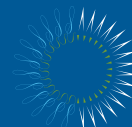




THE ACTUAL VALUE INITIATIVE: OVERHAULING PROPERTY TAXES IN PHILADELPHIA

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EXECUTIVE SUMMARY

For decades, Philadelphia's property tax system has been criticized as outdated and unfair. In many cases, assessments have had little relation to actual property values—or to assessments of similar structures across the street. In the spring of 2013, Philadelphia City Council is expected to adopt an overhaul of the city's property tax system, effective for tax bills due early in 2014. It is called the Actual Value Initiative (AVI).

The Actual Value Initiative would transform property taxation in Philadelphia in three significant ways, changing the certified market value of every piece of property in the city, the way individual assessments are used to calculate tax bills, and how property owners deal with any big tax increases that might result from the new system.

In recent years, no large city has set out to change all three at once. And while transformations of property tax systems in other jurisdictions have been the result of court orders and state mandates, Philadelphia is preparing to act on its own volition.

Perhaps the most important component of the city's plan is the simultaneous reassessment of all 579,383 pieces of real estate in the city. Some properties have not been reassessed since 2004, many others not since the 1980s. According to the city's chief assessment officer, Richie McKeithen, Philadelphia has never experienced a thorough citywide field inspection of every property and its various characteristics.

As the city prepares to undergo what will be a painful transition for some, we set out to better understand the challenges involved. We did so by studying the experiences of other cities and counties, the long history of fitful reforms and partial reassessments that have brought Philadelphia to this point, and the measures that the city is considering to help mitigate the steep tax increases that await some homeowners.

Among the key findings of this report:

- A central reason why the city's assessment system has become plagued with inequities is that the state does not regulate it; Pennsylvania is one of only nine states that impose no

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reassessment timetables or standard assessment methods on local governments. It also is one of just three states to receive a grade of F in “standardized procedures” from the Council on State Taxation, a Washington-based trade group.

- Numerous jurisdictions have adopted measures intended to mitigate the spikes in property taxes that AVI is likely to create for some residents. Some of these measures go beyond the levels of relief currently envisioned or allowed by law in Philadelphia. Whatever programs the city adopts would have several downsides. They would add layers of complexity to a new system that is meant to be simpler and more transparent than the status quo. They also would raise the property tax rate, at least slightly, for everyone.
- One reason Philadelphians have been relatively complacent about longstanding inequities in assessments, analysts say, is that they pay less in property taxes (and more in wage taxes) than residents of many other jurisdictions. On a per capita basis, Philadelphia’s property tax produces only about one quarter the amount generated in Washington and a third of what is collected in Boston and Hartford. These numbers include taxes that help pay for city government and those that fund the school system.
- Efforts to restructure the system have been limited—and are likely to continue to be limited—by the uniformity clause of the Pennsylvania Constitution, which state courts have interpreted as requiring that all types of property be taxed at the same rate. In other jurisdictions, many located in states with uniformity clauses of their own, higher property tax rates are imposed on commercial, industrial and vacant property; in Boston, Chicago and Washington, commercial rates are at least twice as high as residential rates. This is forbidden in Pennsylvania, although the legislature has created several ways to get more tax revenue out of commercial real estate.
- Imposing a new system will solve little in the long term unless assessments are kept accurate and up to date. Doing so will require both vigilance and a commitment to adequately fund the city’s Office of Property Assessment, the agency charged with this responsibility. A 2010 report commissioned by the Pennsylvania Legislative Budget and Finance Committee looked at 14 counties that had met uniformity and equity standards through reassessment. Three years after the reassessments were completed, more than half no longer met the standards.

The comparison jurisdictions studied are Allegheny County, Pa., which includes Pittsburgh; Baltimore; Boston; Cook County, Ill., which includes Chicago; Hartford, Conn.; Los Angeles; and Washington, all of which have grappled with various aspects of the property tax issues now confronting Philadelphia.

This report does not include projections about what the tax rate will be under AVI, how the overhaul will affect assessments in specific neighborhoods, or how much change there will be in the share of property tax revenue generated by residential as opposed to commercial parcels. None of that information will be known until assessment numbers are made public and City Council adopts a new tax rate.

WHY RESHAPING THE PROPERTY TAX SYSTEM HAS BEEN DIFFICULT IN PHILADELPHIA

From time to time, various issues, including Social Security, have been labeled as “the third rail” of American politics: touch it and you risk political electrocution. That description fits the property tax; attempting to change real-estate taxation systems—even those viewed as unfair or illegal—can be extremely difficult.

There are a number of reasons for this. One is that the property tax, when compared to levies on wages and sales, can seem subjective and confusing, especially in places like Philadelphia where assessments are supposed to represent only a fraction of the full market value. This leaves plenty of room for individuals, especially homeowners, to believe that they are being taxed too much—or to question the city’s competence.

And there is the issue of fairness, a concept that means different things to different people. Since the property tax is not based on the ability to pay, it can seem unfair to retirees on fixed incomes and longtime residents living in neighborhoods where property values have risen. Some taxpayers argue they should be taxed on the value of their house when they bought it, no matter how much the value has gone up since. Still others believe that the fair thing to do is to impose strict limits on how much property taxes can go up each year, thereby making the tax burden more predictable and more manageable for everyone.

In addition, an owner-occupied dwelling is widely viewed as a unique sort of asset, meriting special treatment. Voters have come to expect elected officials at all levels of government to promote and protect homeownership—and not just through the deductions for mortgage interest and property taxes in the federal income tax system.

Even so, the property tax remains a stable and reliable revenue source for local government and public schools. In addition, many fiscal analysts argue that property taxes do less damage to a local economy than income, wage or business taxes because real estate, unlike residents or jobs, cannot move to avoid being taxed.

Many jurisdictions have managed to create and maintain property tax systems that are seen as relatively fair and equitable. Philadelphia’s inability to do so lies partly with the state of Pennsylvania and partly with the city itself.

State Obstacles to Change

In most of the United States, state laws and administrative practices determine the general contours of local property taxation. There may be statutory guidelines for assessment frequency, state oversight, assessors’ professional qualifications, how certain types of property can be taxed, and more. Comprehensive reforms have largely been driven by state-level action and legislation. That has not been the case in Pennsylvania, and this has had a major effect on Philadelphia’s efforts to confront inequitable property assessments.

GLOSSARY

Assessed Value: The dollar value assigned to a property by a taxing authority as the basis of determining a property tax bill.

Assessment Cycle: The maximum length of time permitted between assessments on a given property; it can be as little as one year. Pennsylvania does not mandate any assessment cycle.

Certified Market Value: In Philadelphia, this is the value placed on a property by the city to which the assessment ratio and the tax rate are then applied. In many cases under the current system, the certified value is far below actual market value.

Fractional Assessment: A real estate tax system in which the tax rate is applied to a reduced percentage of the stated market value (called the predetermined ratio) rather than the full amount. In Philadelphia, the ratio has been 32 percent.

Full-Value Assessment: A regimen in which properties are assessed at what is deemed to be full market value. This is a key element of the Actual Value Initiative in Philadelphia.

Lack of Statewide Standards

Pennsylvania is one of only nine states that do not impose reassessment timetables or standard assessment methods on local governments. The remaining 41 states and the District of Columbia require reassessment of property values on a regular schedule ranging from one to six years, according to the International Association of Assessment Officers, the Kansas City, Mo.-based professional association for tax assessors.¹ In Pennsylvania, it is up to each county to determine how and when to conduct assessments.

The state is one of only three—New York and Delaware are the other two—to receive a grade of F in standardized procedures from the Council on State Taxation, a Washington-based trade group for corporate and business taxpayers. The few regulations the state does have in place have relatively little bite; a report on the effects of infrequent assessment from the University of North Carolina called Pennsylvania “perhaps the most lax state in enforcing its revaluation laws.”²

Pennsylvania does have a state agency that examines local assessments. The State Tax Equalization Board is a three-member, governor-appointed body with a staff of 18. Its main role is to estimate the aggregate market value of all taxable real estate for each county, compare it to the total assessed value reported by the county, and set what is called the Common Level Ratio—which is used to allocate state funding for schools. The process also serves as a review of how well local assessments reflect market prices and provide a basis for assessment appeals and lawsuits. But the board cannot force counties to reassess.

Some counties in Pennsylvania have gone more than 30 years between mass assessments. The longer a jurisdiction goes without one, the more painful the potential sticker shock that comes with the correction, making action on this front less and less palatable. Absent a requirement for periodic reassessment, “No county spends the time and political currency to reassess properties unless a lawsuit is filed,” Sharon DiPaolo, a Pennsylvania property tax attorney, has written.³ Typically such lawsuits begin when a taxpayer or group of taxpayers allege that assessment inaccuracies make them pay more than their fair share.

There are numerous examples of counties in the state—Chester, Lancaster and Allegheny among them—that have initiated reassessments under court order. In Philadelphia’s case, however, the precipitating event was not a court order but a series of articles in the *Philadelphia Inquirer* that documented mismanagement and political cronyism at the Bureau of Revision of Taxes, the agency that had been responsible for assessments.

The County Commissioners Association of Pennsylvania, in its 2012-2013 policy platform, calls for an appropriate state agency that would oversee property tax assessment, mandate countywide reassessments, and provide financial help to counties to maintain accurate assessments.⁴

The Uniformity Clause and Its Interpretation

Another reason that overhauling property taxes is difficult in Pennsylvania is that the uniformity clause in the state constitution limits how much local lawmakers can tailor the tax to different types of property. The clause reads: “All taxes shall be uniform, upon the same class of subjects.”

Similar clauses appear in some form in the constitutions of all but three states. In many states, those clauses have been interpreted as mandating uniform taxation only within individual sub-classes of property. But the Pennsylvania courts have ruled that all types of property are a single class. This interpretation prohibits what is commonplace elsewhere—sorting types of property into classifications taxed at different levels. Taxing commercial and industrial property at higher rates than residential is often thought to make good political sense.

In Boston, for instance, commercial property was taxed at 3.192 percent in Fiscal 2012 and residential property at 1.304 percent. As a result, nonresidential property, although representing only 35 percent of taxable value, generated 61.3 percent of the revenue raised by the property tax, according to the Boston Municipal Research Bureau.

In Washington, the tax rate was 0.85 percent for residential property, 1.65 percent for commercial properties valued at less than \$3 million, and 1.85 percent for those worth more than \$3 million. In addition, Washington taxed vacant buildings at 5 percent and blighted properties at 10 percent, hoping to encourage development.

Hartford uses fractional assessments to classify property. Homes are assessed at 30 percent of market value and commercial property at 70 percent.

In Cook County, Ill., which includes Chicago, residential properties are assessed at 10 percent of market value and most commercial and industrial parcels at 25 percent.

To a limited degree, three constitutional changes have allowed state and local officials to work around Pennsylvania’s uniformity clause.

In 1968, voters ratified a new state constitution that authorized “special tax provisions” for property owned by the elderly, the poor, and the disabled. The General Assembly created a property tax rebate for low-income, elderly owners funded by the state lottery a few years later.

A 1997 amendment paved the way for homestead exclusions, sometimes called homestead exemptions, which reduce the amount of an assessment that is taxable for owner-occupied residences. Philadelphia is considering adopting a homestead exemption as part of its Actual Value Initiative (AVI).

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Another amendment, adopted in 1984, enabled Philadelphia and Allegheny Counties to offer “gentrification relief” to longtime owner-occupants of areas where prices have “risen markedly” as a result of renovation and new construction. But such relief is not in place in either jurisdiction.

The courts also have upheld the constitutionality of Philadelphia’s Use and Occupancy Tax (U&O), a separate tax paid by businesses based on the amount of space they occupy. In June 2012, City Council, after choosing to postpone adoption of AVI, raised the property tax rate by 3.6 percent and the U&O by about 20 percent. In Fiscal 2013, U&O will generate roughly \$132 million for the School District.

A relatively high percentage of Philadelphia’s property tax revenue comes from residential as opposed to commercial property. In Fiscal 2012, 56 percent of the revenue generated by the property tax came from about 460,000 residential properties, including apartment buildings.

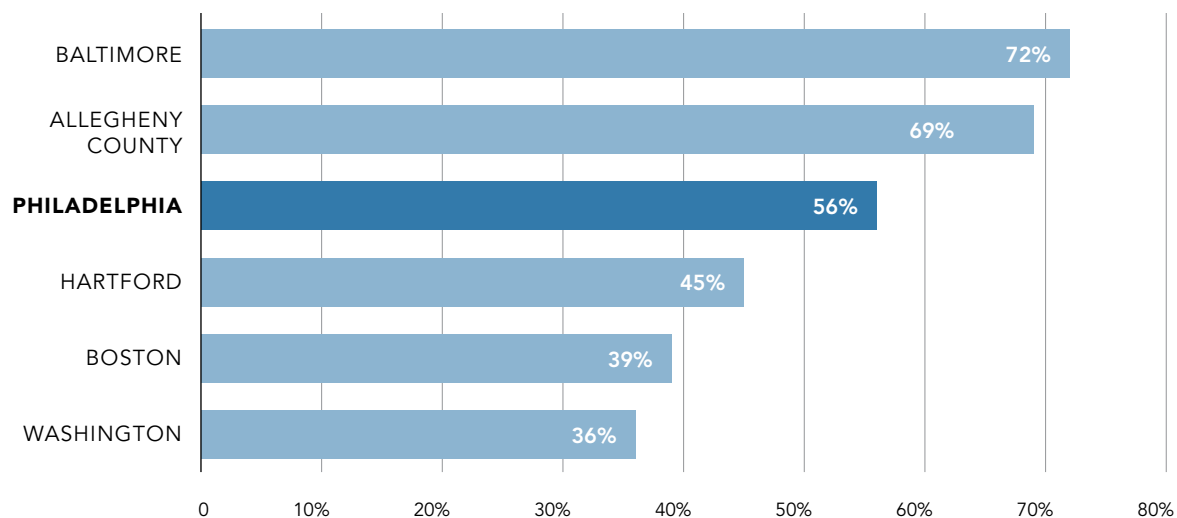
The current share of property tax paid by the residential sector in Philadelphia is higher than in Boston and Washington, cities with thriving central business districts and higher tax rates for commercial properties, although less than in Baltimore or Allegheny County. See Figure 1.

In October 2012, Mayor Nutter, City Council President Darrell Clarke and School Reform Commission Chairman Pedro Ramos announced they would seek state legislation allowing the city to tax commercial and residential properties at different rates. If such a law were enacted, a court challenge likely would follow.

FIGURE 1

PERCENT OF PROPERTY TAX REVENUE FROM RESIDENTIAL PARCELS

This graphic shows the percentage of property tax revenue in each jurisdiction that comes from residential properties. The Baltimore data does not include rental properties, and Allegheny County excludes rental properties of more than six units. Statistics were not available for Los Angeles or Cook County.



SOURCES: Individual county and city assessment offices.

THE TROUBLES OF ALLEGHENY COUNTY

Like Philadelphia, Allegheny County, which includes Pittsburgh, has struggled with property taxation.

The most recent conflict there began in 2005, when a court-ordered countywide reassessment produced property values that would have triggered bigger bills for almost 80 percent of owners. Then-County Executive Dan Onorato refused to use the new numbers and proposed a 4 percent cap on annual assessment increases. But the cap was struck down in the courts. Onorato then declared that the county would use a previous set of property values.

A group of homeowners filed suit, alleging that the county had violated the state uniformity clause by refusing to use the new and presumably more accurate numbers. In 2009, the Pennsylvania Supreme Court agreed with the homeowners, finding that the county's use of older values had shifted taxes unfairly onto lower-value properties. The Allegheny County Court of Common Pleas was given oversight of a mass reassessment intended to correct the inequities.

Upon taking office in January 2012, Rich Fitzgerald, Onorato's successor, tried and failed to halt the release of the new assessments, calling instead for statewide reassessment standards. And the new numbers have drawn criticism from the group of homeowners who took the county to court in the first place. They allege that the assessments still put too much of the tax burden on lower-value properties. Nearly 70,000 appeals have been filed, and final assessments for the entire county are due in December 2012.

LOCAL FACTORS THAT HAVE PREVENTED CHANGE

The current drive to reshape the property assessment system in Philadelphia comes after years of fitful efforts that were stalled by several local factors. Among them were Philadelphia's lesser reliance on the property tax compared to other jurisdictions, the low valuations of properties, the city's relatively high rate of home-ownership, and a lack of political will.

Relatively Low Reliance on the Property Tax

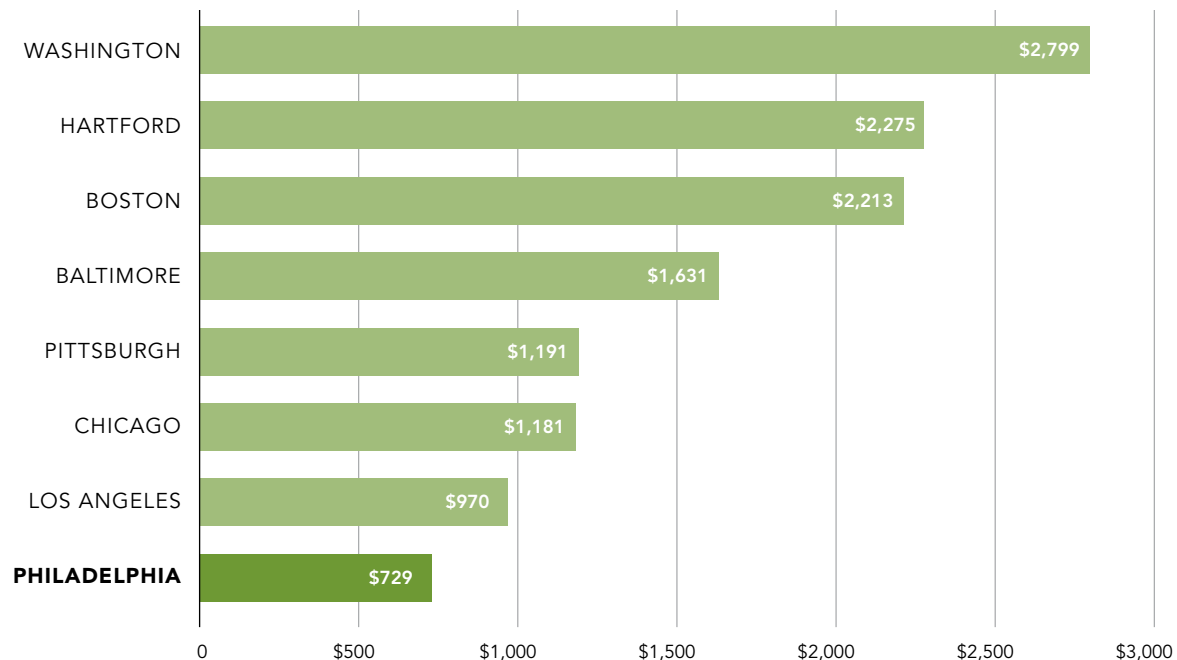
In 2013, Philadelphia is scheduled to use the property tax to generate \$514.9 million for city government and \$637.2 million for the school district, a total of \$1.15 billion. Even so, Philadelphia relies less on the property tax (and more on wage and business taxes) than any of the seven other jurisdictions we surveyed for this study. See Figure 2. In 2011, property tax revenue in Philadelphia came to \$729 per resident, compared to \$2,799 in Washington, \$2,275 in Hartford, and \$2,213 in Boston.

FIGURE 2

PROPERTY TAX REVENUE PER CAPITA

FISCAL YEAR 2011

The calculations include all property tax revenue collected by city or county authorities for all purposes.



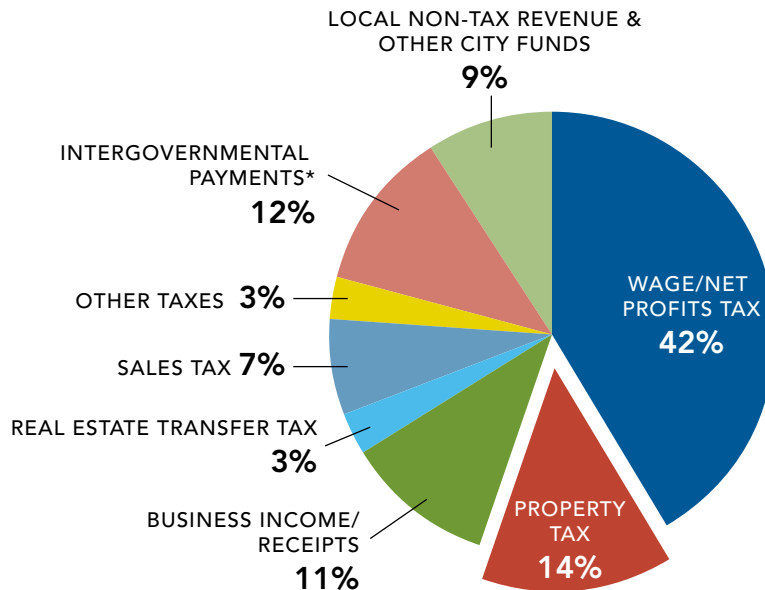
SOURCES: Individual city budgets and 2010 U.S. Census.

FIGURE 3

SOURCES OF GENERAL FUND REVENUE FOR THE CITY OF PHILADELPHIA

FISCAL YEAR 2012

Philadelphia city government gets 14 percent of its general fund revenue from the property tax, a figure that is lower than most other cities. This calculation does not include the portion of the local property tax that goes to the School District of Philadelphia.



*Intergovernmental payments include transfers from the state and federal governments, as well as the Philadelphia Gas Works.

SOURCE: City of Philadelphia.

As a result, Philadelphia city government got only 14 percent of its general fund revenue from the property tax in Fiscal 2012, compared to 42 percent from the wage and net profits tax. See Figure 3.

Not surprisingly, far more attention over the last two decades has been directed at reducing the wage tax rate than fixing inconsistent and inaccurate real estate assessments. In addition, the relatively low property tax bills, some analysts say, have kept elected officials from complaining about the inequities in assessments. "Because it's been such a small part of revenue, the city could leave it alone," said Paul Levy, president and CEO of the Center City District.⁵

Levy and other civic leaders hope that the creation of a new property tax regimen under AVI will allow Philadelphia over time to shift more of the overall tax burden onto the property tax, as recommended by the city's 2003 Tax Reform Commission and its 2009 Task Force on Tax Policy and Economic Competitiveness. Their argument is that the property tax is less damaging to economic growth than taxes on wages and businesses.⁶

Low Property Valuations

Estimates from experts commissioned by the Philadelphia Research Initiative indicate that city property, on the whole, is taxed on only about 13 percent of its true market value, considerably lower than the city's official Predetermined Ratio of 32 percent and the 25.2 percent assessment-to-value ratio set by the State Tax Equalization Board.⁷

This means that the assessed value listed on the tax bill—and the certified market value number on which it is based—both come across to many homeowners as low. As a result, few Philadelphians have had reason to think they are being overtaxed, even those who are paying more than their fair share when compared to their neighbors.

All of this, when combined with the fact that property tax bills generally are lower than bills for comparable homes in the suburbs or in other cities, has enabled the status quo to survive, despite its inequities.

SIMPLIFYING THE TAX BILL: FROM 32 PERCENT TO 100 PERCENT

For many years, Philadelphia has used a fractional assessment system that converts the "certified market value" of land and structure to an "assessed value" on the basis of what in Pennsylvania is called a "predetermined ratio." In Philadelphia, the ratio has been set at 32 percent. Here's how it works now.

Let's take a home with a certified market value of \$100,000, a number which, in most cases, is substantially less than the actual market value. To calculate the tax on the property, multiply \$100,000 times 32 percent to get an assessed value of \$32,000. Then multiply that \$32,000 by the tax rate of 9.771 percent to get a 2013 tax bill of \$3,127.

Under the Actual Value Initiative, the certified market value is supposed to represent the actual market value. And the tax rate would be applied to 100 percent of certified market value, ending the practice of fractional assessment and eliminating a step in the calculation.

This does not mean a \$100,000 house would generate a tax bill of \$9,771. Council plans to adjust the current tax rate downward so the property tax would produce about the same amount of revenue as the city now collects. The new bill could be higher, lower or the same, depending on the new assessment and the new tax rate.

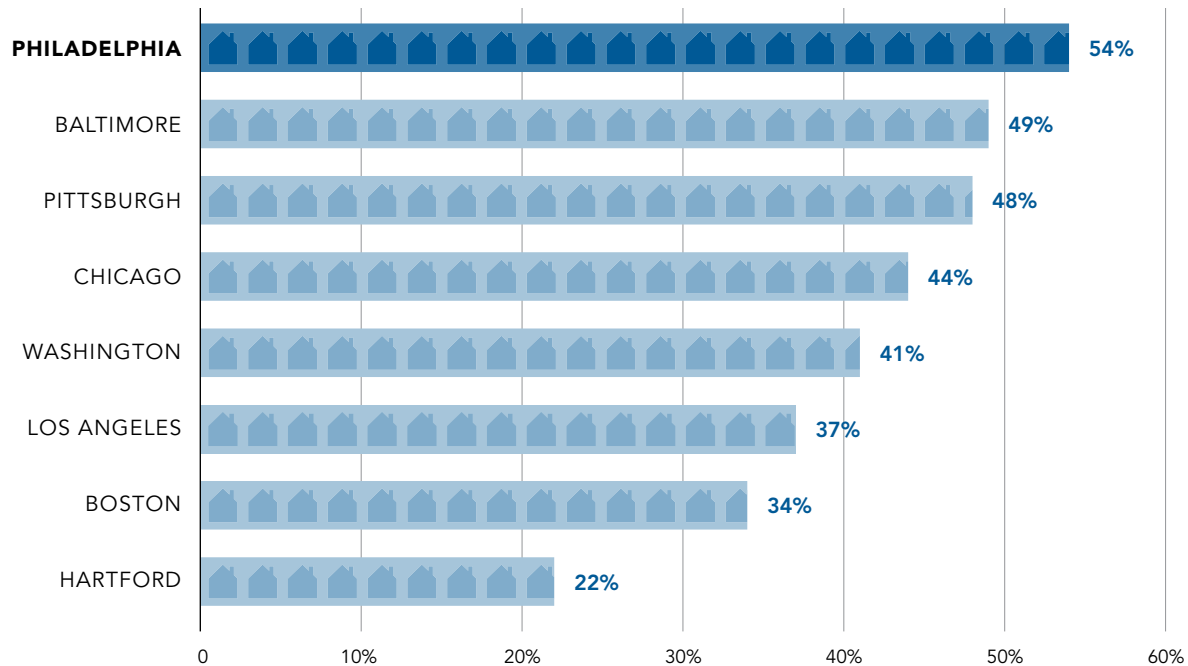
A High Homeownership Rate

Another factor making a property tax overhaul difficult in Philadelphia is that the city has long been a community of homeowners. In 2010, 54 percent of homes in the city were owner-occupied, more than in any of the comparison cities.⁸ See Figure 4. And that number was down from 59 percent in 2000. City officials have been reluctant to risk alienating this large constituency by making any changes that could result in higher property tax bills. In addition, many homeowners in the city are of modest means, and politicians have been wary of taking action that could hurt them. Renters rarely complain about property taxes since they do not pay them directly.

FIGURE 4

PERCENT OF HOUSING THAT IS OWNER-OCCUPIED

Historically, Philadelphia has had a higher percentage of owner-occupied homes than most other cities. That remains true today, even though the percentage has declined in recent years.



SOURCE: U.S. Census American Community Survey, 2011.

An Absence of Political Will

Over the last three decades, officials in Philadelphia have repeatedly resisted assessment-policy changes aimed at addressing inequities. While those changes would have decreased tax bills for some constituents, they would have increased bills for others.

In the 1970s and early 1980s, home prices rose sharply in gentrifying areas, making existing assessments highly inaccurate in those neighborhoods. To protect residents from higher tax bills, City Council moved to freeze all assessments. The city's Board of Revision of Taxes (BRT) objected to the freeze, and a Common Pleas Court judge agreed, ruling that the freeze violated the state's uniformity clause. The city settled the case with a six-year plan to reassess all properties. The BRT gradually changed assessments, although it did not undertake a thorough overhaul. Some policymakers and critics continued to complain about the accuracy of assessed values.

The last official mass reassessment was in 2004, but David Glancey, who chaired the BRT from 1988 to 2007, said his office never had the resources to do it in a way that met national standards.⁹ Instead, he said, evaluators relied mostly on sales data and "drive-bys" to change the certified market values on about 300,000 properties that year. Glancey and others urged moving to a full-value system.

*Overhauling Property Taxes In Philadelphia***A TIMELINE: EFFORTS TO CHANGE TAX ASSESSMENTS IN PHILADELPHIA**

For decades, attempts to overhaul the city's property tax system have failed despite well-documented problems.

1980 A Pennsylvania Economy League report, "The Problems with Philadelphia Real Property Assessment Practices and Solutions," finds that the city has not had a proper reassessment in at least 30 years.

1983 In a Court of Common Pleas consent decree, the Board of Revision of Taxes (BRT) agrees to implement citywide property reassessments over a six-year period and does so.

2002 Voters establish a tax reform commission that recommends citywide reassessments each year and a move to full-value assessment.

2004 The BRT generates new certified values for about 300,000 properties based on sales data and limited field work. Fractional assessment is still in place, and concerns about accuracy remain.

2005 The BRT lays the groundwork for determining accurate property values and ending fractional assessment. City Council opposes these actions, voicing concern about the impact on constituents.

2009 An investigation by the *Philadelphia Inquirer* documents mismanagement and the lack of trained, professional staff at the BRT. Using a computer-assisted mass appraisal model, the BRT establishes new values for all city parcels.

2010 Mayor Michael Nutter declares the new BRT data flawed and issues a moratorium on using the values. Voters approve a referendum to dismantle the BRT. The Office of Property Assessments is created.

2012 Mayor Nutter proposes the Actual Value Initiative (AVI). Council refuses to go along but approves legislation that pledges adoption of AVI in 2013.

2013 New assessments are to be sent out in February. In the spring, Council will consider whether to adopt AVI. If Council acts, the first tax bills under the new system go out in December 2013.

In 2005 and 2007, City Council passed resolutions opposing such a move. Echoing arguments from the 1980s, council members said they were concerned that full-market assessments would hurt some homeowners. Councilwoman Jannie Blackwell, who introduced the 2007 resolution, said in a committee hearing: "Consider the populace that elect us and the fact that they really will not stand for an increase in their taxes, and I think that we should listen to them."¹⁰

In 2010, following allegations of mismanagement and cronyism at the BRT, voters approved a plan to give the board's assessing responsibilities to a new Office of Property Assessment. In 2012, Mayor Michael Nutter presented an AVI proposal, and council members balked again; this time, many of them objected because the final assessments were unavailable, limiting their ability to determine what the new tax rate would be or craft relief policies. But Council did pass legislation promising to enact AVI for 2014. And the state legislature, in return for that promise, enacted measures designed to help the city head off expensive tax appeals in the meantime.

MANAGING THE IMPACT OF AVI

In Philadelphia, it is not yet clear how many tax bills will go up with the adoption of the Actual Value Initiative, how many will go down, and by how much. Preliminary numbers from the Office of Property Assessment made public in the spring of 2012 suggested there will be a lot of owners who see modest decreases—which means they have been overtaxed in years past—and a smaller set of taxpayers facing increases, some of them steep. When City Council resumes the debate over AVI, the question of how to help the latter group again will be front and center.

Throughout the country, property tax relief measures typically are reserved primarily for people who live in homes that they own; that appears likely to be the case in Philadelphia as well. The challenge for local policymakers is to protect residents from the financial shock of higher tax bills while, at the same time, creating a property tax system that is seen as more fair than the status quo and that generates adequate revenue.

Although the overall goals of AVI include transparency and simplicity, each added protection will make the system more complex. And each will cost money, in terms of revenue not collected from those getting the tax break. As a result, each relief measure that is enacted raises the overall tax rate needed to produce a specific amount of revenue and results in other taxpayers paying more.

HOW A CITYWIDE ASSESSMENT WORKS

A mass reassessment of a city is a big undertaking.

Calculating the value of each residential parcel consists of two steps: documenting the characteristics of the parcel—such as size and condition—and then determining what the land and building, if there is one, are worth in the local market. For commercial and industrial tracts, evaluators also may take into account income generated by the property, if that data is available. According to Doug Hill, executive director of the Assessors' Association of Pennsylvania, residential values tend to fluctuate more often and by bigger margins than other types of property values, which makes residential assessments more likely to become inaccurate over time.¹¹

For the current mass reassessment in Philadelphia, the city's Office of Property Assessment is spending roughly \$15 million over more than two years. The effort began with integrating relevant records from other city departments such as recent zoning documents, building permits, deed recordings, and licenses. Then 110 evaluators, all of them city employees, fanned across the city to begin documenting physical characteristics to be entered into a new database. Analysts using a computer-assisted model generated new certified market values, based on 202 local sub-markets each made up of about 36 square blocks. Finally, field workers returned to city neighborhoods to spot-check values for accuracy.

The new assessments will be made public in February 2013.

PROGRAMS ALREADY IN PLACE IN PHILADELPHIA

Even without AVI, Philadelphians have access to several property tax relief programs offered by the city and the state. Those programs, which are limited to specific groups of lower-income homeowners, are likely to remain part of the city's mitigation package.

Circuit Breakers and Other Targeted Protections

Low-income seniors, and some low-income widows and widowers, qualify for a property tax freeze through the Philadelphia Revenue Department. As long as eligible individuals meet the income requirements, their property tax bills do not go up, regardless of changes in tax rates or the assessments of their homes. The income limit is \$23,500 for single or widowed homeowners and \$31,500 for couples.¹² In 2011, 13,362 Philadelphia property owners participated in the program at a cost to the city of \$4.1 million in foregone revenue.

These kinds of programs, which limit property tax liabilities based on income, are known as circuit breakers; they switch off taxes at a certain threshold. Baltimore and Washington have circuit breakers targeted at property owners of limited income, regardless of age or other characteristics.

A separate state program financed by the Pennsylvania Lottery provides property tax rebate checks of up to \$650 a year for the elderly, the disabled, and widowed spouses earning less than \$35,000 a year. Since the cost of living is higher in Philadelphia than in most of Pennsylvania, the state grants a supplemental rebate of up to \$325 to eligible city residents who earn less than \$30,000. In 2011, 41,858 Philadelphia homeowners received a total of \$17.2 million in rebates, and 29,904 of them got the supplements as well for an additional \$5.7 million.¹³ The program also pays rebates to renters earning less than \$15,000 per household, based on an assumption that 20 percent of rent goes to pay property taxes. In Philadelphia, 33,646 renters received rebate payments totaling \$19.1 million in 2011.

In other jurisdictions, the eligibility rules for such assistance are different and, in some cases, less stringent. In Boston, for instance, a state program allows a senior homeowner-household earning less than \$77,000 to claim an income tax credit of \$980 if the household's real estate taxes are more than 10 percent of income.¹⁴ Washington reduces property taxes by 50 percent for seniors and disabled people earning less than \$100,000 a year. Cook County freezes assessed values for seniors earning \$55,000 or less.

Philadelphia also has a rebate program for all active duty Reserve and National Guard members. Other cities offer property tax breaks to groups such as veterans and the families of police officers and firefighters killed while on duty.

Installment Plans

Most homeowners have mortgages, and for them, the property tax generally is included in the monthly payment. In Philadelphia, 40 percent of city homeowners do not have mortgages, a higher portion than any of the comparison cities except Pittsburgh.¹⁵ These owners receive tax bills for the full amount once a year. For low-income homeowners who have paid off their loans, Philadelphia offers installment plans that break the annual bills into smaller payments spread out over the year. The income cutoff for eligibility ranges from \$37,034 for a household of one to \$56,638 for 10 or more. In 2011, 17,324 homeowners took advantage of the program, in which seniors may pay their

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taxes in up to 20 annual installments, up to eight for everyone else; the city places a lien on the properties of anyone who opts for nine or more payments. In addition, installment plans were in place for 1,100 taxpayers who demonstrated hardship. The other jurisdictions in this study allow all property owners, regardless of income, to pay in two to four installments.

Deferrals

Deferrals are a way for certain property owners to keep paying a constant amount of taxes, avoiding increases, until they sell their homes. Only properties that experience tax increases of 15 percent or more in a single year are eligible. The program is essentially a loan from the city to cover years of tax increases. A lien is placed on the property and interest accrues at 6 percent annually on the outstanding balance. All of it, back taxes and interest, is collected when the house is sold or inherited. But in Philadelphia, the program has not had a single participant. Deferral programs in Baltimore and Boston have also generated little interest. Officials cite the relatively high interest rates, reluctance to take on a lien, and the cumbersome application process as reasons.

NOT EVERYONE PAYS: EXEMPTIONS, ABATEMENTS AND DELINQUENCIES

Philadelphia does not collect taxes on every piece of real estate in the city.

Real estate owned by the federal, state and local governments is exempt from the property tax. Most religious buildings, cemeteries, hospitals, educational facilities and other properties devoted to nonprofit use are exempt as well. In 2011, the city had 24,404 fully exempt parcels, and the Office of Property Assessment said they represented about 30 percent of the total value of all properties in the city.

One option—employed by Baltimore, Boston and other cities—is to ask the nonprofit sector for payments in lieu of taxes (PILOTs). For several years in the 1990s, Philadelphia collected as much as \$9 million in PILOTs annually. Then, a 1997 state law made it more difficult to negotiate with nonprofits. In 2011, the amount was \$383,700. Legal experts say that an April 2012 Pennsylvania court decision may return to localities the leverage to negotiate larger payments from nonprofits.

Beyond tracts owned by nonprofits, some properties are permitted to forgo paying some or all of their taxes for a set period of time, as a result of targeted policies. In 1997, Philadelphia introduced 10-year tax abatements for residential conversions to spur development; in 2000, it expanded the abatements to include all new construction or major rehabilitations. For a decade after an abated project is completed, the owners pay taxes on the land but not the building. Citywide, the abatements amounted to \$37 million in forgone revenue in Fiscal 2012.

Pennsylvania also has Keystone Opportunity Zones, designated areas where a number of incentives, including reduced property taxes, are available for a certain number of years. In 2012, there were 194 properties eligible for tax breaks in such zones in Philadelphia.¹⁶

In addition, owners of more than 100,000 properties, about a fifth of all parcels, have outstanding tax bills. The city has a higher delinquency rate than any big city in the country.¹⁷ All told, the city revenue department says that Philadelphia is owed roughly \$295 million in property taxes, interest and penalties; about 20 percent of that amount is listed as “written off” because the delinquencies are more than 10 years old and presumed to be uncollectible.¹⁸

PROGRAMS THAT PHILADELPHIA COULD ENACT

Jurisdictions typically rely on a mix of property tax mitigation strategies, most of them designed to limit the tax liabilities of homeowners with modest incomes. Baltimore, Washington and Boston have packages that include homestead exemptions as well as caps and circuit breaker programs. Washington and Boston also have classification systems allowing commercial property to be taxed at higher rates than residential.

Philadelphia has the ability to add some of these policies to its mitigation portfolio. Any measures that are adopted will increase tax bills for those who do not benefit from them and will make the property tax system more complex.

Homestead Exemptions

Homestead exemptions apply to owner-occupied, primary residences and are offered in 19 states and the District of Columbia.¹⁹ They reduce the assessed value of a property that is subject to taxation, typically by a flat dollar amount. This has the effect of providing greater tax savings in percentage term for properties with lower assessments. For example, the \$30,000 homestead benefit that has been discussed by Philadelphia city officials would amount to a 30 percent discount for a residence with a full-value assessment of \$100,000 and only a 6 percent discount for one assessed at \$500,000.

The exemption would have other impacts. In Philadelphia, a \$30,000 homestead exemption applied to the estimated 340,000 owner-occupied homes in the city would reduce the city's aggregate taxable value by roughly \$10 billion. If the city's aggregate value turns out to be \$90 billion, as some analysts expect, the tax rate would have to be 11 percent higher than it would have been without the exemption to produce any given amount of revenue. As a result of the higher rate, owners of more expensive homes would end up paying higher tax bills than they would have in the absence of a homestead exemption.

Among the other jurisdictions examined in this study, Allegheny County allows an exemption of \$15,000, while homeowners in Los Angeles and all of California get exemptions of \$7,000. Washington, where the median home is valued at \$445,000, exempts \$67,500.

Boston has a formula in which the exemption is worth 30 percent of the average value of all residential property in the city. This came out to \$126,095 in Fiscal Year 2012, leading to a tax reduction of \$1,644 per property. Even with the exemption, no property can be assessed for less than 10 percent of its fair market value.

Gentrification Relief

Under AVI, some of the most dramatic tax increases in Philadelphia are likely to come in neighborhoods where wealthier residents have been moving into new or rehabilitated properties. These areas are said to be gentrifying. Longtime homeowners in such neighborhoods benefit as the values of their properties rise. But they may find it difficult to reap those benefits—or pay their taxes—without selling their homes and moving out.

Civic leaders in these neighborhoods, mostly on the fringes of Center City, have expressed fears that older, low-income residents, as well as some early gentrifiers, could be forced from their homes as the result of AVI. Some longtime residents say it would be unfair for their taxes to double or triple when much of the escalation in their home values has been due to new or refurbished homes subsidized by the city's 10-year tax abatement program. Why, they ask, should they pay a lot more when some new arrivals pay much less?

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In 2012, Philadelphia City Council discussed a gentrification-relief program that would freeze property taxes for residents who have lived in their homes for at least 10 years and otherwise would have faced steep tax hikes. Program funds would be limited to \$30 million in lost tax revenue.

One impediment to enacting such legislation is that the state enabling law, as written, does not permit Philadelphia to apply an income threshold that would allow for the targeting of aid to those residents who most need it. City officials have asked the legislature to authorize a means test, which already is permitted in Allegheny County.

Although many cities contend with the challenges of gentrification, laws that specifically protect longtime owner occupants from resulting property tax increases are relatively rare.

Cook County, Ill., has one, called the Long-Time Occupant Homestead Exemption. It targets citizens who have been in their homes for at least 10 years. For those who earn \$75,000 or less, the exemption limits annual assessment increases to 7 percent; for those who make up to \$100,000, the cap is 10 percent. About 34,000 homeowners were signed up in 2012.

Washington has something similar. It is somewhat less generous in terms of benefits and somewhat more stringent in terms of eligibility—and has gone virtually unused.²⁰ Ed Lazere, executive director of the DC Fiscal Policy Initiative, a local research and public education organization, said that the existence of the credit is not well-known and that Washington has other tax relief programs that protect those who might qualify. His group's position has been that "you do not need something specific to gentrification," he said.²¹

Smoothing/Phasing

In his initial AVI proposal, Mayor Nutter suggested the new tax assessments in Philadelphia should be phased in over three years, a process he called "smoothing." That idea was set aside by City Council in 2012 due to concerns that phasing in higher assessments for some properties could cause temporary tax hikes for others. During the phase-in period, a number of property owners, including some who might reasonably be expecting tax decreases, would have to pay more to help the city make up the lost revenue.

Several other taxing bodies have phased in new assessments. In June 2012, the Connecticut legislature gave municipalities the option to phase in revaluations over five years regardless of whether assessments go up or down. In Baltimore, increased tax bills stemming from revaluation are phased in over three years but taxpayers with decreased assessments are permitted to take advantage of the new values immediately.

Other Options

Philadelphia could amend the 10-year tax abatement program to bring in more revenue from new or renovated properties in the future, thereby limiting reductions to the city's property tax revenues in the years to come. In September 2012, Councilman W. Wilson Goode Jr. introduced legislation calling for the abatement to be reduced from 10 years to five, with the value of the abatement starting at 100 percent and phasing out to zero over the five-year period.

Another possibility would be revenue caps limiting how quickly total revenue from property taxes can grow, effectively putting a ceiling on annual property tax increases across the board. All counties in Pennsylvania other than Philadelphia are subject to either a 5 or 10 percent cap under the

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state's "anti-windfall" law. Three state representatives from Northeast Philadelphia said they will push the legislature to create some kind of cap for the city.

Two strategies that are relatively common in other jurisdictions are off the table for Philadelphia due to the uniformity clause. One is an assessment cap, which limits how much assessments can increase in a single year; caps are in place in Baltimore, Washington and, with income limits, Cook County. The other, discussed earlier, is creating various classifications of property and taxing them at different rates. Enacting either option would require a state constitutional amendment.

BOSTON'S MOVE TO A FULL VALUE SYSTEM

Boston's property tax system underwent a complete overhaul between 1974 and 1984.

Driven first by the courts, then by a state constitutional amendment and ballot initiative, the city created a new full-value system much like the one now under consideration in Philadelphia. Boston's experience is widely viewed as a model of success.

Before the changes started, homes in one Boston neighborhood, Roxbury, were taxed on 40 percent of actual value while homes in another, Charlestown, were taxed on 16 percent. To remedy such inequities throughout Massachusetts, the state Supreme Judicial Court ordered full-value assessments.

In Boston, this raised the prospect of large tax increases in some parts of the city. Concerned homeowners won a series of protections that were built into the city's tax structure over time, including a homestead exemption based on a formula that tracks increases and decreases in assessments automatically.

The "critical factor," according to Joan Youngman, a senior fellow at the Massachusetts-based Lincoln Land Institute, was a 1978 amendment to the state constitution, championed by Kevin White, who was Boston's mayor, and a coalition of residents, unions and other consumer advocates.²² It allowed cities and towns throughout the state to tax four different types of property at different rates. This let Boston apply higher rates to commercial properties and thus shift some of the tax burden away from residential parcels. That option is not available anywhere in Pennsylvania.

Since then, according to Ronald W. Rakow, Boston's Commissioner of Assessing, the city has kept assessments consistent with market value, thanks in part to oversight from the state. In addition, he said, relatively stable property taxation—the legacy of a 1980 statewide ballot initiative that limits the growth in property tax collections to 2.5 percent per year—has helped create acceptance of the system, even in a city that relies on the property tax for most of its local revenue.

"When you have a professional, predictable tax assessment system, people don't feel like they are getting cheated," Rakow said. "They may not like what happened to the values, but if it has happened to their neighbors and is reflected in the market, it at least gives peace of mind that they are being treated like everyone else. I think that's very important for investment purposes."

MAINTAINING THE SYSTEM GOING FORWARD

AVI aims to establish an accurate and transparent property tax system with special measures to help some homeowners handle steep increases in their tax bills. Enacting AVI will be difficult politically. But simply putting it in place will not be enough. The new system will require an ongoing effort and commitment of resources if the city is to prevent it from becoming rife with inequities down the road. Regular reassessments, sufficient funding, and ongoing public engagement are critical to maintaining a functional—and fair—system.

Regular Reassessment

Assessed values can become inaccurate quickly. A 2010 report commissioned by the Pennsylvania Legislative Budget and Finance Committee looked at 14 counties that had met standards for consistent and accurate market values through reassessment. Three years after the reassessments were completed, more than half of the counties no longer met the standards.²³

By law, Philadelphia's Office of Property Assessment (OPA) is supposed to conduct annual reassessments. This does not mean that there has to be an individual appraisal of every piece of property each year. With 579,383 parcels, that is not practical. Instead, after the new, onsite citywide assessments are formally adopted, OPA plans to rely on a computer-assisted mass appraisal system, which takes into account sales data, construction permits, aerial imaging, and other information, to adjust values without assessors going door to door.

Other jurisdictions have various ways of keeping assessments relatively current.

Massachusetts law requires Boston to do a full revaluation of all of its 143,000 parcels every three years. The city also adjusts assessments annually, using sales figures for residential property and trends in rents, vacancy and investment returns for income-producing parcels.

In Washington, assessors review all sales and permits annually. They also visit about 20,000 homes a year in sections of the city where changing sales patterns or appeals indicate errors are likely.

Cook County and Baltimore reassess about one third of all properties each year so that each parcel is revalued every three years. An Allegheny County court decision prohibits staggered reassessments there on the grounds that they violate the uniformity clause.

In Philadelphia, Chief Assessment Officer Richie McKeithen has pledged to supplement the computer model with street-level data. "In this business, our life's work is getting out in the field, at least every four years," he said. But there is nothing in either city or state law requiring that assessors visit every city block on a regular basis.

Funding

Governments often delay or underfund the reassessment of properties because the work is expensive. The initial reassessment is the most costly; the expense of annual updates usually decrease once a professional assessment system is in place.

Philadelphia's current mass reassessment, which began in late 2010, was funded through an increased allocation in the city's operating budget. OPA spent \$5.7 million in Fiscal 2011 (July 2010 to June 2011) and about \$9.1 million in Fiscal 2012. In Fiscal 2013, OPA is budgeted to spend \$11.7 million, including \$1.3 million for professional services from assessment consultants and experts in modeling and valuation. In Philadelphia, spending per parcel was \$15.72 in Fiscal 2012 and will be \$20.26 this year as the AVI revaluation is completed.²⁴ These numbers are in line with industry standards.

OPA was budgeted to add 84 new, permanent positions in Fiscal 2013 to make workloads more manageable, bringing its total number of employees to 218. The office has made efforts to professionalize the staff through the Certified Pennsylvania Evaluator (CPE) program, which requires 90 hours of instruction. OPA projects that 99 employees will be certified by August 2014, up from the current 32; all newly hired evaluators will have to obtain CPE credentials within two years.

Tight city budgets in the future could make it hard for the office to keep up with changing property values. In some other states, including New York, counties and towns get help from their state governments in financing regular revaluations. But Pennsylvania has no such program.

Public Engagement

Assessors and public officials in cities where property assessments are generally seen as current and accurate stress the importance of educating the public about assessments. Transparency is central to public engagement and understanding. Property owners are more willing to accept new assessments if they believe the overall system is fair, said Jack Gordon, the manager of residential assessment in Washington.

In some cities, in the weeks after property owners receive their annual assessments, assessors meet with community groups in libraries and senior centers to explain why assessments went up or down in a particular neighborhood and to help qualified residents apply for relief. Education programs also explain how appeals work. That kind of contact will be particularly necessary in the period leading up to December 2013 when, according to the current schedule, Philadelphians are to receive their first property tax bills under the new system—the first ones with new certified values, no more fractional assessments, and any mitigation options that have been adopted.

Many localities also generate detailed assessment reports on an annual basis. Most publish key ratios such as assessment-to-sales and various measures of fairness and accuracy on city and state websites. In addition, they track the amount of revenue lost to property tax exemptions and taxpayer protection programs.

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“The public education effort alone can be a huge cost in time and effort, but those who put in the time find it’s worth it,” said Doug Hill, executive director of the Pennsylvania assessors’ association. “You have to build the public’s confidence that the process is transparent and that this is all about equity.”²⁵ David Glancey, the former chair of the Philadelphia Board of Revision of Taxes who began to push a program for “full-value” assessments nearly a decade ago, echoed Hill’s advice. “Buy-in is really important,” Glancey said. “You won’t make every property owner happy, but if you don’t do this the whole thing could explode.”

City Council and the Nutter administration still have important work to do on AVI in the months ahead. In addition to making sure assessments are accurate, they must strike a policy balance among potentially conflicting goals: protecting those who face much higher assessments, keeping the overall tax rate at a politically acceptable level, and raising enough revenue to finance essential city services and the school district. Civic leaders and public officials alike have expressed the hope that, once the smoke clears, an accurate and equitable property tax assessment system might become a foundation for comprehensive city tax restructuring.

ENDNOTES

- ¹ The other states that do not require cyclical assessment are Alabama, Alaska, California, Delaware, Georgia, New York, New Jersey and Vermont. (International Association of Assessing Officers, *Property Tax Assessment Policies and Practices Survey*, 2010, found at <http://www.iaao.org/sitePages.cfm?Page=442>, and individual states).
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- ⁴ County Commissioners Association of Pennsylvania, "Pennsylvania County Platform 2012-2013 Official Policy Statement," found at <http://www.pacounties.org/GovernmentRelations/Documents/Platform20122013.pdf>.
- ⁵ Interview with Paul Levy, president and CEO, Center City District, August 28, 2012.
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- ⁹ Interview with David Glancey, former chairman, Philadelphia Board of Revision of Taxes, May 17, 2012.
- ¹⁰ Philadelphia City Council, Committee on Law and Government, February 12, 2007, found at <http://legislation.phila.gov/transcripts/Public%20Hearings/lawngov/2007/lg021207.pdf>.
- ¹¹ Interview with Doug Hill, executive director of the Assessors' Association of Pennsylvania, April 24, 2012.
- ¹² Social Security benefits, pensions and income from savings and investments are all counted.
- ¹³ Pennsylvania Department of Revenue Bureau of Research, *Report to the Pennsylvania General Assembly on the Property Tax Rent Rebate (PTRR) Program for Property Taxes or Rent Paid in 2011*, September 2012, found at http://www.portal.state.pa.us/portal/server.pt/community/property_tax_relief/7452/property_tax_reduction_allocations/510335.
- ¹⁴ For renters, the value of the credit is the amount by which 25 percent of their rent exceeds 10 percent of their income.
- ¹⁵ U.S. Census Bureau, American Community Survey, 2011. Data available through American FactFinder, found at <http://factfinder2.census.gov/faces/nav/jsf/pages/index.xhtml>.
- ¹⁶ Keystone Opportunity Zone Philadelphia Program, found at <http://www.philakoz.org/>.
- ¹⁷ Patrick Kerkstra, "Property-tax delinquents owe city, schools \$515.4M," *Philadelphia Inquirer*, June 11, 2012.

- ¹⁸ Figures provided by Mike Isard, research director for finance and revenue, City of Philadelphia, Department of Revenue, October 10, 2012. Numbers are for balances due as of August 31, 2012.
- ¹⁹ This is a count of homestead exemptions that apply to all owner-occupied, primary residences. Twenty-six other states offer the exemptions for veterans, the disabled or the elderly. Count compiled using *Significant Features of the Property Tax*, found at http://www.lincolinst.edu/subcenters/significant-features-property-tax/Report_Residential_Property_Tax_Relief_Programs.aspx. Lincoln Institute of Land Policy and George Washington Institute of Public Policy. (Residential Property Tax Relief Programs; accessed October 8, 2012.)
- ²⁰ Washington D.C. Office of Revenue Analysis, *District of Columbia Tax Expenditure Report*, April 2010, found at http://cfo.dc.gov/cfo/lib/cfo/ora/032910_final_tax_expenditure_report.pdf.
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- ²⁴ These budget figures do not include employee benefits.
- ²⁵ Interview April 24, 2012.

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ABOUT THE AUTHORS

Emily Dowdall and Susan Warner of the Philadelphia Research Initiative wrote this report. It was edited by Larry Eichel, the initiative's project director.

ABOUT THE PHILADELPHIA RESEARCH INITIATIVE

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