Alert | Real Estate/Government Law & Policy

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Philadelphia City Council Approves Changes to Tax Abatement Programs and Imposes Residential Construction Tax

On Dec. 10, 2020, the Philadelphia City Council approved three bills that would change the city's tax abatement programs and impose a new residential construction tax. As of the date of this writing, Bill No. 200366 has been signed into law by Mayor Jim Kenney; Bill No. 200653 and Bill No. 200556 are awaiting his signature. The three bills passed the City Council with veto-proof margins and will take effect Jan. 1, 2022, substantially impacting real estate developers and affordable housing projects in the city. This GT Alert summarizes the three bills.

Bill No. 200366: Extension of Residential Tax Abatement

Under Philadelphia's long-standing residential tax abatement program, residential property owners may qualify for a 10-year tax abatement on the value of improvements related to new construction and rehabilitated properties. Historically, residential property owners could obtain a 100% tax abatement for 10 years. At the end of 2019, however, the City Council and Mayor Kenney significantly changed the residential tax abatement program, and those changes are being revised again. Under the first version of the revisions, owners who applied after Dec. 31, 2020, would only receive the full 100% tax abatement during the first year; thereafter, the abatement would decrease by 10% each year until the program was phased out entirely at the end of the tenth year.

An extension to the phase-out of the residential tax abatement program was needed due to a large backlog of abatement applications caused by the impending application deadline and COVID-19-driven delays. As a result, the City Council has extended the current application deadline by one year, to Dec. 31, 2021, and residential property owners can still receive the full 100% abatement for 10 years by submitting the abatement application by Dec. 31, 2021. For applications submitted after Jan. 1, 2022, the full 100% abatement will apply to the first year and be subject to 10% yearly reductions over the subsequent nine years. In the short-term, this extension benefits residential real estate developers in the city by creating demand, as individuals will be incentivized to purchase homes and apply for the abatement by Dec. 31, 2021 to take advantage of the 10-year 100% abatement. In the longer term, the phased-out schedule of the abatement could lower demand for new construction and rehabilitated properties in the residential space.

Bill No. 200653: Reduction of Commercial & Industrial Tax Abatement

As with the residential tax abatement program, commercial and industrial property owners may also qualify for a 10-year 100% tax abatement on the value of improvements related to new construction and rehabilitated properties. But, once Bill 200653 becomes law, the commercial and industrial tax abatement will only be reduced by 10% and will be not phased out over 10 years. If Bill No. 200653 is signed into law, the commercial and industrial tax abatement would be lowered to 90% for 10 years for any application submitted on or after Jan. 1, 2022.

The estimated $83 million in revenue generated from the reduction of the commercial and industrial tax abatement program will be used to fund the Neighborhood Preservation Initiative, which is a $400 million bond program that will, among other things, subsidize new affordable housing projects and support first-time homebuyers and neighborhood business corridor revitalization. In total, the City estimates that the Neighborhood Preservation Initiative is expected to create $2.5 billion in economic activity, produce $71 million in new tax revenues over the first four years, and support 14,700 jobs. The city's focus on affordable housing provides a significant opportunity for developers of such projects, given the amount of subsidies that would lower the overall costs of affordable housing projects.

Bill No. 200556: Imposition of Residential Construction Tax

Bill No. 200556 imposes a new 1% construction tax, known as the Development Impact Tax, on the construction or improvement costs of newly constructed and improved residential properties. Future regulations will provide more substance to the scope and implementation of the Development Impact Tax, including which construction activities qualify as an improvement, the methodology for calculating construction or improvement costs, and so on.

If signed into law, the Development Impact Tax will apply to all residential building permit applications filed on or after Jan. 1, 2022, and will be payable in two stages: 50% of the tax will be due upon the issuance of the building permit (or 100%, if a certificate of final inspection is not required) and the remaining 50% will be due upon the issuance of a certificate of final inspection.

In general, the bill defines improvements as repairs, constructions, or reconstructions that rehabilitate or bring a property into compliance. Ordinary upkeep and maintenance are not considered improvements. The bill also carves out certain improvements to properties from the tax, including improvements to properties used for learning, benevolent, charitable, and patriotic purposes, public properties, properties in Keystone Opportunity Zones, and improvements related to the preparation of an existing residential rental unit for turnover to a new tenant. Further, for mixed-use projects, if a significant portion of the residential property is used or intended for use for non-residential purposes, the tax will only be charged with respect to the improvements made to the portion of the structure used for residential occupancy, including any related common space.

The Development Impact Tax, which also will help fund the aforementioned Neighborhood Preservation Initiative by generating approximately $9 million to $11.7 million in revenue per year, is supported by a local chapter of a major building group. Mo Rushdy, treasurer of the Building Industry Association of Philadelphia (BIA), remarked that "[a]s we did in 2018, the BIA has made the hard decision to support and endorse [the Development] Impact Tax. We are acutely aware of how Philadelphia has turned into an extreme housing example of the 'haves and the have nots', and that more must be done immediately to ensure our City has opportunities for all to grow and flourish. The BIA believes it is time to collaboratively craft policies that help all residents in this City share in its prosperity."

Overall, this bill would help commercial real estate developers in combatting the high costs of developing commercial properties in the city, because the Development Impact Tax was initially proposed as a 1% tax on commercial properties. For mixed-use and residential real estate developers, the bill is a mixed outcome – if residential projects provide for affordable housing, developers would benefit from subsidies under the Neighborhood Preservation Initiative, but, if not, the Development Impact Tax would be an additional cost of doing business in the city.

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