AEI Housing Center

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Tax abatements: The best kept secret to revitalize struggling communities – without taxpayer money

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Disclosure:
The authors have a financial relationship with Places Platform LLC, which is interested in meeting housing supply shortages through walkable oriented development and in the development of metrics for all types of real estate.

Detroit: A Plague of 134,000 Vacant Residential Lots

- Detroit continues to have a massive vacant residential lot problem.
  - The AEI Housing Center estimates that Detroit has 134,000 vacant lots – about 36% of its residential lots.

Map of Vacant Parcels in Detroit

Source: AEI Housing Center, www.AEI.org/housing.

The Framework

Upper left quadrant is the focus of this presentation.

Your Community is Struggling **Surrounding Communities are Thriving**	**Your Community is Thriving** **Surrounding Communities are Thriving**
Your Community is Struggling **Surrounding Communities are Struggling**	**Your Community is Thriving** **Surrounding Communities are Struggling**

Source: AEI Housing Center, www.AEI.org/housing.

Single-Family Detached Homes Built from 2010-2018 around Detroit & Adjacent Areas

Map of Single-Family Detached Homes Built from 2010-2018

Note: Due to reporting latency for Wayne County public records, 2018 is the most recent reporting year for newly constructed homes.
Source: AEI Housing Center, www.AEI.org/housing, https://heat.aeihousingcenter.org/toolkit/year_built_map

How to Change the Economics of Development

The fundamental problem is a mismatch between construction costs and new construction sale prices/rents.

- High property tax rates depress home prices and rents.
  - Philadelphia: Baltimore rents with NYC construction costs.
  - Due to Detroit's high tax rate compared to its neighbors, builders/developers are unable to build and sell at a profit.

A well-designed tax abatement program can transform project economics, making construction financially viable by temporarily reducing tax burdens.

- Reduces property tax costs for a set period, improving cash flow.
- Enhances developer profitability, as homebuyers and property managers are willing to pay higher purchase prices in exchange for lower property taxes during the abatement period.
- Encourages investment in new construction by mitigating financial risk and improving project feasibility.

The tax abatement program has distinct advantages over other forms of development:

- Does not require any immediate government expenditures and the forgone revenue is temporary.
- Is superior to substantial rehabilitation or new construction subsidy programs:
  - Does not inflate costs and can't be corrupted.
  - It is simple; unleashes a swarm of small builders, developers, subcontractors, lenders, and workers.
- Expires after a fixed period (say 10 years), after which the city collects the full tax amount, bolstered by property value increases from the city's renewal.

Source: Brookings Institute, Central Philadelphia Development Corporation, University of Pennsylvania, WHYY, Philadelphia City Government, Journal of Policy Perspectives, Census, and AEI Housing Center, www.AEI.org/housing.

How a Tax Abatement Works – Example: Philadelphia's 10-Year Tax Abatement

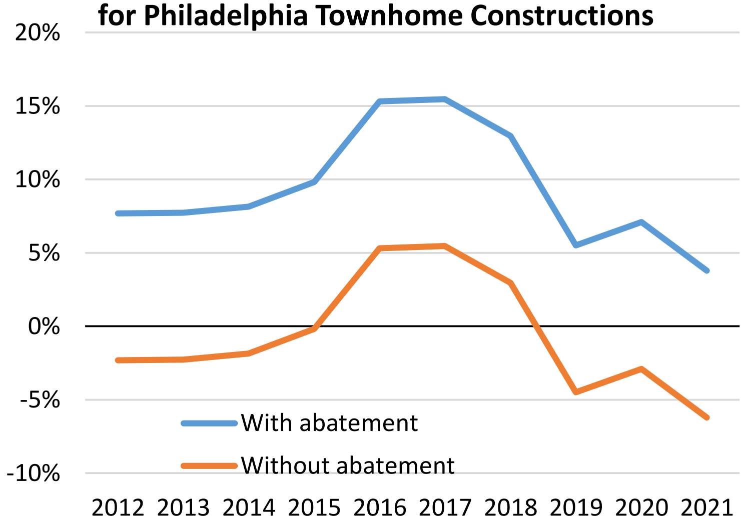
Insights from a 2024 FHFA Study*

- Premium calculations:
  - The price premium from the abatement is theoretically the present value of the future tax savings. However, the true impact is uncertain due to variable factors like home price appreciation, policy adjustments, and discount rates.
- Price effect:
  - The study estimates around a 10% increase on newly built home prices. This corresponds to nearly full capitalization of the property tax abatement into prices.
- Beneficiaries:
  - The abatement policy effectively incentivizes new development by raising the prices that builders can command for new construction. Not mentioned in the FHFA paper is that buyers can finance this price premium, which is more than offset by the lower taxes, which lowers their monthly payment –all else equal. This thus makes it easier for buyers to qualify for the loan.
- Expected price trends:
  - The analysis predicts that the 10% price increase should taper off each year, vanishing by year 11 as the abatement expires.

Our Insights

- Profit margins are normal and without tax abatement, many projects would not have worked.
- Without tax abatement, profit margins for actual townhome construction would be about 10 ppts. lower. Without the tax abatement, most townhome projects, especially those built after 2010, would not have been feasible.
- A "normal" profit margin is about 10-15%.

Average Profit Margin for Philadelphia Townhome Constructions



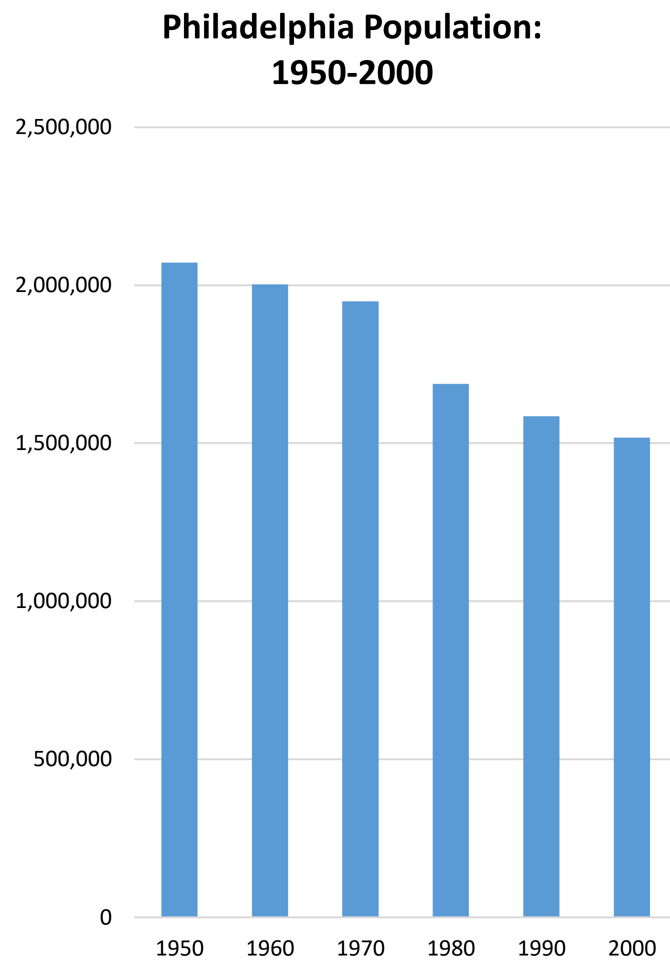
* Coste, Jonah. Capitalization of Property Tax Incentives: Evidence From Philadelphia. Federal Housing Finance Agency Working Paper, 2024. Available at: https://www.fhfa.gov/sites/default/files/2024-01/wp2401.pdf.

Source: FHFA and AEI Housing Center, www.AEI.org/housing.

Philadelphia 10-Year Tax Abatement Case Study

In 2000, Philadelphia faced a bleak future: depopulation, urban blight, & strained city finances

- Philadelphia's population shrank for five straight decades (1950-2000), declining from an all-time high of 2.1 million residents in 1950 to 1.5 million in 2000.
- White residents increasingly moved to growing suburbs.
    - From 1980-2000, the population in Philadelphia City declined by 10%, while the surrounding suburbs grew by 15%.
    - From 1970 to 2000, the total number of jobs in Philadelphia, especially industrial jobs, declined by 200,000.
    - At the same time, the number of jobs in suburban counties consistently increased.



Source: Brookings Institute, Central Philadelphia Development Corporation, University of Pennsylvania, WHYY, Philadelphia City Government, Journal of Policy Perspectives, Census, and AEI Housing Center, www.AEI.org/housing.

In 2000, Philadelphia faced a bleak future: depopulation, urban blight, & strained city finances (cont.)

- Depopulation also had an impact on urban blight: As the population declined, demand for homes declined with it. This led to more and more townhomes becoming derelict, abandoned, and then eventually torn down, leading to an explosion of vacant lots.
  - "In 2000, Philadelphia had more vacant and abandoned properties per capita than any other large city," consisting of "26,000 vacant houses, 31,000 trash-strewn vacant lots, and 2,500 vacant industrial and commercial structures."
- Philadelphia also had roughly 35,000 abandoned cars in early 2000, often dominating entire vacant lots, like the picture on the right.
- Some tracts, particularly those around Center City, had vacancy shares of more than 50% in 2003.

Abandoned Cars in the City of Philadelphia

Source: Census, NBC10 Philadelphia, and AEI Housing Center, www.AEI.org/housing.

To reverse these trends, Philadelphia enacted a ten-year property tax abatement program applicable to all newly-built or renovated homes

1990s

Center City's Revitalization

- Philadelphia's Center City District (CCD), a business improvement district undertaken in the 1990s, may have played a major role in Philadelphia's renewal story.
  - But St. Louis's example seems to show that broad renewal is possible without a center city-based renewal approach.
- In 1997, CCD expanded an existing tax abatement program to 10 years for commercial-to-residential conversions, which was successful in reducing office space glut and increasing the residential population in the city.

2000s

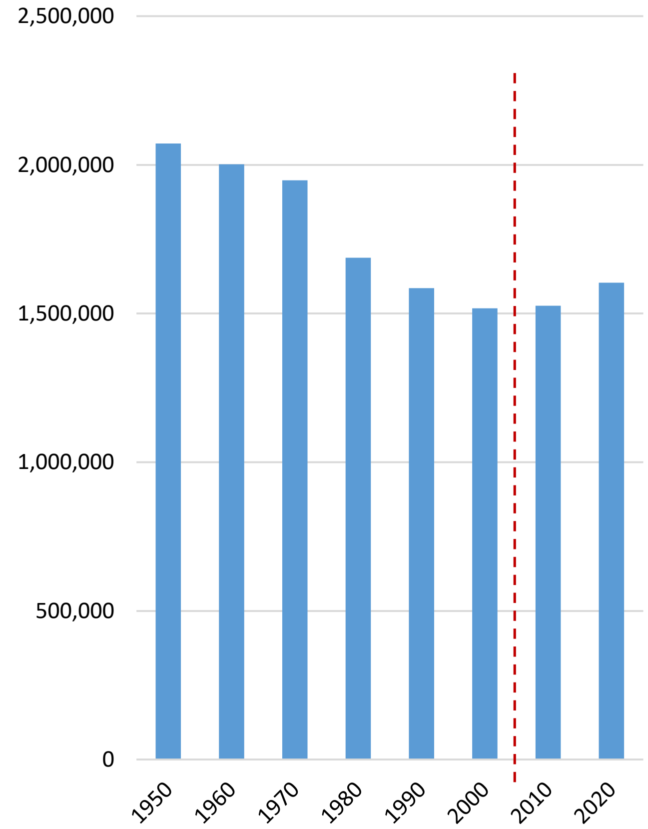
The existing ten-year property tax abatement program for commercial-to-residential conversions was expanded to include newly built residential structures and renovated homes

- In 2000, Philadelphia enacted a ten-year property tax abatement program applicable to the improvement value of all newly-built residential structures or renovated homes.

Thereafter

Reversing decades of severe decline, Philadelphia's population grew by 1% from 2000-2010 and by 5% from 2010-2020.

Philadelphia population: 1950-2020

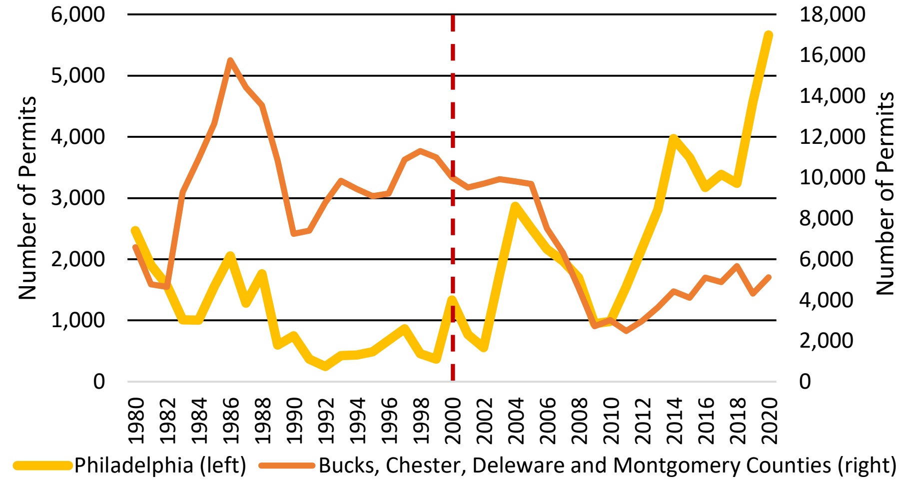


Source: Brookings Institute, Central Philadelphia Development Corporation, University of Pennsylvania, WHYY, Philadelphia City Government, Journal of Policy Perspectives, Census, Federal Housing Finance Agency, and AEI Housing Center, www.AEI.org/housing.

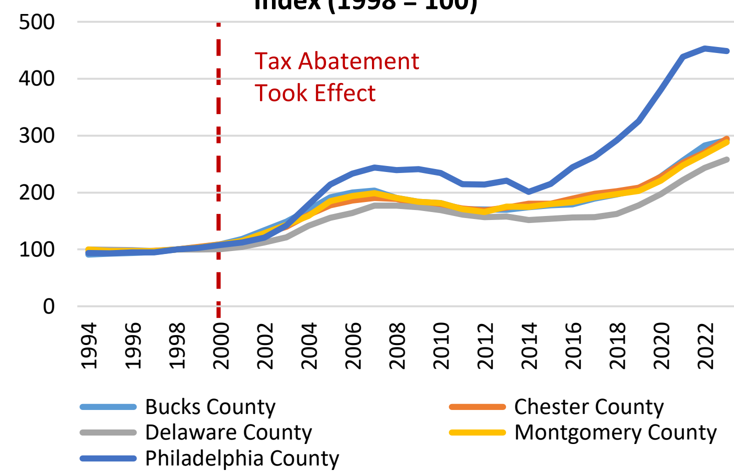
With the expanded 10-year tax abatement in place, new housing construction quickly shifted from the suburbs to the city by making urban projects more competitive, a significant advantage for Philadelphia

- Since 2000, Philadelphia county's residential building permits grew even as they fell in 4 neighboring counties. This divergence is particularly noticeable after 2010 (top chart).
    - Philadelphia's urban in-fill development replaced some of suburban green-field development in the 4 suburban Pennsylvania counties (Bucks, Chester, Delaware, & Montgomery).
    - With new construction becoming profitable, building in the city became a viable alternative to building in suburban areas.
    - From 1996-1999, suburban permits were 14 times Philadelphia's. By 2020, Philadelphia's permits slightly exceeded the suburban total.
    - In short, tax abatement leveled the playing field, allowing the City of Philadelphia to compete with its suburbs.
- Since 2000, property values (adjusted for the gross living area) for homes built before 1980 have also diverged between Philadelphia and adjacent Pennsylvania counties, indicating the increased attractiveness and demand for Philadelphia's older housing stock (bottom chart).
    - This has significantly reversed the effects of blight and helped increase property values of existing townhomes and 2-4 unit structures by an estimated $27 billion.

Total Number of Permits (Single-Family and Multifamily) by Geography: 1980-2023



Median Price per sq. ft. of Gross Living Area (Single-Family Detached, Townhomes, Condos, and Duplexes) Built Before 1980: Index (1998 = 100)*



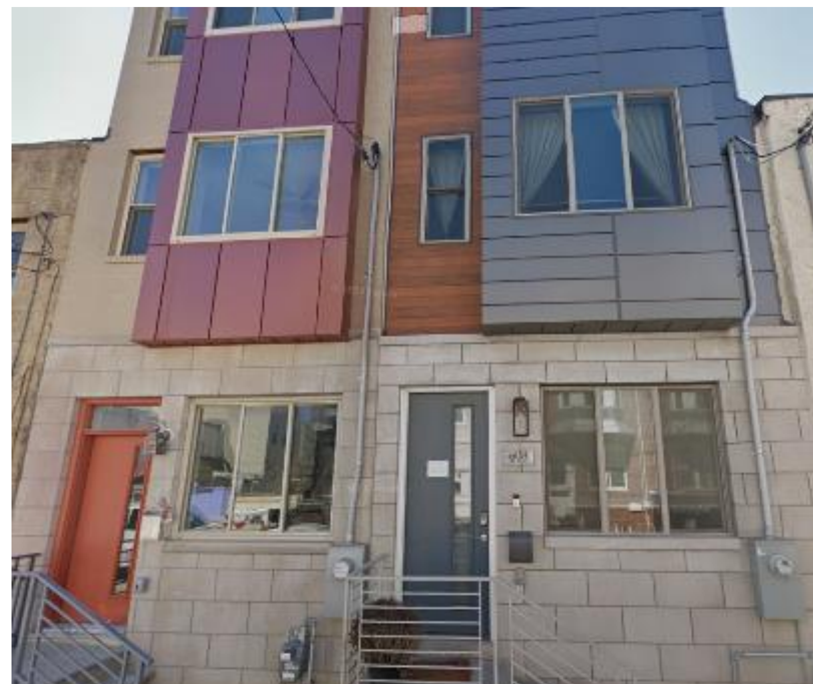
* We use public records sales and assessor data to calculate a median sale price per sq. ft. of gross living area. While we limit the sample to homes built before 1980, this is merely to measure home prices trend on a constant-quality basis. The results can be generalized to newer houses as well.
Source: Census Bureau Permit Data, housing.data.app, and AEI Housing Center, www.AEI.org/housing.

Example: Vacant lots began to be converted into new townhomes

- One example of two adjacent lots in the southeast quadrant of South Philadelphia.
  - They are located on [606 and 608 Hoffman Street] and had been vacant since at least 2007.
    - These homes are in the southeast portion of South Philadelphia and City Council District 1 (with a 4.3% vacant townhome lot share in 2023).
  - These lots combined are 1,100 square feet.
- In 2020 and 2021, new townhomes were built on the vacant lots.

Lots as seen in 2009.

Properties as seen today:
Left: 4 bd, 3 ba, 2,100 sq. ft. gross living area. Listed for $475,000.
Right: 4 bd, 3 ba, 1,600 sq. ft. gross living area. Sold for $417,000.



Source: AEI Housing Center, www.AEI.org/housing.

Example: Entire blocks were renewed

- Example from Olde Richmond in the Kensington/Frankford sub-market in City Council District 1.
- 2003: Census tract with a 20% vacant townhome lots, and many older, poorly maintained townhomes.
- Today: Mix of older, well-maintained townhomes and new ones. The vacant lot share decreased by 14 ppts. (from 20% to 6%), eliminating substantial amounts of blight and boosting home values.

Google Streetview Image as-of August 2019
(As seen from the perspective shown by the arrow below)

2004

2023

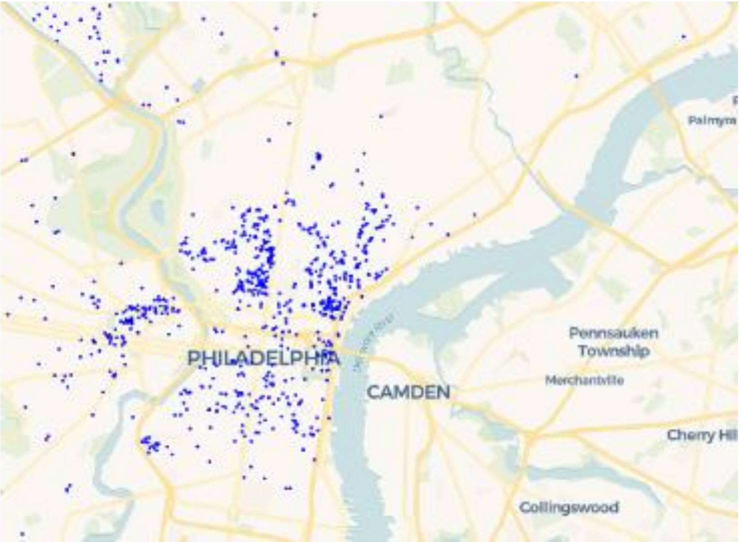
Source: Google Earth Pro, AEI Housing Center, www.AEI.org/housing.

Smaller buildings distributed the benefits of development more evenly and widely than larger ones

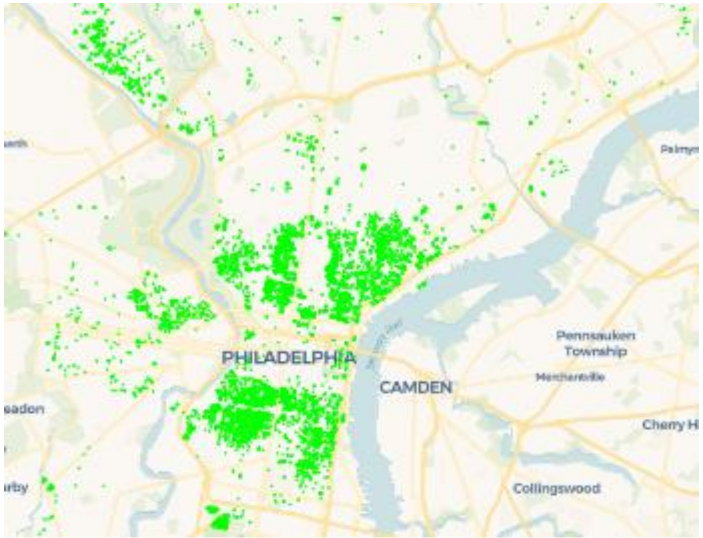
- Newly-constructed townhome development radiated outward from City Hall over time.
- Areas on the edge likely would have been next in line for redevelopment.

	Units		Buildings	Avg. units per building
	Count	% of total	Count	
1-4 unit building	21,100	35%	17,400	1
Small and mid-sized MF	24,100	40%	878	27
Large multifamily (MF)	15,500	25%	59	262
Total	60,800	100%	18,300	3

Map of Small and Mid-sized Multifamily Buildings Built 2000-2023



Map of 1-4 Unit Buildings Built 2000-2023



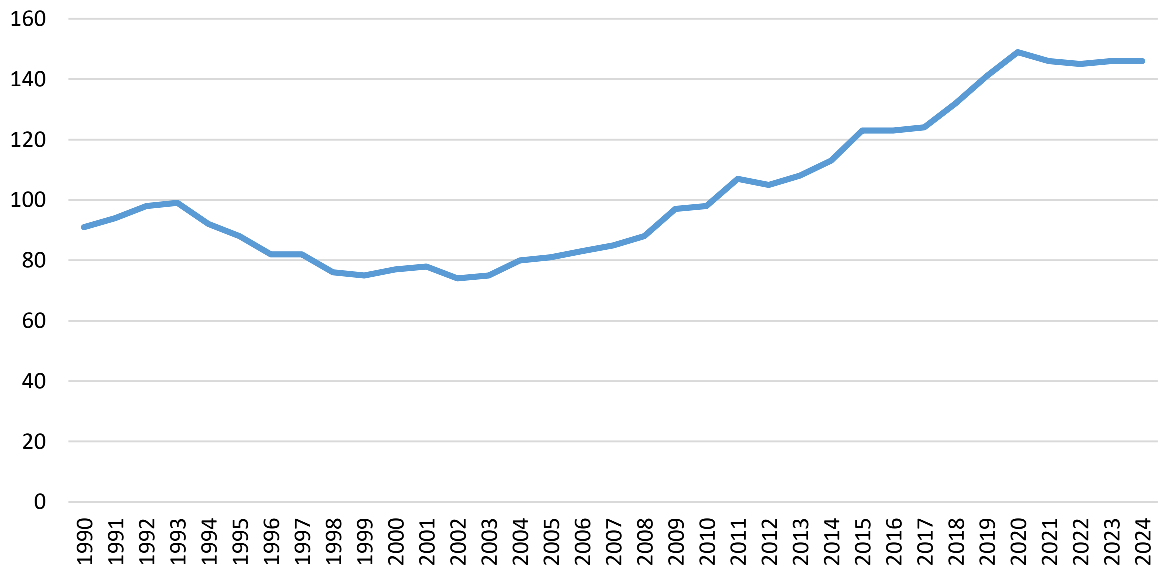
Map of Large Multifamily Buildings Built 2000-2023

Note: Each dot on the map is a building built 2000-2023 .
Source: AEI Housing Center, www.AEI.org/housing.

Philadelphia became more livable

- Due to its renewal, Philadelphia started to add amenities, benefiting all residents.
- Supermarkets require a critical mass of potential customers to create a profitable catchment area.
- After bottoming out at 80 stores in the early-2000s, Philadelphia saw the number increase along with its renewal.
    - From 2000 to 2024, the number increased from 80 (1 per 19,000 residents) to 146 (1 per 10,700 residents).
    - This has provided many long-time residents with easier access to higher quality and less expensive food.

# of supermarkets or superstores in Philadelphia

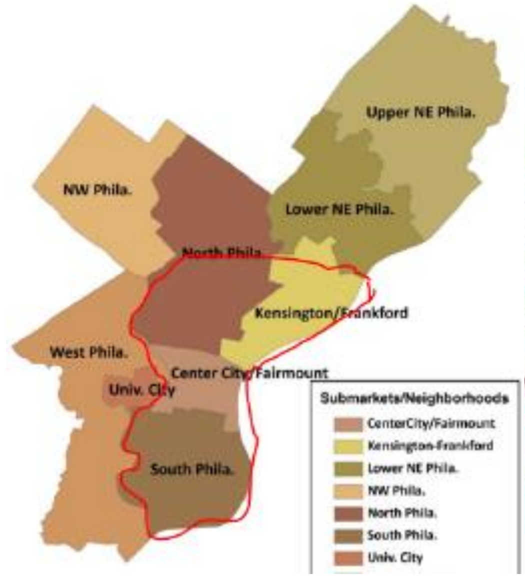


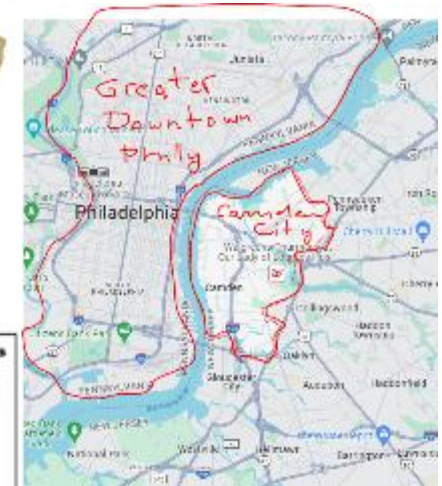
Source: USDA and AEI Housing Center, www.AEI.org/housing.

A Natural Experiment:
Contrasting Greater Downtown Philadelphia and Camden City

Greater Downtown Philadelphia vs. Camden City: A natural experiment in a tale of two cities

- To illustrate the effect of the tax abatement, we created as close to a natural experiment as possible:
  - The treatment area, which we call “Greater Downtown Philadelphia” (GDP), consists of Center City, South Philadelphia, most of Kensington, and the southern half of North Philadelphia (red area on the map).*
  - We focus on this area because it had an unusually high 2003 vacant lot share of 15.0%, while the rest of Philadelphia had a vacant lot share of 9.0%.
  - Our control is Camden City, NJ, right across the river from Philadelphia, which had a vacant lot share of 14.4% in 2003, almost identical to GDP.
- Overall, Camden City in 2000 represented a microcosm of GDP, with similar property values, rents, vacant lot shares, incomes, and building types.





2000 Housing and Population Characteristics for Camden City and Greater Downtown Philadelphia

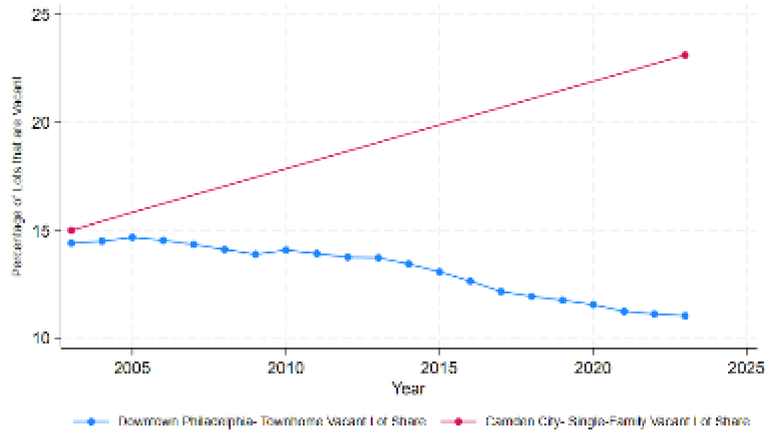
	Camden City	Greater Downtown Philadelphia
Population	79,900	517,600
Pop. Density (per sq. mile)	8,960	13,700
Townhome Percentage	55%	57%
Median Household Income	$23,400	$24,900
Minority Percentage	93%	60%
Median Contract Rent	$440	$400
Median Property Value	$40,700	$45,000
Vacant Lot Share (2003)*	15.0%	14.4%
Median Price per sq. ft. of Gross Living Area, built pre-1980*	$27	$32

Note: For the Greater Downtown Philadelphia, we combined a group of four Census Public Use Microdata Areas (PUMAs): 04105, 04107, 04109, and 04110. PUMAs have an average population of 130,000 and are the smallest unit of geography in Census micro-data. Complete characteristics for Camden City, Philadelphia City, Downtown Philadelphia, and each PUMA can be found in the Appendix. This table uses data from the 2000 Decennial Census, unless otherwise noted by an asterisk.
* These results come from public records data., which does not provide the same level of economic or demographic detail as Census PUMA data. For Camden City, this is single-family vacant lot share, while Philadelphia is a townhome vacant lot share, as described in the methodology.
Source: 2000 Decennial Census and AEI Housing Center, www.AEI.org/housing.

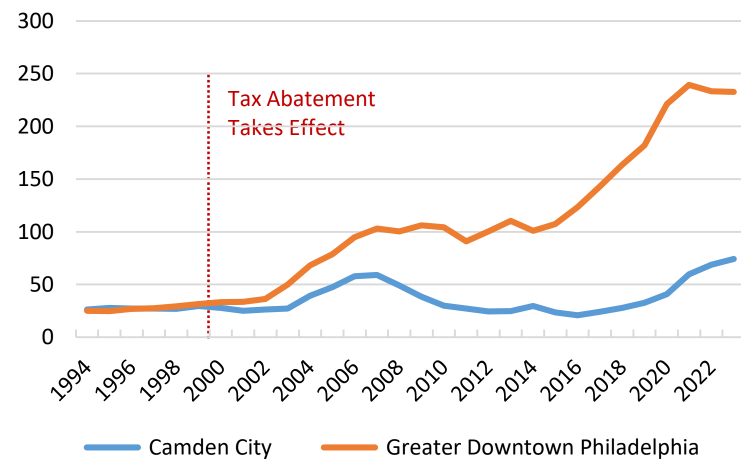
Greater Downtown Philadelphia vs. Camden City: A natural experiment in a tale of two cities (cont.)

- Despite having roughly the same starting point in the early 2000s, over the next two decades, Greater Downtown Philadelphia (GDP) and Camden City had very different outcomes.
  - From 2003 to 2023, the townhome vacant lot share:
    - Declined 3.4 ppts from 14.4% to 11.0% in GDP.
    - Increased 8.0 ppts from 15.0% to 23.0% in Camden City.
  - From 2000 to 2023, the median sales price per sq. ft. of gross living area:
    - Rose 7-fold (from $32 to $231) in GDP.
    - Rose 3-fold (from $27 to $73) in Camden City.*
  - From 2000 to 2020, the population:
    - Increased 12.8% in GDP, reversing five decades of previous declines.
    - Fell 10.2% in Camden City, continuing its decline.
  - From 2000 to 2020, median household income:
    - Increased 177% in GDP.
    - Increased 55% in Camden City.
- Philadelphia's renewal likely had other positive effects, including greater stability in home values in the aftermath of the Great Financial Crisis, lower crime, greater vibrancy, and an improved fiscal position of the city.
- We attribute this favorable result for GDP in large part to Philadelphia's tax abatement program, which Camden did not have.

Vacant Lot Share: Camden City and Greater Downtown Philadelphia: 2003-2023



Median Sale Price per GLA for Single-Family Detached, Townhomes, Duplexes, Condos Built Before 1980**



* Camden's growth in median sale price per GLA was also more prone to economic downturns, as evidenced by the steep negative decline during the Great Recession.
** We use public records sales and assessor data to calculate a median sale price per sq. ft. of gross living area. While we limit the sample to homes built before 1980, this is merely to measure home prices trend on a constant-quality basis. The results can be generalized to newer houses as well.
Source: American Community Survey, Decennial Census, and AEI Housing Center, www.AEI.org/housing.

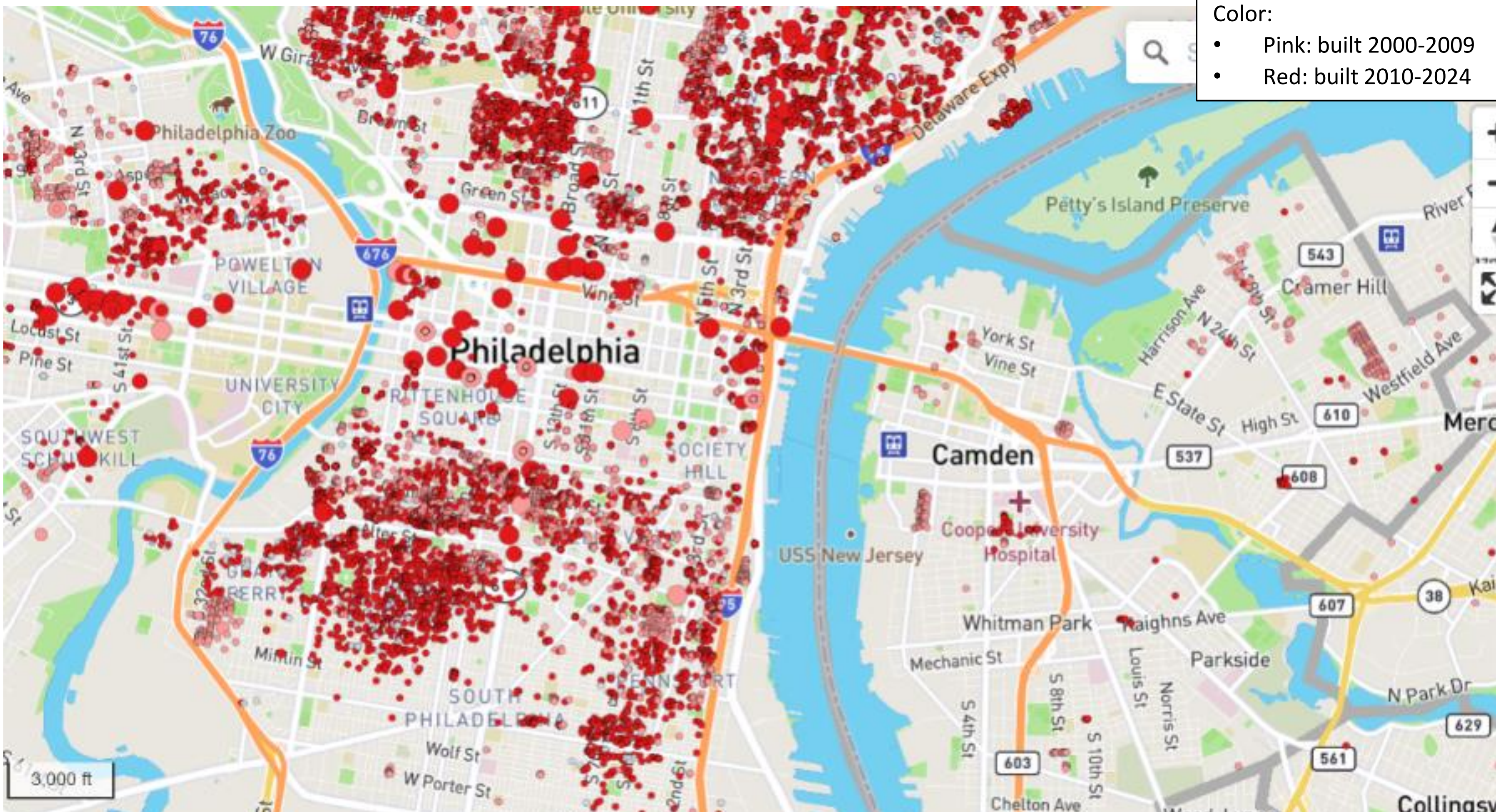
Greater Downtown Philadelphia vs. Camden City: A natural experiment in a tale of two cities (cont.)

- The differences in outcomes are clearly visible when focusing on structures built since 2000.
- Philadelphia (left on map) experienced lots of development, while Camden (right on map) experienced very little.

Each dot is a structure.
Size:
- Small = single-family
- Large = apartments

Color:
- Pink: built 2000-2009
- Red: built 2010-2024

Map: New construction since 2000 around Center City Philadelphia compared to Camden

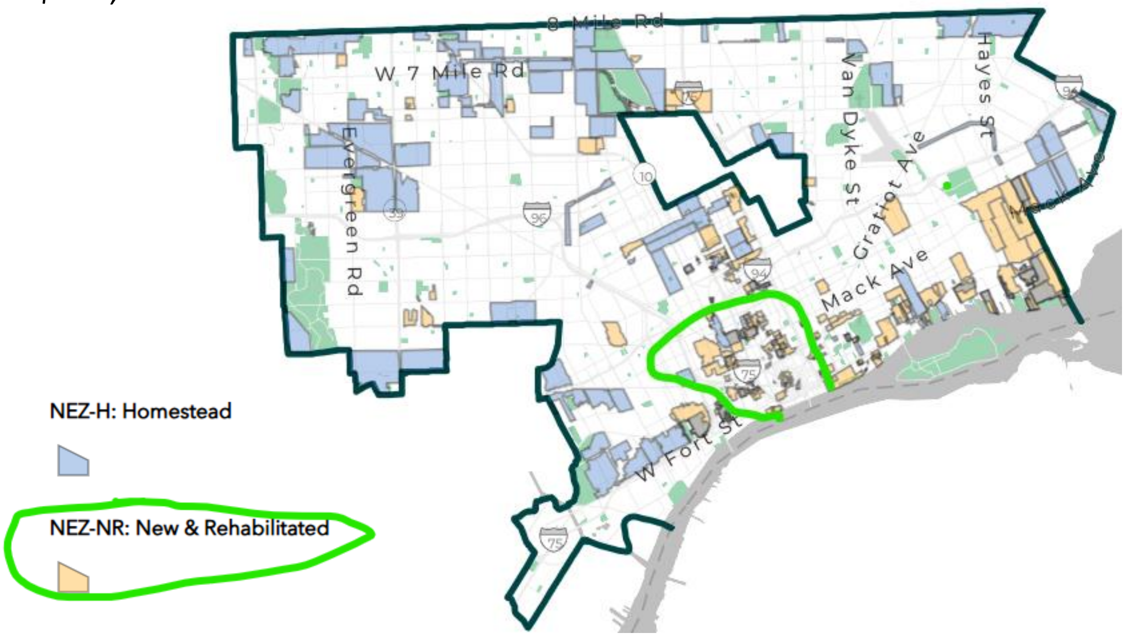


Source: AEI Housing Center, www.AEI.org/housing.

Can the Philadelphia Experience be Replicated Elsewhere?

Detroit already has a limited property tax abatement program

- **Detroit's Neighborhood Enterprise Zone New Construction (NEZ-NR) property tax abatement program**
  - A 15-year 50% tax abatement for 1-, 2-, and townhome units.
  - Unfortunately, limited to 15% of land area by state law.
  - For new SF development in Detroit, NEZ-NR appears to be a pre-condition.
    - Nearly all of the about 300 single-family homes built since 2019 and sold over the last 5 yrs. were in areas designated "NEZ-NR" (light orange shapes on map) and were concentrated in a narrow rectangle north of Grand Circus Park (green circled area on map).
  - The most popular type of new construction development is townhome-style condos, which sell for about $500,000.



Source: City of Detroit, Redfin and AEI Housing Center.

Comparing Philadelphia and Detroit

Among other industrial cities, Detroit is often lauded for its [turnaround](). However, it has had much less development, and less broadly-based development, than Philadelphia.

The maps show new residential structures built from 2000 onward in:

- Philadelphia (top map) and
- Detroit (bottom map).

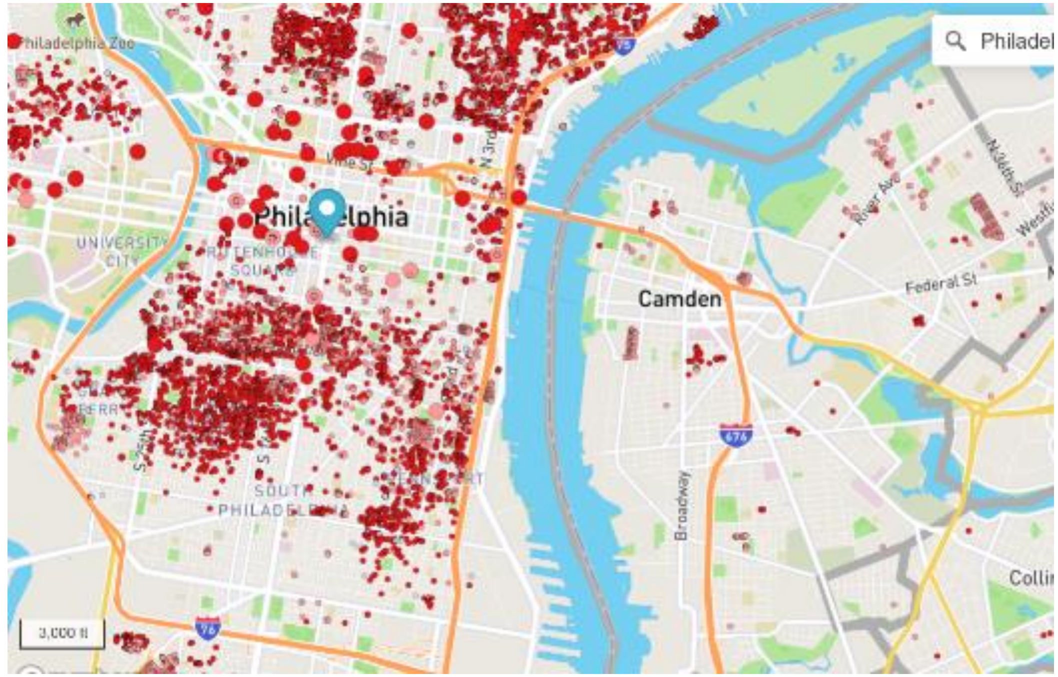
Size legend:

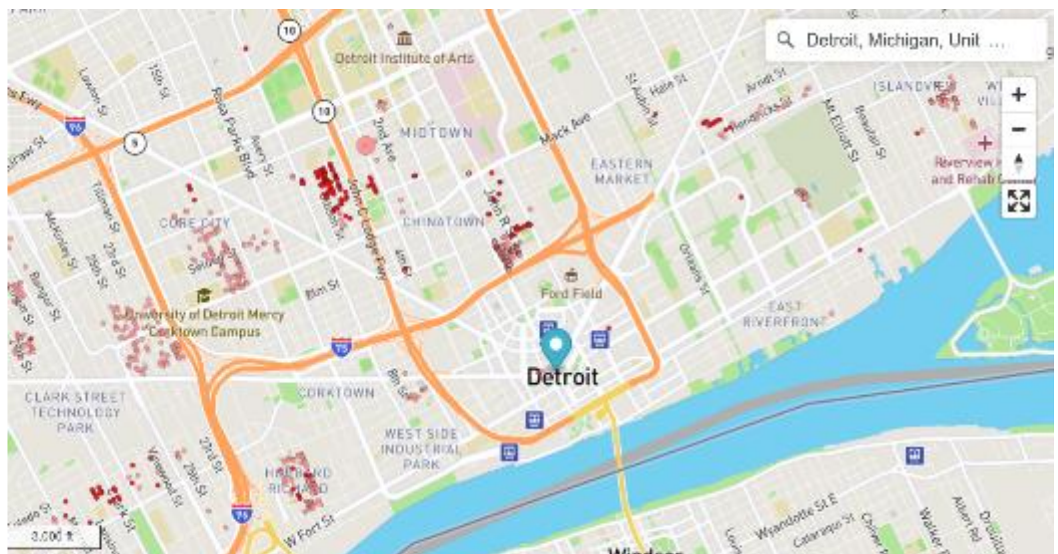
- Small dots are single-family,
- larger dots are apartments.

Color legend:

- Pink: built 2000-2009
- Red: built 2010-2022

Maps for other industrial cities are available at: https://heat.aeihousingcenter.org/toolkit/year_built_map





Source: AEI Housing Center, www.AEI.org/housing.

The formula for successful community revitalization appears straightforward:

1. **By-right zoning**, which does not require approval from zoning boards or city or county councils.
2. **Short and simple land use rules**, fast permitting, and less expensive building standards.
3. **Large enough property tax abatement for:**
   - Office/retail to residential/mixed use conversions
   - Vacant lot to residential construction
4. **Allow greater density in lots of areas** particularly around walkable and amenity-rich areas. Options include:
   a) Greenfield subdivisions: Plat smaller lots.
   b) Light-touch density infill: Build townhomes on vacant lots or on dilapidated older structures.
   c) Livable Urban Villages: Re-densify commercial and industrial areas and renew surrounding neighborhoods.
   d) Light-touch density infill without teardown: Allow ADUs.

Implementing these policies would unleash American ingenuity and enterprise by allowing builders of all sizes to build abundant market-rate housing over time, thereby increasing the housing stock and providing affordable housing options.

Make it feasible and they will build!

Resources

My email:
Tobias.Peter@aei.org

AEI Housing Center Website:
https://www.aei.org/centers/housing-center/

Housing and Economic Analysis Toolkit (HEAT):
https://heat.aeihousingcenter.org/toolkit/

AEI Housing Center Case Studies (including detailed Philadelphia study):
https://www.aei.org/housing-supply-case-studies/