A PRIMER ON PHILADELPHIA REAL ESTATE TAXES

January 2013: Center City Residents' Association, Suite 2500, 1600 Market St. Phila. Pa. 19103 by Stephen N. Huntington Exec Dir. - 215 546 6719 - snh@centercityresidents.org

The New World of Realty Taxes – At present, Philadelphia realty taxes are calculated as follows:

> The current assessment, typically a fraction of actual market value, is multiplied by the "predetermined ratio" (32%) and multiplied again by the current tax rate of 9.771%, a calculation which results in an effective rate of 3.13%. Hence, a property currently assessed at $100,000 is taxed $3,130.

In February of 2013, under the Actual Value Initiative (the AVI) the Office of Property Assessment (OPA) will issue new market value assessments for realty taxes due in 2014 which will be calculated at:

> Actual market value multiplied by the AVI tax rate (to be determined by City Council and the Mayor this Spring and expected to be in the neighborhood of 1.2% to 1.5%).[1]

While any number of questions remain about the new AVI program, four points seem relatively certain.

- Assessments have not kept up with market changes for at least a decade so that the new AVI assessments will exceed current assessments. The numbers released so far suggest that the total of all current assessments will be around 40% of the total of all AVI assessments to be issued this February, so that for every $100,000 of assessed value in the current system there will be approximately $250,000 of assessments in AVI.

- The Mayor and Council seem committed to "revenue neutrality", meaning that the total amount of taxes generated in AVI's initial year should be no larger than the revenue total collected under the old system.

[1] This simple formula could become complicated if modifications are inserted such as the Homestead Exemption (see page 6) or caps/deferrals/subsidies (see page 8).

- To maintain revenue neutrality, the current tax rate will be lowered so that, for the City as a whole, the lower rate when multiplied by the higher assessment will yield the same bottom line.

- The assessment figures released so far, in the words of a Pew Report, suggest that there will "be a lot of owners who will see modest decreases – which means that they have been overtaxed in years past - and a smaller set of taxpayers facing increases, some of them steep".[2] If this is the case, many owners will pay less and the few who pay more will have to make up for the lower payments of the many to ensure revenue neutrality.

Real Estate Taxes and The City Budget - For fiscal year ending 2012, the real estate tax generated $1.134 billion, $501 million for the City (14.3% of $3.6 billion in total revenues) and $633 million for the School District (28% of $2.2 billion in receipts). On the City's ledger, realty taxes ranked second only to the wage tax which accounted for 34% of City receipts. In addition to its share of the real estate taxes, the School District receives 100% of the City's Use and Occupancy Tax, which generated $108 million in 2011-12, so that real estate revenue from both sources amounted to approximately 33% of the District's income.

An Overview of City Taxes As A Whole - Philadelphia's current real estate taxes are low when compared to other East Coast cities which obtain about twice as much of their tax revenue from real estate.[3]

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[2] "The Actual Value Initiative – Overhauling Property Taxes in Philadelphia" November 28, 2012 Pew Charitable Trusts Philadelphia Research Initiative authored by Emily Dowdell and Susan Warner and edited by Larry Eichel referred to hereafter as "Pew Report". Pg 13. This study is must reading for those interested in this topic and may be accessed on line at the following link. http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Philadelphia_Research_Initiative/Philadelphia-Property-Taxes.pdf

[3] Philadelphia obtained 17% of its tax revenue from real estate while comparable figures for New York and Washington DC were 41% and 36% respectively. Center City Reports "Employment: Creating Opportunity for Philadelphia Residents" Sept 2012. pg. 3. Philadelphia real estate revenues per capita are only about a quarter of the amount generated in Washington and a third of what is collected in Boston and

While Philadelphia's real estate taxes may be a bargain compared to other cities, the overall tax burden shouldered by Philadelphians is higher than the tax load carried by citizens in most cities.[4] The story is the same for the taxes levied on Philadelphia's businesses which ranked in the top 20 most taxed in a national survey of 421 cities.[5]

To compensate for its relatively low realty taxes, levies on wages and profits account for 66% of Philadelphia's tax intake. In New York the wage/profit portion is 34%; in Washington DC, 35%.[6] Critics note that lightly taxed real estate can't leave the City which is not the case for employees whose wages are taxed and businesses whose profits are taxed. In fact, employees and businesses have decamped with depressing regularity. Despite a 4% uptick in 2011, City employment over the long term has nosedived from 746,000 in 1990 to 656,000 in 2011, and City job losses from 2000 to 2010 were 250% higher than in the suburbs and five times the national average [7]. This trend bodes ill for the City's largest revenue source, the wage tax, which accounts for about 34% of all City income, including revenue from the Federal and State governments.

The Current Real Estate Tax System - The current structure is both opaque and unfair. The system lacks transparency because even when owners have a handle on their property's value, convoluted calculations are needed to convert a home's market value into its tax

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Hartford, all cities where commercial properties pay a higher percentage of real estate taxes than is the case in Philadelphia. Pew Report pg 8.

[4] While apples to apples comparisons of the tax burdens between cities are difficult to compile and should be taken with a grain of salt, it is still depressing to read a study of the burden of major taxes on families in the most populous cities in each of the 50 states and the District of Columbia. For families with incomes ranging from $25,000 to $100,000 in 2011, Philadelphia ranked either second or third most expensive. "Tax Rates and Tax Burdens in The District of Columbia: A Nationwide Comparison 2011". Issued September 2012.

[5] 2011 Kosmont-Rose Institute Cost of Doing Business Survey. This survey is frequently used by businesses in relocation searches. In the area from Washington DC north, Newark and New York were the only east coast cities included in the top twenty most expensive list.

[6] Center City Reports "Employment: Creating Opportunity for Philadelphia Residents" Sept 2012. pg. 3.

[7] Pew Charitable Trusts Philadelphia Research Initiative "Philadelphia 2011 The State of the City" pg. 14.

bill.[8] In addition to being opaque, a history of spotty and unprofessional assessments has created a system which unfairly levies widely varying tax bills on substantially similar properties.

Because Pennsylvania's uniformity clause has been interpreted as barring the taxation of property at different rates,[9] the City developed a work around in the form of a second real estate tax, the Use and Occupancy (U&O) Tax of 5.51% assessed on the commercial use of real estate but calculated on the assessed value of the real estate being used.[10]

The real estate tax rate has increased 17.3% via three raises in as many years, the last of which, enacted in 2012, amounted to 3.6 %. U&O taxes assessed against commercial usages were increased 20% last year, from 4.62% to 5.51%.

In 2012 it was estimated that 18% of the realty parcels in the City were in default owing a total of $515 million, a sum which had increased 9.4% in the preceding year.[11]

AVI (Actual Value Initiative) Reassessment - In 2014, real estate taxes will be computed on the AVI assessment of each property's fair market value. In preparation for 2014, the City's Office of Property Assessment (the OPA) is assessing the fair market value of the City's 579,000 properties (340,000 of which are owner occupied [12]). But even if these new assessments are delivered as scheduled in February, property owners will not be able to calculate their 2013 taxes due in 2014 until City Council and the Mayor legislate the AVI tax rate, a process that will occur this Spring.

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[8] Philadelphia uses a fractional assessment system that converts a property's market value to an assessed value by multiplying the assessed value by the "predetermined ratio", 32%. To calculate a tax bill, an owner must multiply the "predetermined ratio" (32%) by the assessed value and multiply that product again by the current tax rate (9.771%) to arrive at the 3.13% effective in 2012.

[9] Pa.Const. art. 8, s 1, P.S. (1969). In other jurisdictions such as Washington DC, Boston and Chicago, tax rates levied on commercial, industrial and/or vacant property are two to three times higher than the rates for residential property. Pew Report pg. 5.

[10] *Wanamaker v. Phil. Sch. Dist*. 441 Pa. 567, 274 A.2d 524 (1971).

[11] Plan Philly June 9, 2012 Patrick Kerkstra.

[12] Pew Report pg. 16.

Revenue Neutrality And The AVI Tax Rate - The Administration and various City Council members have pledged that AVI should be "revenue neutral", meaning that the total amount of taxes generated under AVI should be no larger than the amount collected under the old system.[13] To achieve revenue neutrality, a lower tax rate would be applied to the higher assessments.[14] But even if the total sum generated by the tax does not change, the amount paid by individual property owners in the new system will differ depending upon the differential between their current assessment and their property's AVI assessed value.

A December 21 Daily News article reported Mayor Nutter as stating that the assessed value of all but 16,000 of the City's properties amounted to $96.5 billion.[15] Nutter was quoted as "eyeing a 1.3% tax rate or a 1.4% rate with a homestead exemption that would lower assessments by $30,000". However, a 1.3% levy on total assessments of $96.5 billion would net $1.25 billion, $100 million more than projected receipts for fiscal year ending 2012. A 1.4% rate with a $30,000 Homestead exemption would generate slightly less, $1.21 billion but still $60 million more than projected receipts for FYE 2012. The question of whether, on a bottom line basis, these rates are revenue neutral depends on a number of factors including:

- The year selected as the benchmark for revenue neutrality
- Revenue shrinkage arising from collection difficulties and appeals successfully challenging assessments and

[13] Pittsburgh, but not Philadelphia, is prohibited by state "anti windfall" legislation from gathering more than 105% of its previous year's realty tax revenues via increased assessments as distinguished from an increase in the tax rate. 16 P.S. 4980.2.

[14] Figures released so far suggest that AVI city wide assessments will be approximately 2.5 times larger than the current assessment total. If this guesstimate proves correct, the tax rate in a revenue neutral scheme would be 1.25%, 40% of the current 3.13% rate. In a revenue neutral scheme assuming AVI assessments are 2.5 times larger than current assessments, the 5.25% U&O tax levied on commercial usage but assessed against property value would be decreased commensurately to around 2.2%.

[15] Apparently there was no discussion as to whether this $96.5 billion figure included properties subject to the ten year tax abatement which, during the ten year period, pay real estate taxes only on land and not on structures.

- The value of properties not included in the assessment such as the 16,000 unassessed properties

The Impact of A Homestead Exemption - Both Council members and the Administration have discussed implementing a Homestead Exemption for resident owners which would reduce assessments by the amount of the exemption. [16] If a $30,000 exemption were enacted, a house or condominium assessed at $100,000 would be taxed at $70,000 so that, if the rate were 1.3%, the exemption would decrease the tax bill $390 from $1,300 to $910.

In a revenue neutral AVI scheme, a Homestead Exemption would create tax savings for owners of relatively inexpensive properties and increase the tax bills for properties priced at the high end of City real estate. If each of the City's 340,000 home owners obtained a $30,000 exemption, total taxable values would decrease by $10.2 billion so that, assuming a 1.3% tax rate, `revenue generated would be $1.12 billion, $130 million short of the goal the Mayor is reported to be "eyeing". To make up for that missing $130 million, the tax rate would have to be increased 11% from 1.3 % to 1.45%.

While the Homestead Exemption does raise tax bills for higher value homes, the increases generated would significantly impact the carrying charges for homes in only a few corners of the City's most affluent neighborhoods. The tax increase on a $625,000 property generated by a $30,000 Household Exemption in a 1.45% system would only be $500/year or about 1.5% of the likely financing charges for such a parcel.[17] Few Philadelphia homes are worth more than $625,000.[18] The Homestead Exemption would not result in significant tax increases on homes in the City's rapidly growing neighborhoods such as

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[16] City property owners received a homestead exemption application form accompanied by a cover letter which suggested that the homestead amount would be $30,000 but the letter also contained an asterisk noting that the figure was "subject to change" because Council has yet to pass a bill setting the exemption amount.

[17] Assuming a $500,000, 30 year, 5% mortgage.

[18] The average 2012 sales price in the four Center City zip codes (02,03,06 and 07) covering Society Hill, Wash West, and the Rittenhouse Fitler neighborhoods was $546,703. Source Trend Multiple Listing Service.

Graduate Hospital (av. sale price $296,308) or Northern Liberties (av. sales price $335,564).

Realty Tax Sources: Homes/Businesses/Non Profits - Any discussion of adjusting tax rates to AVI should consider the relative share of total real estate taxes that should be shouldered by commercial and residential properties. Currently, commercial properties account for 44% of the City's real estate tax receipts, closer to 50% when the U&O receipts are considered. Philadelphia's commercial properties pay more than those in Baltimore (28%) but less than commercial realty in Hartford (55%), Boston (61%) and Washington (64%).[19]

Any discussion of tax rates also has to account for the large and growing percentage of land mass owned by the driving forces of Philadelphia's economy - hospitals and universities which account for 36% of City employment[20]. All that employment is good for the wage tax, but because "meds and eds" occupy tax exempt real estate, they diminish the intake for realty taxes. In 1995, a PILOT (Payment in Lieu of Taxes) initiative gathered $9 million for the City from more than 40 nonprofits. That income dwindled over the years to $387,000 in 2011 after legislation limited the exposure of nonprofits to municipal challenges regarding their tax exempt status. However, in a decision characterized as a "game changer", the Pennsylvania Supreme Court recently reinstated the former standards which led to the higher PILOT payments in the 90s. [21]

Work Arounds: Subsidies, Deferrals, & Revenue Caps - The AVI assessments will inevitably generate protests. Particularly troubling will be complaints of long time residents in gentrified areas whose home values have increased not because they have improved their properties, but because investments made by new neighbors have increased values in the surrounding area. The value of homes

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[19] Pew Report pg. 6. These percentage are not those presented in the Pew Report but are derived by subtracting the residential percentage found in the Report from a 100% total.
[20] Center City Reports "Employment: Creating Opportunity for Philadelphia Residents" Sept 2012, pg. 4.
[21] 10 P.S. 371 et seq.; *Mesivtah Eitz v. Pike County Bd. 44 A3d 3 (Pa. 2012). Pittsburgh Post-Gazette,* May 2, 2012, "Ruling 'Game Changer' for Non Profits".

owned by old timers in these neighborhoods may be out of kilter with their income levels. The logical fix would be a means test targeting tax relief for longtime homeowners which would take into account their income and assets. [22]

There are only three remedies for outsize real estate tax increases: cash subsidies, deferrals, and caps/freezes – all of which add complexity to the system and call upon taxpayers not included in these programs to shoulder their costs.

There are tax relief programs currently in place which do not provide the measures of relief needed to address issues presented by AVI:

- *Cash subsidies* – In 2011, 12.2% (41,858) of the City's owner residents received Pennsylvania Lottery property tax rebates averaging $546 given to elderly/low income citizens, a sum which would pay for $42,000 of assessed value in a 1.3% system or $37,600 in a 1.45% system.[23]

- *Deferrals* – A homeowner whose real estate taxes are increased by more than 15% in any given year may apply to the City seeking a deferral until the home is sold although the balance deferred carries above market rate interest at 6%.[24] Also available for low income residents is an installment payment program.[25], [26]

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[22] A state statute permits gentrification relief for longtime residents but, for Philadelphia County only, bars financial need from being a determinant. 72 PS 4749.6.

[23] The program is available to owners over 65 or widowed owners over 50 with incomes of less than $35,000.

[24] Sec. 19-1307 Philadelphia Code. The Revenue Department is directed to review the income, expenses and assets of the applicant in using its discretion to issue the deferral. The Pew Report at pg 15 states that "the program has not had a single participant".

[25] The Pew Report at pg 15 states that the 7 other cities surveyed did not restrict installment programs to low income residents.

[26] Part of the City's tax delinquencies, albeit a relatively small part, may arise because 40% of the City's homeowners have no mortgage so that their taxes are due in a lump sum rather than amortized through 12 monthly mortgage payments.

- *Caps/freezes* – A property tax freeze protects older low income residents against tax rate or assessment revisions for which 13,362 owners qualified in 2011.[27]

Carrying AVI Into the Future - AVI's immediate success will depend in large part on whether those taxpayers asked to pay more believe the new system is fair. The task of explaining AVI's merits will fall on the Administration's shoulders. In this city of neighborhoods, it should be conducted face to face, community by community.

Looking further down the road, AVI market based assessments will permanently eliminate one current problem: the present system's lack of transparency. Property owners will be able to easily calculate what they should pay and, perhaps more important, what their neighbors should pay. But as time passes, the current system's second problem, fairness, will inevitably resurface unless assessments are regularly adjusted because future investments and urban trends will make some properties more valuable and depreciate values elsewhere either on a comparative or absolute basis. Accordingly, future budgets must designate sufficient funds to ensure that regular reassessments are conducted by a workforce which is well staffed, properly funded and adequately trained.

[27] Pew Report pg. 14. The program is available to owners 65 or older with incomes of less than $31,500 for a couple or $23,500 for single persons.