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Tax Incentives Offered to Encourage Development in Philadelphia

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Philadelphia's recent demographic surge and economic growth has sparked much conversation regarding the future of the city. Those that are optimistic point to Philadelphia's universities, medical institutions, culture, history and geographical location as reasons for confidence in Philadelphia's continued development. Those that are not so optimistic are quick to note the barriers that have prevented Philadelphia from thriving over the last 40 years, including inequality, inadequate job growth, poverty, the public school system and the municipal tax structure.

Philadelphia's tax structure in particular has been a hotly debated policy issue, particularly in light of persistent city budget constraints. The pressure to increase tax revenue is constantly weighed against the inherent disincentives that tax increases create in terms of investment and development in Philadelphia.

In response to concerns about this tax burden, Philadelphia offers a number of tax incentives to encourage development in the city. Two options for real estate developers include tax abatements and Tax Increment Financing (TIF). These incentives are very different and offer different benefits to developers, but both can lower the cost of developing in Philadelphia such that an otherwise uneconomical investment may make sense.

Tax Abatements

Philadelphia offers four types of tax abatements for developers and property owners seeking to decrease their property tax liability. Three pertain to residential improvements or construction, while one is available for nonresidential properties. The abatements are: a Development Abatement for New or Improved Residential Properties; an abatement for Rehab Construction for Residential Properties; an abatement for New Construction for Residential Properties; and an abatement for Rehab and New Construction for Commercial and Industrial Properties.

The Development Abatement for New or Improved Residential Properties, under State Act 175, is unique because it is the only abatement of the four that does not last for 10 years. Unlike the other abatements, the duration is for the earlier of 30 months or until the property is sold and only applies to developers looking to either sell or rent after constructing or rehabbing a property. The abatement starts on the first day of the month after the building permit is issued and a developer seeking this abatement must apply by Dec. 31 of the year the building permit is issued.

The abatement for Rehab Construction for Residential Properties under Ordinance 961 applies to residential properties both being sold or occupied by the current owner. The abatement freezes the assessment value of the qualifying property for 10 years to the extent the value would increase from the improvements. Like the Development Abatement for New or Improved Residential Properties, the abatement must be applied for by Dec. 31 of the year the building permit is issued.

The 10-year abatement for New Construction for Residential Properties under Ordinance 1456-A applies to property owners and developers that are building a residence to sell it, while the 10-year abatement for Rehab and New Construction for Commercial and Industrial Properties under Ordinance 1130 applies to commercial properties that are being rehabbed or constructed. In both cases, the application timing requirements are more stringent as the developer must apply for these abatements within 60 days of the date the building permit is issued.

Tax Increment Financing Districts

TIFs are designed as a way to use funds that developers would otherwise be using to pay the costs of tax increases from construction to finance the construction. The city, usually in connection with the Philadelphia Authority for Industrial Development, and a developer, decide on an amount of incremental tax revenue that would result from a development over the term of a TIF and the developer then takes out a loan in the form of municipal bonds for that amount. The bonds are then repaid with the incremental tax revenue that results from the increase in the value of the property, by redirecting the increased taxes that would otherwise go to the city or school district. Under the TIF structure, the taxing bodies continue to collect the base amount of tax revenues (the amount paid annually prior to the improvements), but forgo increased tax revenues during the life of the TIF, which is limited to 20 years.

TIFs are authorized by the commonwealth of Pennsylvania and implemented under Section 21-1400 of the Philadelphia Code and function by creating a geographical district for which the benefits of the TIF apply. A TIF can apply to real estate property tax, use and occupancy tax, city sales, and business income and receipts tax.

Which Works Best and When?

Unlike TIFs, abatements are of general applicability and do not need any special approval, being essentially an as-of-right entitlement if properly applied for. Abatements are therefore relatively simple to obtain and are available to a wider group of developers and even owner-occupiers. The abatement saves the developer, owner or tenant from an annual expense and effectively increases the value of the improvement.

TIFs, on the other hand, provides a stream of money to the developer, rather than a freeze on costs. As a result of its structure, and the lien priority of tax payments, a developer can pledge this stream of payments to obtain upfront financing to pay for the costs of the development project. This can help a developer leverage the potential benefits of a project into something more ambitious while simultaneously achieving a development goal of the city. From the perspective of Philadelphia, the TIF allows the city to "capture" the tax incentive given to a developer and assign it to a particular area, in the form of incentivized development.

Obtaining a TIF requires discretionary approval from each governing body that will forgo taxes (i.e., Philadelphia City Council and the Philadelphia School Reform Commission for projects that will utilize both city and school district tax revenues) and at least one public hearing in which interested parties are afforded an opportunity to express their views on the financing plan. Consequently, obtaining TIF approval is a much more political process, and typically only practical in the cost of a larger project, with significant public interest.

The abatement process, on the other hand, gives less control to the city because it applies to all of Philadelphia rather than a certain defined area. In both cases, the city's tax revenue is only temporarily reduced, as both abatements and TIFs only apply for a specific period of time.

Practice Tips

Abatements are available for all qualifying projects and so should always be kept in mind by attorneys representing clients in development or construction projects. For practitioners, it is important to be mindful of the various deadlines and application guidelines, so opportunities are not missed. For those representing tenants or buyers of property under construction or to be constructed, it may be worthwhile to include language in the contract for sale or lease requiring the current owner of the property to comply with the appropriate guidelines as a condition to effectuating the deal. This is particularly important with TIFs as Philadelphia imposes reporting and other requirements on projects receiving city funding, such as the preparation of an Economic Opportunity Plan.

Abatements are more of a blunt tool for fostering development in the city, while TIFs are more directed. Both play a role in encouraging development and, over time, increasing the city's tax base.

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