues and outweigh the near-term gains from proposed changes to the program. As shown in the table below, in 2014, it took between 15 to 18 years for cumulative revenues from the current abatement program to outweigh the total amount of School District revenue generated from the proposed changes. In 2018, those crossover points are now 18 to 22 years.

District Crossover Year Comparisons: Year Total Revenues Generated by Current Program Outpace Total Revenues from Modification		
Common Scenarios Examined: 2014 & 2018	2014 Study Crossover Year	2018 Study Crossover Year
Eliminate the full abatement immediately	15	18
Eliminate the School District portion of individual abatements	18	22
Phase out individual abatements after year 5 (by 20% per year)	15	18

There is no single "best" way to refine the abatement. Each option involves tradeoffs that policy makers need to weigh and consider.

- While each modification to the program would cost the School District money over the long term, over a five-year period, completely eliminating the abatement generates an **additional $7.8 million** for the District. Eliminating only the School District portion of the abatement generates an additional **$9.2 million** for the District over five years, the largest five-year gain of any scenario examined. The proposed Construction Impact Tax would reduce these totals by an estimated $148,000 and $164,000, respectively, over five years.
- Gradually reducing the abatement over time reduces the risk of development loss and related tax revenue loss because it allows developers time to adjust construction and financing strategies to account for these changes. For residents, a gradual reduction in the abatement allows homeowners a chance to absorb the incremental property tax increases over time.
- Among the proposals for modifying the abatement, ones that cap the abatement on residential properties at a certain threshold yield the most revenue for the City and School District over 30-years (net present value). This study does not apply value caps to commercial properties. Capping the value of the abatement would disproportionately impact commercial projects as those assessed values are generally much greater than the corresponding values on residential projects. Ultimately, applying these same caps to commercial properties would depress development and cost jobs.
- Limiting the abatement to certain areas of the city is unlikely to spur development in neighborhoods with low usage now unless it is coupled with an enhancement to the value of the abatement. Within this option, other targeted policy adjustments may be needed to preserve housing affordability and avoid displacing long-time residents or at-risk populations.
- Finally, any potential adjustments that come with a significant administrative burden for either the City or those seeking the abatement should be considered carefully as the challenges have the potential of diminishing the benefits of such options.

The Options: The below table summarizes the estimated loss of development, implied loss of construction jobs, the value of the abatement benefit over various periods, and the year in which projected revenue gains from modifying the abatement are outweighed by revenue that would have been generated under the current program. The higher the crossover year, the longer it takes for the current abatement program to generate more revenue than the proposed scenario. Additionally, the table presents other administrative considerations and estimated impacts with the proposed Construction Impact Tax.

Scenarios Examined	10-Year Loss of Development	Job Loss (FTE)	30-Year Net Present Value (NPV)	5-Yr Revenue to District	District Crossover Year	Combined Crossover Year	Administrative Considerations	NPV Loss w/ Construction Impact Tax	Job Loss w/ Construction Impact Tax
Current Program - No Change	--	--	$79M	--	--	--	--	4% to 6%	100 to 150 jobs
Eliminate the full abatement immediately	40% to 50%	1,700 to 1,900	$55M to $65M	$7.8M	18	15	Lowest difficulty	5% to 8%	3% to 5%
Eliminate the School District portion of individual abatements	30% to 35%	1,200 to 1,500	$58M to $68M	$9.2M	22	18	Low difficulty	8% to 11%	3% to 4%
Limit individual abatement terms to 5 years	30% to 35%	1,200 to 1,400	$55M to $65M	--	18	16	Low difficulty	3% to 5%	2% to 4%
Phase out individual abatements after year 5 (by 20% per year)	20% to 30%	800 to 1,000	$60M to $70M	--	18	16	Moderate difficulty	5% to 7%	5% to 8%
Phase out individual abatements starting year 8 (by 25% year 8, 50% year 9, 75% year 10)	20% to 25%	800 to 1,000	$60M to $70M	--	15	14	Moderate difficulty	4% to 6%	6% to 8%
Phase out individual abatements by 10% per year over 10 years	30% to 40%	1,100 to 1,300	$60M to $70M	$2M	19	16	Moderate difficulty	9% to 12%	2% to 3%
Eliminate the School District portion on value above the first $150 per square foot (residential)	10% to 15%	800 to 900	$65M to $73M	$1.3M	16	14	High difficulty	2% to 3%	1% to 2%
Eliminate School District's portion on value above $500k per unit (residential)	14% to 19%	500 to 600	$66M to $74M	$2.5M	20	16	High difficulty	3% to 5%	6% to 8%
Cap abatement at initial construction value	<5%	800 to 900	$60M to $69M	$0.9M	16	14	Highest difficulty	5% to 7%	1% to 3%

Notes: Job loss represents the 10-year reduction in construction jobs held by Philadelphians. Jobs would remain reduced by the number or percentage shown for the entire 10-year period due to the reduction in construction activity.

What's Next: While the study does not look at every potential change to the program, it looks at a sufficient number of examples to show the range of potential impacts. As policy makers and stakeholders engage in a robust discussion of whether to change the program and, if the program is changed, how, this study provides a foundation to understand how each option will impact tax revenue, jobs, and development in Philadelphia.